ANNUAL REPORT & ACCOUNTS 2018

Saffron Building Society

Always there for our Members. Since 1849

CHAIRMAN'S STATEMENT

GEOFFREY DUNN, CHAIRMAN

Mutuality has to have a future

This year is the 170th anniversary of the founding of our Society. This milestone means a lot to me, to our staff and to all our Members as it demonstrates the importance of mutuality in our highly competitive world. Building societies offer something different, and approach their work in a different way from high street banks and other lenders in the modern financial services industry. It's our aim to be here for our Members for another 170 years and continue to help people achieve their aim of owning a house and saving for the future.

The benefits of mutuality

When I graduated from university I bought a house together with three friends. My grandmother helped me with the deposit and I was able to enjoy the benefits and security of setting foot on the property ladder. However, young people trying to buy their first home nowadays face many more challenges than I did then, and they need our help.

So, in my view, if we are to make real progress in helping young people to buy their own home, it is imperative that all of our members actively support their Building Society to grow and flourish. After all, it is the members that own our Society and by helping to support it, they are helping themselves to get better priced and designed products, better service and they are also helping to ensure that mutuals (i.e. Building Societies) stay vibrant and active in the financial landscape and do not disappear into the Regulatory undergrowth. You may not know that nearly a quarter of all mortgages are provided by building societies, who lent £70 billion in new mortgages in 2018. Mutuals helped 115,000 people buy their first home last year, that's nearly a third of the total of First Time Buyers.

On the other side of the balance sheet, almost one fifth of all cash savings are with building societies, who hold over £280 billion in savings balances.

Last year, building societies offered a savings rate more than 0.5% above the average rates from the high street banks. During the banking crisis in 2008, many high street lenders withdrew from the mortgage market as they no longer considered it profitable.

At the core of all mutual societies is a desire to remain steadfast to our guiding principle of being here for our customers through thick and thin.
Of course we are realists. We need to be profitable so that we can invest for the future, retain our staff and deliver the products and services our customers need now and in the years ahead. However, our long-term aim is to look for ways to help our customers through volatile times.

Our results

The last five years have seen us invest heavily for the future so that our finances, staff and infrastructure are built to generate more success. The reality though is that we still face many challenges. The Strategic Report and the CEO's report explains the impact of current year adjustments to our capital reserves in 2018, which coupled with the additional capital buffers required by our regulator to be held by us from January 2019, means we must continue to prioritise the building of our capital strength. Political uncertainty has the potential to harm the economy and the impact of Brexit means there could be pressure to raise interest rates if inflation starts to creep up. In addition, we operate in a highly competitive environment, which means we have to be at our best to continue to offer excellent services.

So how are we going to do this?

Our plans

Looking ahead, the Board and the Executive team will both work hard in the year ahead to continue to focus on delivering a further strengthened capital position and to ensure that the Society remains not just operationally strong, but also well positioned to participate in future profitable lending opportunities.

We aim to steer a steady ship with our eyes fixed on the risks and changes prevalent in the economy. As always, our main aim is to keep serving our members in the best and most effective way we possibly can. One thing though that has changed over the years is the complexity of what people need.

There is no such thing as a standard customer and we recognise that everyone has very different needs and requirements. For example, a self-employed mother in her 40s has very different needs from a young graduate trying to pay off student loans and save for a first home.

That's why we will continue to provide the best possible savings and lending products. Each will be designed to look after the specific needs of people at different stages of their lives. Our investment in technology means that we'll be faster than ever before in providing a service which we believe will continue to improve each year. Quick decisions and efficient online access, for those preferring to use the internet or a phone, will mean that our servicing is seamless and better than ever.

The future

While the government has a huge role to play in fixing the housing crisis, Saffron Building Society aims to continue its tradition of innovation and being among the best at supporting those who want to own a house and save for their family's future.

Things are very competitive at the moment so we need to be smarter and more agile, respond more quickly and continue to develop our technology. We want to be pioneers, and offer increasing standards of service. But our principles will not change and we will always try to work in a straightforward and compassionate way. While it's not easy to get it right all of the time, and sometimes we have to take some tough decisions, that's how we try to serve our members. We will also maintain the focus on delivering sustainable profitability that will help to build our capital strength.

I believe mutuality is more important than ever before and that we must cherish what it provides. However, to do that we must continue to use building societies and cultivate their values. If we all look after our mutual societies then they will continue to look after us.

Everyone at Saffron Building Society would like to thank you for your continued support. We aim to build on 170 years of success and continue to serve you for many years to come.

Geoffrey Dunn, Chairman

CHIEF EXECUTIVE'S REPORT

COLIN FIELD, CHIEF EXECUTIVE OFFICER

2019 will be the 170th anniversary of the Society's founding. While we are celebrating the service we have provided and the challenges we have overcome, our focus for the future will continue to be ensuring our long term success. During 2018, we continued to see improvement in the likelihood of our customers to recommend us to others. We also continue to make progress in the development of our staff, again seeing approximately 80% of open roles recruited from within. It is vital for the success of your Society that we make continued progress in these areas because it is by providing excellent and trusted service that we will serve our Members needs and indeed grow as a Society.

2018 Performance

The financial highlights from 2018 are included within the Strategic Report, but I'd like to make reference to the main headlines.

As your CEO I have explained the need for your Society to improve its profitability to enable it to meet the increasing capital demands imposed by regulation. In common with our experience over recent years, our underlying performance in 2018 has been good. The mortgage book returned to growth for the first time since 2014, loan impairment remained under control and our expenses were held materially flat. It is therefore especially disappointing that I have to report two matters that have impacted the Society this year. During the audit an error was uncovered in the measurement of the Societies Effective Interest Rate Asset that required a negative adjustment to reserves of £2.2m. This was not a cash (loss) item, but rather represents the incorrect recognition of the timing of revenues. In other words, the model (created in 2015) had brought forward the recognition of some income in subsequent years, that should have been recognised later. This issue relates back to the implementation of a new accounting standard, FRS102, in 2015. The 2017 accounts have been restated to reflect this issue.

For the 2018 year, we have adopted a new basis of fair value measurement for our legacy portfolio of equity release mortgages. The new valuation technique is in line with market practice and takes into account the potential volatility of the lifetime book. In total, the reduction in value to reflect the No Negative Equity Guarantee has increased to £3.5m from £0.6m recorded at the prior year end. The total charge to the income statement relating to the equity release book totalled £3.7m in the year.

The impact of the EIR error and the change of basis of the valuation of our equity release mortgage book coupled with the introduction of the revised capital buffers required by the regulator on 1 January 2019, have impacted our capital reserves and will impact the ability of the Society to build upon the growth experienced in 2018. We have responded by initiating a plan that will strengthen our capital reserves through a combination of reducing costs whilst managing the size of the balance sheet. Further discussion about regulatory capital position is in the capital section on page 18 of the Strategic Report.

We continue to balance the needs of our Mortgage and Savings Members whilst also ensuring that the Society makes returns sufficient to maintain its future viability. During the year, rates payable on savings accounts increased by 0.16% whilst mortgage rates increased by only 0.03%. Despite this movement, we held our total net interest margin flat year on year, through careful management of the balance sheet.

Saffron has invested significantly in both technology and systems, and people capability over recent years and this investment is reflected in a cost base that is higher than other Societies of similar size. We have challenged ourselves to restrict the growth of our cost base and whilst we have been mostly successful, we did see cost increasing in 2018 due to two factors. Firstly, the introduction of the General Data Protection Regulation which involved nearly everyone across the Society and consumed significant time and money. Secondly, we commissioned a Society wide salary benchmarking exercise that resulted in pay increases to the majority of our front line staff.

Your Society is 170 years old!

The Society is 170 years old in 2019. Whilst we are celebrating the service that we have provided and the challenges that we have overcome, our focus will remain: to ensure our success into the future. One of our key challenges is the role of branches in delivering services to our Members.

Branches play an important role for many Members and we are rightly proud of the service that we offer. We are increasingly seeing that both current Members and new customers are demanding improved capability through other channels. We have developed capability, but we need to make further improvements to both our online and mobile capability for us to retain our relevance in the future. Our challenge is to meet the needs of all our Members at a cost that we can afford.

Whilst much has changed over the last 170 years, some of the challenges faced by Members have remained stubbornly familiar. The original purpose of a Building Society and the mutual movement was to help its Members to own their own home. In recent years the number of businesses lending to customers has increased significantly, but the challenge of home ownership remains as significant today as it has ever been.

It is our goal to support potential homeowners by taking an individual approach to each mortgage application that we receive. In 2018, we placed a significant focus on helping first time buyers who struggle to get onto the housing ladder. We completed 199 first time buyer mortgages, representing 30% of all mortgages written by Saffron in 2018. In addition to supporting first time buyers, we supported 70 customers who wanted to build their own home and small property developers that were looking to build homes for sale.

People

We seek to develop our people. This year we launched new development programmes designed to increase the skills, knowledge and competence of our people. We also seek to reward our people and this year we reviewed and developed the rewards and benefits that we offer to ensure that we remain competitive in the local area..

At the end of the year, we said goodbye to two members of the Executive team, Sarah Howe, our Chief Customer Officer and Clive Moore, our Chief Risk Officer. We are delighted that our Head of Credit, Raj Marwaha has been appointed as our new Chief Risk Officer, whilst Simon Taylor, a highly experienced business leader has joined us on an interim basis to support us until we find a permanent replacement for Sarah. I would like to thank both Sarah and Clive for the contribution that they have made to the Society and wish them the very best for the future.

I am very proud of our people and the commitment, dedication and enthusiasm they show for both our Members and the Society.

Community

One area in which we take enormous pride is in the positive impact that we make to our local communities and this year I feel that we can be especially proud.

We awarded £18k via our Community fund to eight diverse local charities. Individual and group staff initiatives have raised a further £12.5k for over 20 different charities. Alongside funds raised we have given our time and expertise providing financial education to over 700 year 6 pupils in Hertfordshire, held interview skill workshops at the Uttlesford Careers Fair, helped plant the edible garden with Dig It charity based in Saffron Walden, supported Saffron Walden Town Football Club to secure the ground lease for the next 100 years and worked with WizeUp, a non-profit organisation delivering financial education and life-skills to Secondary school students in three local high schools, an initiative which we plan to expand in 2019.

One of our success stories in 2018 is the Saffron Community Choir, which is free for anyone to join, irrespective of their singing experience and ability. It has gone from strength to strength, seeing attendance double, in turn requiring a bigger rehearsal venue. In December we were honoured to open for The London Community Gospel Choir at Saffron Hall and joined them for the finale. It was a spectacular and uplifting evening and all the Choir members were thrilled to have been given this opportunity.

Looking Ahead

At the time of writing, both the economic and political environment is uncertain. It is difficult to predict what will happen, or the impact but we are well positioned and have made plans that will help us navigate any uncertainty. Should an economic downturn occur, then we are prepared; we have carried out stress tests that provide us with confidence that we are well set to weather a storm.

Our vision is for the Society to be the place that Members trust to help them to manage their financial health throughout their life. To do this, we need to expand our capability and expertise and forge deeper relationships with our Members.

In 2019, our priority is to further improve our service and processes, to improve our capability and deliver cost reductions to make your Society financially and operationally strong and resilient, ready for the next 170 years!

Colin Field, Chief Executive Officer

STRATEGIC REPORT

This strategic review sets out our progress against strategy together with an assessment of the environment in which we operate and principal risks we face.

The UK's impending exit from the EU dominated both the political and economic landscape throughout 2018. In a reversal of the backdrop to 2017, momentum in consumption by households was greater than previously expected, supported by the strong labour market and resilient household confidence; whereas business investment has been more subdued than anticipated as "Brexit" uncertainty intensified. The labour market has been strong with the employment rate and vacancies at record highs and unemployment at its lowest since the mid-1970s with growth in regular pay rising to over 3%. With UK GDP growth modest by historical standards and forecast to remain so for a number of years, cost pressures have fed through to CPI inflation which has remained above the Bank of England's target of 2%. In August 2018 the Bank of England increased the UK Bank Rate from 0.5% to 0.75%.

The increase to Bank Rate was welcome news for savers and the Society was able to pass on the full increase to many of its products, balancing the immediate change with views on competition and funding requirements.

In order to pass on the increase to our savings Members, the Society also increased the Society's mortgage standard variable rate ("SVR"), taking into consideration the need for the Society to operate with a range of competitively priced mortgages. Whilst most competitors also increased their respective SVR, the UK mortgage market remains extremely competitive and, despite these increases, mortgage rates have fallen during the year.

House price inflation has slowed in general, though more noticeably within the London and South East markets which have been disproportionately affected by regulatory and tax changes. Against this backdrop, the Society increased the value of mortgages it advanced during the year with continued strong demand from first time buyers and experienced landlords.

The prospects and implied path of market interest rates continue to suggest a gradual increase and to a limited extent. Irrespective of changes to market rates, competition for deposits is increasing, driving rates higher and placing pressure on the Society's margins if such increases are not reflected in market rates for mortgages.

Increases in longer term interest rates and residential house prices are generally positive for the Society's financial performance however, these movements have been more than offset by adverse changes to accounting estimates in relation to the portfolio of lifetime mortgages.

The Group's business and strategy

The Society was founded in 1849, making it 170 years old this year. Despite many changes in the world in which we live the Society's core purpose has remained constant, namely to help people purchase property and to provide a secure home for their savings.

First time buyers are central to our core purpose and our mortgage proposition but our 'Everyday Situations' range of mortgages also caters for other customers looking to move home, or seeking a mortgage for a buy-to-let property. For customers with more complex needs our 'Special Situations' range can accommodate customers requiring something out of the ordinary: contractors or self-employed, young professionals, those renovating a property or purchasing an unusual property type. All our mortgages are also available through intermediaries (brokers). Whatever the situation, Saffron will take into account individual circumstances, apply common sense and provide a personal, reliable service.

Our wide range of savings products include instant access, fixed-term, tax-free and regular savings as well as award-winning accounts designed especially for children's savings.

Outside of our core borrowing and savings products we are also able to offer financial advice, annuities, funeral planning, estate planning, inheritance tax planning and financial products including personal loans through a network of selected partner organisations. A summary of products offered across our network is shown below:

	Channel		
Mortgages	Phone	Online	In-branch
Residential	•		•
Buy-to-let	•		•
Self-Build	•		•
Development	•		•

	Channel		
Savings	Phone	Online	In-branch
ISAs	•		•
Deposits		•	•
Children's accounts			•

	Channel		
Other products	Phone	Online	In-branch
Financial planning			•
Unsecured loans		•	•
Protection	•	•	•

The Society has a wholly-owned trading subsidiary, Crocus Home Loans, which acquired mortgage assets in the financial periods up to 2007. These mortgage balances are in gradual decline naturally through redemption or repayment. No assets were acquired in 2018.

The Group has assets of £1,036million and operates from its head office in Saffron Walden, Essex and Customer Service Centre in Little Chesterford together with branches across three counties, employing 162 colleagues.

The Society's strategy is to deliver long-term value to its Members, strengthening its capital through sustainable financial performance and effective risk-management. Being a mutual means we put our Members first and we strongly believe in rewarding loyalty through existing customer only interest rates and Members only products.

A key element of the strategy is the financial stability of the Society, and in particular improving capital strength. Over the previous three years the Society has reduced its balance sheet size as it has focused on delivering its IT investment programme and in preparation for the phased introduction of CRD IV capital buffer requirements which at 1 January 2019 now sees the Capital Conservation Buffer fully implemented at 2.5% and the Countercyclical Buffer set at 1%. The Society has, through the audit process, identified an error in the initial treatment of the effective interest rate (EIR) modelling upon transition to FRS 102, leading to a prior year restatement of the capital position which is explained in more detail in note 1 to the financial statements. During 2018 the Society changed the basis of measurement of the Lifetime Mortgage portfolio. This model incorporates potential volatility of house prices over future periods resulting in a change to the fair value of the portfolio which is explained later in this Strategic Report and Note 30 to the financial statements. These issues have placed additional capital constraints on the business.

The short term strategy for the Society is to recover the capital impact of these issues though the delivery of a capital improvement plan, which has been devised by management and approved by the Board.

The Society has reviewed the cost base, which is high in comparison to its peers. It will be a focus of management to deliver savings which can allow the Society to be resilient over the uncertain economic market ahead and to allow for future growth in the medium to long term, which will benefit all Members.

STRATEGIC REPORT

Key performance indicators

One of the Board's roles is to set the strategy for the Society. The Board manages the Society and oversees delivery of the agreed strategy using an extensive range of performance and control reports, including use of key performance indicators (KPIs). The KPIs adopted throughout 2018, with comparison against 2017 are presented in the table below together with explanatory comment.

	2018	Restated 2017
Trading performance		
Gross mortgage advances	£165m	£146m
Total mortgage balances	£862.2m	£838.3m
People experience		
Engagement	69%	69%
Member experience		
Net promoter score	+59.4	+57.3
Customer satisfaction	86.9%	93.5%
Financial sustainability		
Profit before tax	£1,618k	£4,326k
Net interest margin	2.12%	2.07%
Management expenses ratio	1.62%	1.57%
Common equity Tier 1 ratio	11.7%	11.2%*
Liquidity coverage ratio	208%	151%

*12% in Financial Statements 2017 pre-restatement

Measure	Explanation	2018 performance	Trend compared with 2017
Gross mortgage advances	Our lending policy and underwriting criteria are designed to ensure lending is responsible and affordable. Each year the Board sets a target level of new lending in line with risk appetite, anticipated demand for the Society's lending products and as part of broader capital management strategy.	Total advances of £165m exceeded target	Improving
Total mortgage balances	The total size of the Society's mortgage assets. The Society needs to maintain sufficient balances of quality mortgage assets to meet demand from Members and generate sufficient income.	Mortgage assets ahead of plan	Improving
Engagement	The Board strives to make Saffron a great place to work with high levels of staff engagement, motivation and commitment. An annual survey of all employees measures multiple aspects of employee satisfaction as well as overall engagement. There is no specific target set for this measure as the Society strives for as high as score as possible and act on results and findings. (The results are unchanged as the next Society survey will be undertaken in June 2019 to allow changes to be embedded following past feedback).	69%	Stable
Net promoter score	This is a measure of how likely our Members are to recommend the Society to others. It represents the difference between the number of Members who would recommend the Society (promoters) minus those that would not recommend the Society (detractors). The Society sets extremely high standards for this measure. A score in excess of 50 is widely regarded in industry as exceptional.	An average score of 59.4 was achieved across the year, meeting target	Improving
Customer satisfaction	The Society seeks always to look after its Members through the delivery of good value products and services and consistently good service Customers visiting the branches or transacting online are requested to provide feedback on their experience with the Society. This measure distils the results of surveys conducted throughout the year. There is no specific target set for this measure as the Society strives for as high as score as possible and act on results and findings.	Score of 86.9%	Reducing
Profit before tax	This represents the amount earned by the Society after taking into account all expenses and provisions excluding taxation. Profits are the principal source of capital for the Society.	Profit before tax of £1,618k	Reducing

STRATEGIC REPORT

Measure	Explanation	2018 performance	Trend compared with 2017
Net interest margin	This represents the difference between interest received by the Society from its mortgages and other loans less interest paid on its deposits and other borrowings. This needs to be sufficiently high to generate a profit whilst providing consistent and fair rates to members.	Operated within target range throughout the year	Improving
Management expenses ratio	Management expenses comprise both administrative expenses and charges for depreciation and amortisation and represent the costs of running the Society's business. This ratio measures the proportion that these costs bear to the mean average total assets of the Society and is an indicator of efficiency. The Society currently operates with a high ratio compared with peers and reflects recent periods of significant investment made by the Society combined with a reduction in overall balance sheet size. The Board expects this ratio to reduce over the medium term through a combination of asset growth and cost reduction. The ratio increased in 2018 principally due to lower mean total assets.	Did not achieve target management expenses ratio	Declining
Common Equity Tier 1 ratio	Growing the Society's capital strength relative to its size is a key element of the Board's strategy. Common Equity capital is the highest quality capital available and, for the Society, comprises accumulated profits held in reserves. This ratio represents the relationship between Common Equity capital total assets, weighted by the level of risk they carry. The Board targets improvements in this ratio even as the Society grows.	11.7%	Improving (after restatement)
Liquidity coverage ratio	It is important to maintain appropriate levels of liquidity. This ratio represents the regulatory measure of liquidity adequacy and is one measure of liquidity. Liquidity is maintained throughout the year at levels necessary to significantly exceed regulatory requirements and our own stress tests.	Operated ahead of requirements throughout the year	Stable

The Board also receives comprehensive quantitative and qualitative information from management and the management committees covering a whole range of measures to assist the Board in assessing financial performance, delivery against strategic goals, evidence the Society is operating within risk appetite and conduct and culture.

Financial performance of the business

The Society prepares its financial results under Financial Reporting Standard (FRS) 102, "The Financial Reporting Standard applicable in the UK and Republic of Ireland" and elects to apply the measurement and recognition provisions of IAS39 "Financial instruments: Recognition and measurement (as adopted for use in the EU)".

The Chief Executive's report on pages 6 and 7 also contains information on the Society's financial performance for the year and factors affecting the results and should be read alongside this section.

Profits are the principal source of new capital available to the Society. As a mutual, owned by its Members and without external shareholders, any profits are retained within the business contributing to capital strength and providing the platform for continued investment in service improvements for Members.

Overview of Income Statement

	Group	
£millions	2018	2017 (restated)
Net interest income	21.7	22.1
Other income and charges	(3.3)	(0.6)
Administrative expenses	(14.1)	(13.9)
Depreciation and amortisation	(2.6)	(2.8)
Impairment losses	(0.1)	(0.4)
Other provisions	-	(0.1)
Profit before tax	**1.6**	**4.3**
Tax	(0.3)	(0.1)
Profit after tax	**1.3**	**4.2**

More detailed explanation of financial performance is provided below.

Income

The Group's income is derived from interest, fees and similar charges arising from its investments in loans secured on residential property. It also earns interest on its liquidity portfolio, rental income from its freehold properties and fees and other income from third parties with whom the Society partners and acts as introducer.

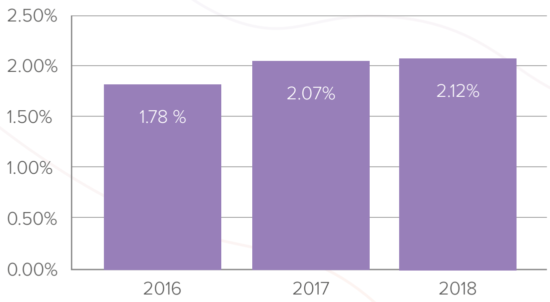
Net interest income

The net interest margin for the year ended 31 December 2018 was 2.12% (2017: 2.07%).

Net interest income is the principal component of the Group's income and represents the difference between interest received from Members and the Group's liquidity portfolio and interest paid to Members or other stakeholders providing funding to the Group. The amounts of interest will vary according to both the volume of assets and liabilities and rates of interest that apply. Net interest margin represents net interest income divided by average assets for the year. The objective is to optimise net interest margin so that we balance the requirement to offer attractive rates for savers and borrowers whilst ensuring sufficient profits are generated to support the Society's capital position.

STRATEGIC REPORT

Net interest margin



In August 2018 the Bank of England announced the first increase in Bank Rate for ten years. The Society responded with an increase to its Standard Variable Rate ("SVR") with effect from September 2018 however, competition for high quality mortgage business remained intense throughout the year with continued downward pressure on mortgage rates. As part of the broader financial strategy to manage overall balance sheet size the Society continued to take a measured approach to lending to achieve targeted levels of advances at appropriate rates and once again chose not to simply compete on price alone. Gross mortgage advances of £165million (2017: £146million), coupled with a successful strategy to retain existing high quality business, contributed to an increase in overall mortgage assets from £838.3million to £862.2million. Interest receivable decreased to £30.7million (2017: £31.1million).

The increase in Bank Rate was welcome news to our savings Members with the Society passing on the increase in full in most instances, seeking to achieve an appropriate balance between rewarding savers and balancing activity to match with the broader funding need of the Society. Net interest income for the year ended 31 December 2018 decreased to £21.7million (2017: £22.1million).

Other income

Fees

Fees receivable consist of certain mortgage-related income together with commissions from sales of insurance and financial planning products. Fees payable include other mortgage-related costs and bank charges.

Other operating income

Other operating income principally comprises of rental income from the Society's investment properties, together with any movements in the fair value of the properties. The properties were professionally valued on an open market value basis in October 2018 and increased in value by £55k (2017: £105k).

Net fair value movements

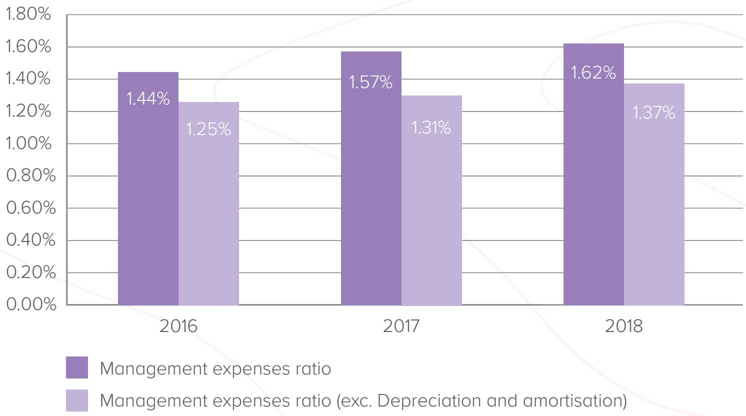
This income category comprises income from the use of derivative financial instruments (Derivatives). Derivatives are used solely for risk management purposes and are an important tool for the Society in managing exposure to changes in interest rates arising from the Group's portfolio of fixed rate mortgages and savings products. Although entirely used for managing risk, not all derivatives are in qualifying hedge accounting relationships. The net expense of £3.6million (2017: expense of £0.6million), analysed below, arises almost entirely due to the aggregate of changes in the fair value of derivatives not in qualifying hedge accounting relationships. During the year, the Society has also undertaken the exercise of adopting the Black-Scholes basis of valuing the equity release mortgage book. The model considers both House Price Inflation (HPI) and the HPI volatility in addition to actuarial factors such as mortality rates and the long term cost of funds. The adoption of the new model has resulted in a significant adjustment in the carrying value of the asset in the year reflecting both potential HPI volatility and an increased discount rate due to the movement observable market of long term funding costs. This coupled with the actual redemption activity in the year have reduced the carrying value of the asset in the year by a total of £3.4m.

	Group	
£000s	**2018**	Restated 2017
Net income from hedge accounting differences	135	59
Fair value movement in derivatives not in qualifying hedge accounting relationships	2,104	691
Change in fair value of assets and liabilities not in qualifying hedge accounting relationships	(5,838)	(1,389)
Total	(3,599)	(639)

Administrative expenses

Administrative expenses comprise of staff costs together with all other costs and overheads necessary for the Group to function. Together with depreciation and amortisation charges they comprise the total operating costs for the Group.

Control of operating costs forms a part of the broader strategic objective to grow the relative capital position but must be balanced with the conflicting objective to continue to invest in the Society to improve services to Members and meet regulatory and legal requirements. Administrative expenses of £14.1million compare with £14.0million in 2017. Further charges for depreciation and amortisation of £2.6million (2017: £2.8million) principally reflect the continued amortisation of the Society's IT investment completed in 2017. The Group's management expenses ratio expresses total group administrative expenses as a percentage of average group assets and has been presented both inclusive of and excluding charges for depreciation and amortisation.



Other operating charges

Other operating charges for the year ended 31 December 2018 of £112k (2017: £63k) comprise administrative expenses incurred by the Society's closed defined benefit pension scheme but borne by the Society. In 2018 provision of £56k was also made for the estimated additional liability arising through Guaranteed Minimum Pensions equalisation, following a UK ruling impacting all defined benefit pensions schemes.

Charges for impairment and provisions

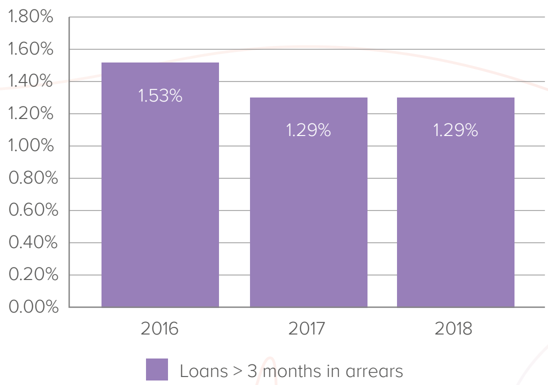
The Group is proud of the arrears performance of its residential mortgage assets, reflecting individual underwriting, clear lending policies and robust credit risk management practices and continues to experience low levels of arrears.

Impairment charges	**Group**	
£000s	**2018**	2017
Collective impairment charge	31	65
Individual impairment charge	108	291
Total	139	356

The Group is a Receiver of Rents on 15 properties (2017:17) representing capital balances of £7.0million (2017: £7.2million) and all in respect of loans originated before 2009. This portfolio is actively managed and it is the Board's intention to seek an orderly disposal of properties in this portfolio. During the year ended 31 December 2018 the Society appointed a new LPA Receiver to manage the portfolio and assist the Society in selecting exit strategies for each individual property. A further three properties were disposed of in the year ended 31 December 2018 and as at 31 December 2018 offers accepted on 11 properties. Further disposals are planned in 2019.

This portfolio is reviewed each year and assessment made of the carrying value and expected future cash flows. This assessment contributed to a requirement to make an additional impairment charge of £0.2million.

The arrears ratios (number of loans >3 months in arrears) as a percentage of the total loan book remained at 1.29% at 31 December 2018 (2017: 1.29%). Further information on the quality of the Group's loan portfolio, including information on loan forbearance activities can be found in Note 29 to the Accounts.



Provisions for liabilities

Other provisions comprise amounts set aside to cover obligations under the Financial Services Compensation Scheme (FSCS) Levy. In common with other regulated deposit takers, the Society pays levies to the FSCS to enable the FSCS to meet claims against it. During 2018 the FSCS repaid final amounts due to HM Treasury following the previous failures of Bradford and Bingley and Dunfermline Building Society. The Society has received its final invoice for its share of interest and capital costs and recognised an income of £0.1million in respect of the Scheme year ending March 2019 (2017: charge of £0.1million for Scheme year ended March 2018).

Taxation

The statutory rate of corporation tax has been 19% since 1 April 2017, giving an effective tax rate for the year ended 31 December 2018 of 19% (2017: 19.25%). The Group corporation tax charge in the year of (£353k) (2017 Restated: (£82k) includes primarily the recognition of a deferred tax asset due to losses carried forward from the prior year restatements identified in the period which can be fully offset against future profits in the next 3 years. A reconciliation of the effective rate to the statutory rate of taxation is provided in Note 9 to the financial statements.

Overview of Statement of financial position

The Group generates new assets principally through the origination of new mortgage loans secured on residential property. After reducing in size in each of the previous three financial years, total assets increased to £1,036million at 31 December 2018, compared with £1,017million at 31 December 2017.

	Group	
£millions	**2018**	2017 (restated)
Liquid assets	152.5	154.5
Loans and advances to customers	862.2	838.3
Fixed and other assets	21.5	24.4
Total assets	**1,036.2**	**1,017.2**
Shares	784.0	802.3
Borrowings	162.6	121.5
Other liabilities	26.0	30.9
Subordinated liabilities	10.3	10.3
Total liabilities	**982.9**	**965.0**
Reserves	53.3	52.2
Total liabilities and reserves	**1,036.2**	**1,017.2**

Liquid assets

The Group's liquid assets mostly comprise of assets reported on the balance sheet in the form of cash deposits, debt securities and other high quality liquid assets. The Group holds liquid assets to ensure it has sufficient levels to meet its obligations as they fall due and in accordance with the Board's risk appetite and regulatory requirements.

At 31 December 2018 the Group's portfolio of liquid assets totalled £152.5 million (2017: £154.5million) and comprised of the following:

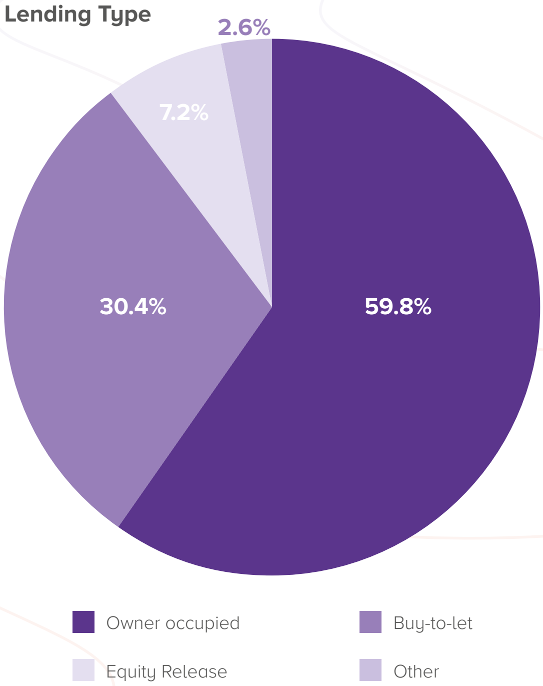
	Group	
£millions	**2018**	2017
Bank of England	49	58
UK Government debt	43	13
Other bank deposits	27	29
Non-UK Government debt	-	15
Supranational debt	33	39
	152	**154**

At 31 December 2018 the ratio of liquid assets to shares, deposits and loans stood at 16.1% (2017: 16.7%). A key measure of liquidity under CRD IV is the Liquidity Coverage Ratio (LCR). At 31 December 2018 the Group's LCR was 208% (2017: 151%).

Mortgages

The Group's total portfolio of loans and advances mostly comprise of owner-occupied and buy-to-let mortgages. The Group also has a small portfolio of equity release mortgages and non-residential loans but is not looking to expand these portfolios.

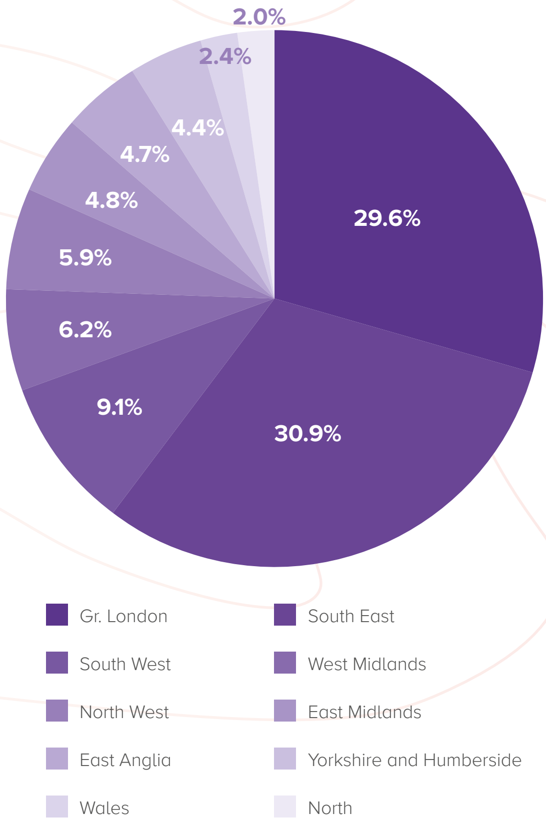
Lending Type



The majority of the Group's lending is sourced from mortgage intermediaries but the Group is also able to directly advise customers when selecting a mortgage and expects this channel to increase in importance in the medium term. The Society recorded gross lending of £165million in the year ended 31 December 2018 (2017: £146million). Stated after the impact of mortgage repayments, voluntary redemptions and other movements, total loans and advances to customers (net of impairment) at 31 December 2018 was £862.0million, compared with £838.3million at 31 December 2017.

The Group lends throughout England and Wales and its exposures are geographically spread across the regions, although its location in the South East of England leads to an intentional concentration towards London and the South East reflecting our regional heartland.

Geographical Dispersion

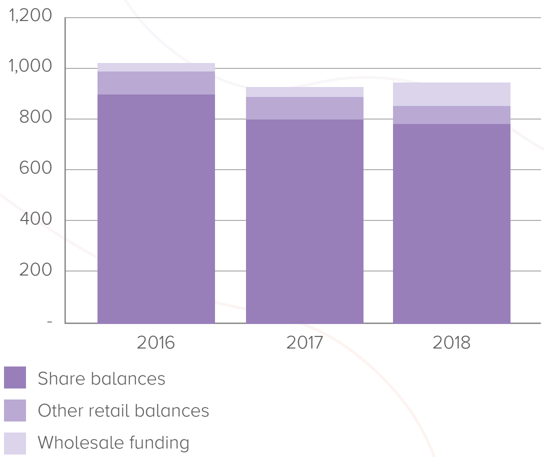


Funding the business

It is important that the Group has access to an appropriately diverse range of funding sources for risk management purposes. Retail funding, provided by Members' savings, remain the most important element of the Group's funding, supplemented, where appropriate, by corporate savings and deposits (for example, solicitors' client money) and limited use of wholesale facilities. The Group is also a participant in the Bank of England's Sterling Monetary Framework.

The Society has also signed a statement of commitment to adhere to the principles of good market practice published within the UK Money Market Code, produced by the Bank of England's Money Market Committee.

The Group's funding requirement is determined by a combination of mortgage demand, regulatory requirements and risk appetite.



Retail funding

The Society has to balance the levels of retail inflows it attracts with the Society's overall liquidity position and mortgage funding requirements. During the year ended 31 December 2018 the Society increased its net mortgage balances by almost £24million, which was more than covered by the Society's drawdown from the TFS and therefore resulted in a lower requirement for retail balances. Accordingly, during the year ended 31 December 2018, the Society experienced a net outflow of shares and other deposit balances of almost £35million, ending the year with balances of £853.3million (2017:£888.1million). The Group strives to offer fair and competitive interest rates at all times, prioritising existing Members over new, but recognises it should not appear in the "Best Buy" tables every week.

Over the last twelve months the average rate paid on our share accounts has been 0.90% (2017: 0.86%).

Wholesale funding

The Society remains an active participant of the Bank of England's Sterling Monetary Framework (SMF), accessing the Funding for Lending Scheme (FLS) and more recently the Term Funding Scheme (TFS). As at 31 December 2018 the Society held £25m of FLS and £40.7m of TFS funding, with the FLS funding maturing in the first quarter of 2020 and TFS funding maturing between quarter 4 2021 and quarter 1 2022. The Society has also accessed shorter (6 month duration) funding through the Bank's Index-Linked Term Repo (ILTR) facility which is used to support funding diversification. Other wholesale funding is obtained from a range of counterparties, typically other financial institutions and local authorities and typically for periods of up to two years in duration.

Asset encumbrance

The Group uses certain assets as collateral to support the raising of secured funding under the Bank of England's SMF. Collateral is also used to support financial derivative contracts entered into by the Society as part of its management of interest rate risk. As at 31 December 2018, 15.6% of the Group's assets were encumbered (2017: 11.6%) representing £134.6million of residential mortgage assets (2017: £70.8million) and £25.6million of other assets (2017: £47.4million).

Capital

Capital consists of general reserves (accumulated profits), the available for sale reserve plus collective provisions for impairment and the revaluation reserve in respect of the Group's freehold properties. The Group also has in issue subordinated liabilities that expire in January 2028. Capital regulations require intangible assets and pension scheme surpluses to be deducted from available capital. The Group holds capital to protect its Members from the effect of shocks or stresses.

The Group capital requirements are set and monitored by the Prudential Regulation Authority (PRA) in the form of Internal Capital Guidance (ICG). All of the Group's capital ratios remained in excess of regulatory requirements throughout the year.

After regulatory deductions the Groups regulatory capital stood at £55.2m (2017 restated:£52.2m). Further details on the capital position, including reconciliation to the Group's reserves is provided in Note 30 of the accounts. Prior to restatement (explained in Note 1), 2017 total regulatory capital was £54.7m.

A measure of capital strength commonly reported amongst financial institutions is the Common Equity Tier 1 (CET1) ratio. This ratio signifies the relationship between our strongest form of capital (accumulated profits held in reserves, Tier 1) against our assets, weighted by the level of risk they carry.

The Group's CET1 ratio increased by 0.5% to 11.7% at 31 December 2018 (2017 restated:11.2%). Gross capital (which includes Tier 2 capital, such as subordinated liabilities) as a percentage of shares and borrowings was 6.7% (2017 restated:6.7%).

The board has implemented a programme of management actions aimed at strengthening the capital position through various measures, including cost reduction and balance sheet management. Executing this plan will be a key focus for the Group through 2019 to continue to best serve our Members in the long term.

Financial Risk Management Objectives and Policies

In executing the Group's strategy and in undertaking its routine business and activities, the Group is exposed to a range of risks. The primary goal of risk management is to ensure that the outcome of risk-taking activity is consistent with the Society's strategies and risk appetite and appropriate for the level and type of risks that it takes paying regard to regulatory guidance. It ensures that there is an appropriate balance between risk and reward in order to optimise Member returns and, when issues arise they are managed for the best outcome of the Society and its Members.

Risk management framework

The Society's Enterprise-wide Risk Management Framework (ERMF) provides the foundation for achieving these goals through:

- articulating the Society's risk management practices and procedures;
- documenting a consistent framework for risk management across the Society;
- establishing minimum standards around key risk management framework issues;
- articulating the Society's risk strategy and enterprise wide risk appetite; and
- directing the approach to risk governance throughout the Society.

The ERMF sets out the Society's method of managing risk via:

- defining its Risk Appetite, which is the level of risk that Saffron is prepared to accept whilst pursuing its business strategy, recognising a range of possible outcomes as the business plan is implemented;
- detailing the 3 Lines of Defence (3LoD) model and its operation within the Saffron Risk Management Framework;
- determining the roles and responsibilities of the committees in place to govern risk;
- identifying those roles responsible for the key risks and how the oversight operated together with the reporting structure to ensure independent oversight of risk decisions;
- documenting the main risk management processes under its approach of Identify; Evaluate; Mitigate; Report; Manage and Challenge;
- describing the key risks facing the Society and how they are managed; and
- listing and explaining where the policies sit in the Saffron hierarchy and how they operate.

The ERMF is supported by policies and procedures to embed the principles into the business.

The "Three lines of defence" model

The Society adopts a "three lines of defence" model to enable it to separate risk management activities between:

- those that own and take risk and implement controls (1st line);
- those that oversee, monitor and challenge the first line (2nd line); and
- the audit functions which provide fully independent assurance (3rd line).

Risk governance

The oversight and direction of the Board is central to the Society's risk management framework. The Board exercises governance over risk through a series of Board committees and management structures. Each of the Board committees includes at least two Non-Executive Directors (one of whom chairs), with other committee members drawn from the Executive and appropriate members of senior management. The Committees forming part of the Risk Management framework comprise of:

Committee	Chaired by
Board committees	
Risk, Audit, Compliance and Conduct Committee	Non-Executive Director
Board Credit Committee	Non-Executive Director
Management Committees	
Assets and Liabilities Committee	Chief Financial Officer
Executive Risk Committee	Chief Risk Officer
Credit Committee	Chief Risk Officer
Product Management Committee	Chief Commercial Officer

Further details on the Committees can be found in the Corporate Governance Report on pages 28 to 29.

Risk appetite

The Board defines risk appetite as "the level of risk the Society is prepared to accept whilst pursuing its business strategy as a mutual society set up for the benefit of its Members, recognising a range of possible outcomes as the business plan is implemented". Risk appetite is reflected in qualitative measures set out in the Society's ERMF and in a series of quantitative measures that are reported to the Board at each meeting.

Risk appetite is formally reviewed at least annually but may be revised more frequently to reflect emerging risks, changes to the economic and market environment or for any other reasons considered appropriate.

Risk culture

The Board places significant emphasis on every level of the organisation having an awareness of risk and the importance of effective management of risk. Each department across the organisation is expected to take ownership for the identification and management of risks specific to their areas, with the Board and Management Committees, together with the three lines of defence model ensuring a strong risk culture is embedded throughout the organisation, set by the "tone from the top". As a mutual organisation, exemplary conduct is also expected from everyone in the organisation and conduct is taken into consideration when making decisions on remuneration across all levels of the organisation to ensure incentives do not drive poor customer outcomes.

Stress testing

Stress testing is a risk management tool used by the Group to understand the impact of severe but plausible scenarios on its business model. The Group uses a prescribed Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP) to identify and quantify the capital and liquidity risks it faces. Stress testing is undertaken as part of these processes with the combined output used to inform the Board's risk appetite, certain policies, together with management actions and contingency plans.

In addition, the PRA carries out an assessment of the Society and may issue revised capital or liquidity guidance specifying minimum capital and liquidity levels based on their assessment of the risks faced by the Group, including under stress.

Recovery and Resolution plans

It is a requirement for all Banks and Building Societies to construct plans that detect possible failure and minimise the consequences of failure should it occur. The Society maintains a Board-approved Recovery Plan and a separate Resolution Plan that outlines a menu of options the Society could credibly take to recover from a Society-specific or market-wide stress. The Resolution plan contains prescribed information necessary for the Bank of England to establish an orderly resolution of the Society in the event that recovery cannot be achieved. The Recovery Plan and Resolution Plan documents are updated at least annually.

Principal risks and uncertainties

There are a number of potential risks and uncertainties which could have a material impact on the Group's performance and could cause actual results to differ materially from expected and historical results and also have the ability to threaten its business model, solvency or liquidity.

The principal risks that arise from the Group's operations, and which are managed under the risk management framework, are described below.

Credit risk

Description:

Credit risk is the risk that a customer is unwilling or unable to honour its obligations to the Society as they fall due, resulting in an actual or potential loss exposure for the Society. The Society segments credit risk into two categories: Retail and Treasury. As a primary lender the Group faces credit risk as an inherent component of its lending activities. Adverse changes in the credit quality of the Group's borrowers, a general deterioration in UK economic conditions or adverse changes arising from systemic risks in UK and global financial systems could reduce the recoverability and value of the Group's assets.

Mitigation:

The Society operates within a credit risk appetite which directs our lending to lower risk / lower return sectors of the mortgage market, both in terms of property location and borrower characteristics and this is monitored carefully and benchmarked against external loss and risk data.

Market risk

Description:

Market risk is the risk of any impact on the Society's financial position due to adverse movements in market rates, such as interest rates, House Price Indices (HPI), equity prices, currency or commodity prices. The principal exposures faced by the Society, in terms of market risk are significant repayment or product switches within the society mortgage book which have an additional downside impact on the carrying value of the Effective Interest Rate (EIR) fair value asset attached to the mortgage asset. A further risk is the impact to the equity release mortgage book of movements in the long term discount rate, HPI downturn and volatility in the house prices which have a significant impact on the fair value of the equity release asset, along with the repayment risk attached to redemption of the underlying mortgage asset.

Mitigation:

The Society manages market risk through on-balance sheet matching of assets and liabilities or derivative financial instruments. Following the adoption of FRS102, movements in interest rates and other indices have a direct impact on the value of certain balance sheet items which in turn creates volatility in reported earnings that cannot be completely mitigated. These balances are monitored on an ongoing basis, with action taken when required.

Liquidity / Funding risk

Description:

Liquidity risk is the risk that the Society is unable to make available sufficient resources to meet its current or future financial obligations as they fall due, or is only able to do so at a premium cost. This includes the risk the Society attracts excessive liquidity through poor product management, acting as a drag on financial performance. The Group relies on its access to sources of funding to finance the origination of new business and working capital. If access to funding became restricted, either through market movements or regulatory or Government action, this might result in the scaling back or cessation of new lending.

Mitigation:

The Group, through its treasury operation, overseen by the Assets and Liabilities Committee, seeks to mitigate this risk by managing the Group's liquidity portfolio and actively seeking alternative sources of finance. Note 29 to the Accounts, "Financial Instruments" contains additional narrative and numerical information in respect of the Group's approach to the management of credit risk, market risk and liquidity risk.

Operational risk

Description:

Operational risk is the risk of incurring losses resulting from inadequate or failed internal processes, people or systems, or from external events. This definition includes legal risk and environmental risk together with events or circumstances where disaster recovery planning does not work. The activities of the Group expose it to any operational risks relating to its ability to implement and maintain effective systems to process its transactions with Members and customers. A significant breakdown in IT systems of the Group might adversely impact the ability of the Group to operate its business effectively.

Mitigation:

To address these risks, the Head of Operational Risk maintains department-specific risk and control self-assessments (RCSA) covering the operations of the entire Society. RCSAs are reviewed and tested on a regular basis and the results reported to the Executive and Risk, Audit, Compliance and Conduct Committee (RACCC). Any incidents and near misses are assessed in terms of potential cost to the Society and the causes identified to improve controls. Additionally the Group's internal audit function (provided externally by PwC) carries out targeted reviews of critical systems and processes to ensure that they are properly designed and operate effectively. The Group has a Business Continuity Plan which is kept under regular review and is designed to ensure that any breakdown in systems would not cause significant disruption to the business.

IT Security / Cyber-crime

Description:

Cyber-crime and the security of information held by the Society are a present and growing threat that the Society's systems might be infiltrated allowing the intruder to take control of customer accounts or download sensitive data for personal gain.

Mitigation:

The Society continues to invest in the maintenance and development of technology, which includes cyber-risk reduction initiatives and further progress towards attainment of Information Security industry standards.

Compliance risk

Description:

Compliance risk is the risk of financial loss, reputational damage and or regulatory censure arising from failure to comply with regulatory or legislative requirements. The market sectors in which the Group operates and the markets from which it receives its funding have been subject to extensive intervention by the UK Government, European Union and other regulatory bodies. To the extent that such actions disadvantage the Group, when compared to other market participants, they represent a risk to the Group.

Mitigation:

In order to mitigate this risk, the Group has been active in explaining its position to the authorities and works with its professional advisors in this process. Ultimately there are three risks when it comes to ensuring that we comply with regulations:

a) Failing to identify new or developing regulatory requirements / guidance;

b) Failing to comply with all regulatory requirements; and

c) Failing to identify breaches and take appropriate action.

A dedicated compliance team, reporting directly to the CEO, monitor rule compliance through a programme of departmental and thematic reviews and, under the supervision of RACCC, ensures that the Society stays within the various regulatory regimes and provides Executive management and the Board with regular updates on regulatory issues.

Conduct risk

Description:

Conduct risk forms a part of compliance risk and is the risk that the Society acts in a way which delivers adverse outcomes for customers and therefore not in accordance with the requirements or principles of Treating Customers Fairly.

Mitigation:

Every department in the Society is aware of and responsible for ensuring Members are put first and the highest standards of conduct upheld, with regular training provided to ensure these principles are embedded in the culture of the Society. The Compliance team acts as second line of defence and reports to RACCC on conduct matters.

Business risk

Description:

The Group faces competition in all the core markets in which it operates. There is a risk that its profitability and/or market share may be impacted by the actions of its competitors.

Mitigation:

To mitigate this risk, the Group maintains close relationships with its Members and customers, business introducers and other significant participants in the markets in which it is active as well as participating in sector-wide organisations (for example, the Building Societies Association) and initiatives. This allows market trends to be identified and addressed within the Group's business strategy.

Future outlook and uncertainties Regulatory developments

There are a number of significant future regulatory developments that can be expected to have a material impact on the Society's business model and operations if implemented.

Capital buffers

Under European law, building societies are required to hold a minimum amount of capital to protect the Members' funds and remain solvent in the event of severe economic stresses. In addition to these minimum requirements, further buffers have been introduced to ensure that Members' interests are protected even in the most adverse scenarios. In 2019, these buffers have been increased by 0.5% and consist of a capital conservation buffer set at 2.5% of risk weighted assets and a countercyclical buffer (CCyB) at 1%. The CCyB can be used by the financial regulators to adjust the resilience of the banking system to the changing scale of risks expected to be faced. As such, it may be increased up to a maximum of 2.5%. A 0.5% increase in a buffer would require the Group to hold approximately £2m of further capital for regulatory purposes.

Basel III Reforms

In December 2017 the Bank for International Settlements' Basel Committee on Banking Supervision published its report "Basel III: Finalising Post-crisis reforms". The document sets out the Committee's finalisation of the Basel III framework. The revisions to the framework seek to restore credibility in the calculation of risk-weighted assets and improve the comparability of capital ratios. Revisions include changes to the standardised approach for credit risk, introducing a more granular approach to risk weights and are expected to take effect from 1 January 2022. Moving to the revised framework will require the Society to hold additional capital for regulatory purposes.

Economic outlook

The defining issue for 2019 remains Brexit, more specifically the market, economic and political turbulence that it may cause. Against this backdrop, the Society is taking a cautious approach to mortgage activity until such time as the path ahead becomes clearer.

It remains ever more important for the Society to see through the short-term volatility around Brexit and position itself, through capital improvement, for long term success. We have continued our investment in our key people to ensure we are in a position to deliver our strategies, while investing in our IT infrastructure and Community to ensure that we are a Society which is fit for purpose for our current and prospective Members whilst retaining our mutual values.

Financial performance

The economic conditions facing the society over 2019 are uncertain, however the Society is well positioned to navigate the risks that may present, because of the diligence that has been applied in the areas of mortgage underwriting, balance sheet and treasury management.

Mortgage arrears and impairment remain well controlled with the low levels of impairment recognised in the year relating to the provision and disposal of the legacy assets within our Receiver of Rent portfolio. It is our intention to fully dispose of this portfolio within the next 12 to 18 months.

Balance sheet and treasury management has continued to be a core area of focus for the Society. Since 2013, the Society has sought to optimise its levels of liquidity and also obtain sufficient sources of funding to enable it to manage effectively and efficiently.

The Society also subjects its business model to stress testing to confirm that it can withstand deep and sustained economic shocks whilst maintaining sufficient liquidity and capital to continue operating effectively.

Notwithstanding the continued focus on financial and risk management, the Society faces a number of risks and uncertainties from its business operations that could materially impact on its financial position.

Credit risk: Economic conditions, and prospects, impact on the performance of the Society's mortgage assets, as does political uncertainty. Improving unemployment typically reduces arrears levels and defaults whereas rising interest rates can create affordability issues. Full consideration is given to these risks in the Society's underwriting processes with loan affordability demonstrated at much higher rates than the product applied for. The Society monitors the performance of its mortgage assets very closely with a range of qualitative metrics regularly reported to Board. The Society also operates an arrears and repossessions policy focusing on proactive engagement with borrowers facing difficulty meeting their mortgage payment obligations. The Society does exercise forbearance in certain circumstances. These are reported in Note 29, "Financial instruments".

Funding costs: A consequence of continued economic uncertainty is the risk to future cost of funding necessary to support the Society's lending activities and liquidity position. The Society is a participant in the Bank of England's Sterling Monetary Framework and has made drawdowns under the Funding for Lending Scheme ("FLS") and Term Funding Scheme ("TFS"), with amount repayable by 2020 and 2022, respectively. As a consequence of both schemes being no longer available, market rates for retail deposits have increased markedly during 2018, particularly in the last quarter of the year. An increase in Bank rate or market rates would place further pressure on funding costs. Political uncertainty further adds to this risk.

Lifetime mortgages: There are risks and uncertainties in respect of the Group's portfolio of Lifetime Mortgages that could impact on financial performance. A reduction in house prices or increase in life expectancy could result in some mortgages suffering losses as a result of the no-negative equity guarantee feature of the product. Lifetime mortgages are held at fair value, which includes provision against such losses.

Pension Scheme obligations: The Society has an obligation to fund the Saffron Building Society Pension Scheme (the "Scheme"). The Scheme is closed to future accrual and has been closed to new employees since August 2003 however, the obligation still gives rise to a risk that the Society will be called upon to provide additional funding should the Scheme's liabilities exceed its assets. The funding obligation is based upon regular triennial actuarial valuations, the most recent being 30 April 2017 in which the Scheme was in surplus of £1.2m. The Scheme is also subject to annual valuation for FRS102 purposes and was reported in the financial statements for the year ended 31 December 2018 at a surplus of £0.1m (2017: surplus of £0.2m).

Geoffrey Dunn
Chairman
On behalf of the Board
13 March 2019


'Our business is built on two things - trust and serving our Members'

CORPORATE GOVERNANCE REPORT

The Board of Directors is responsible for providing leadership and setting the strategic direction of the Society within a framework of prudent and effective controls which enable risk to be assessed and managed in accordance with the Board's risk appetite.

This report provides Members with information on the Society's' corporate governance framework. The Society has regard to the UK Corporate Governance Code to the extent that it is relevant to a Building Society. A revised UK Corporate Governance Code was issued by the Financial Reporting Council in July 2018 and applies to accounting periods beginning on or after 1 January 2019. Our regulators the PRA and FCA encourage each building society to explain in its Annual Report and Accounts whether and to what extent it adheres to the Code. Where the Society does not comply with the code it gives an explanation of non-conformance.

Leadership

The role of the Board

It is the Board's role to set the strategic direction for the Society, ensure that the necessary financial and human resources are in place to meet them and review the performance of the Executive team. The Board also maintains a framework to enable risk to be assessed and managed in accordance with its risk appetite.

At the end of the year the Board consisted of two Executive Directors, one of whom is the Chief Executive Officer and six Non-Executive Directors (including a Chairman).

Our Chief Customer Officer resigned from the Board on 19 November 2018. The Nominations Committee maintain a succession plan for Executives and Non-Executive Directors.

The Board met six times in 2018 including a session dedicated to strategy and has a formal calendar of items for review. The Board retains certain powers for decision-making but also delegates certain responsibilities and powers to Committees which are listed below. The Chairman holds meetings at least twice a year with the Non-Executive Directors without the Executive Directors being present. The Non-Executive Directors meet once a year without the Chairman inter alia to review the Chairman's performance.

Roles of the Chairman, Non-Executive Directors and Executive Directors

The Society maintains a clear division of responsibility between the Non-Executive Directors and Executive Directors and these are outlined in job descriptions and a table of delegated powers.

The Chairman

The Chairman is responsible for the leadership of the Board and its effectiveness. The Chairman sets the governance agenda, standards and expectations for Board Directors and ensures constructive challenge and openness between Non-Executive and Executive Directors. The Chairman and Vice Chairman are elected by the Board on an annual basis.

Non-Executive Directors

Non-Executive Directors constructively challenge and help develop proposals on strategy and oversee executive performance.

Executive Directors

The Board delegates the implementation of the strategy and the day-to-day management of the Group to the Leadership Team which is led by the Chief Executive Officer.

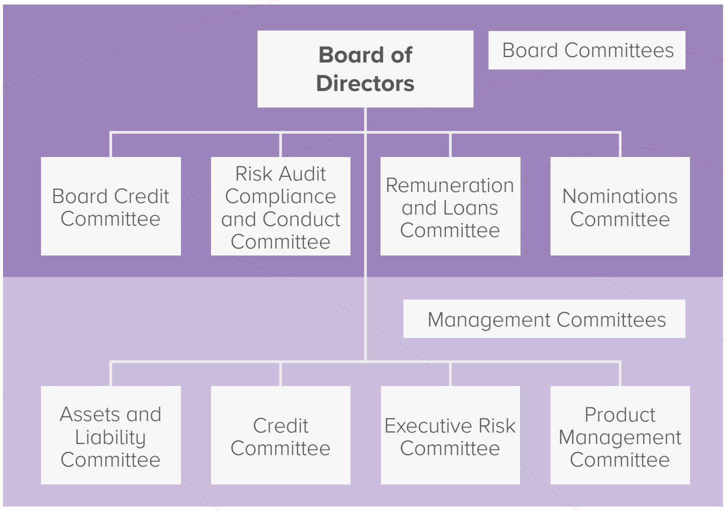
Effectiveness

Composition of the board

The names of the directors together with brief biographical details are provided on pages 40 to 43. The Board has established Committees to consider certain specialist areas in more detail than would be appropriate at a Board meeting. Each Committee operates within defined terms of reference. Minutes of meetings, evidencing the level and quality of challenge, are formally recorded and proceedings are reported to the full Board by the respective Committee Chairperson. The Committees and their summary terms of reference are set out below. The full terms of reference may be obtained on request from the Society Secretary. The governance structure of the Society is shown opposite.

Board Committees

As referred to above certain matters are delegated by the Board to Board Committees. Details of the Board Committees are given here.



Remuneration and Loans Committee

The Board has established the Remuneration and Loans Committee which comprises all the Non-Executive Directors and is chaired by Nick Treble (Vice Chairman). It sets remuneration policy for Directors and reviews and approves remuneration arrangements and service contracts for Executive Directors. The Committee takes responsibility for monitoring compliance with the regulatory Remuneration Code as it applies to Material Risk Takers under the Senior Manager Regime. It also considers and approves loans to Directors or connected persons. The Committee meets at least twice a year to review remuneration and as necessary to approve applications for Directors' loans. The Committee makes an annual report to Members which can be found on page 32.

Nominations Committee

The Board has established the Nominations Committee which consists of the Senior Independent Director, Neil Holden, who chairs the Committee, the Chairman of the Society, Vice Chairman and Chief Executive Officer. The Committee reviews the balance of Board skills, independence, experience and knowledge, its structure and composition, any new appointments and the performance of Directors. The Committee also ensures that the Society meets its statutory responsibilities giving due consideration to relevant laws, regulation and codes; in particular to be responsible for adherence to the Building Societies Act and follows good practice in corporate governance, including reviewing the UK Corporate Governance Code. In the appointment of new Directors the Committee is cognisant of the need for diversity around the Board table and uses a professional search firm or open advertising to encourage applications from a range of candidates. The Committee considers diversity in the context of experience, background and skills as well as gender and ethnicity.

Risk, Audit, Compliance and Conduct Committee

The Risk, Audit, Compliance and Conduct Committee ('RACCC') is a committee of the Board and comprises nominated Non-Executive Directors, excluding the Chairman, and is chaired by Neil Holden (Senior Independent Director). Members of the Executive and senior management are invited to attend as appropriate.

A sub-committee focusing on compliance and conduct risk ensures a balanced and proportionate approach is taken to the key risks. The Committee (including the sub-committee) reviews the effectiveness of the relevant Group systems of internal control and monitors compliance with regulatory requirements and relevant codes of practice. It considers and approves the remit of the risk and compliance management functions and provides input, review and challenge to Executive management's identification and assessment of risks. It provides ongoing monitoring of the overarching and specific risk management frameworks and ensures that either the Society remains within its risk appetite and tolerances in the various aspects of its business or that management takes appropriate mitigating actions where the risk appetite is being, or appears to be at risk of being, breached. It approves and oversees the delivery of the annual integrated assurance plan comprising the internal audit and risk management and compliance plans. Internal audit services are currently provided to the Society by PwC under the terms of a specific engagement. Under the Committee's terms of reference, it has responsibility to approve the terms of engagement, appointment, reappointment or dismissal of the internal auditors.

These activities are based on a thorough risk assessment of the full scope of the Group's business activities and in the context of the Board's strategy and risk appetite. It is also responsible for managing the relationship with the external auditor, including an annual review of auditor effectiveness and their appointment, reappointment and removal. All Non-Executive Directors on this Committee have experience that is relevant to the role and at least one member present has recent financial experience.

CORPORATE GOVERNANCE REPORT

During 2018 the Committee met seven times to fulfil its responsibilities and, in particular, considered reports for the following:

- the effectiveness of the system of internal control;
- the plans and activities of internal and external audit, risk, compliance and financial crime teams;
- the effectiveness and independence of internal and external audit and the effectiveness and resourcing of risk, compliance and financial crime teams;
- the principal risks faced by the Society, together with evidence that the Society is currently operating within risk appetite and will continue to do so based on the outlook for those risks; and
- the integrity of the Group's financial statements.

In considering the integrity of the Group's financial statements RACCC reviews at least annually the acceptability of accounting policies and quarterly, the significant financial judgements. The external auditor, Deloitte, is also utilised to help ensure that suitable accounting policies have been implemented and appropriate judgements made by management. As a result of discussions with both management and the external auditor, RACCC determined the key risks of misstatement of the Group's financial statements related to the following judgement areas.

Revenue recognition using the effective interest rate (EIR) method

The Group recognises mortgage income on an effective interest rate basis, which includes the deferral of related fees and commissions paid and received. During the course of this year's audit, testing revealed that the EIR model, built and implemented in 2015 contained modelling errors. Correction of these errors has led to a restatement of the prior year results, explained more fully in note 1. RACCC has been engaged throughout the model changes to correct the mechanics within the model to conform with IAS 39 recognition and measurement standard around EIR. Management have engaged with RACCC surrounding the behavioural curves representing the likely remaining lives of the mortgages and therefore the associated interest income and related fees and provided adequate explanations to RACCC's challenge. RACCC are satisfied that the prior year adjustment has been appropriately applied within the financial statements.

Loan loss provisioning

Board Credit Committee ('BCC') monitor the performance of the Group's loan book throughout the year and review the methodologies and assumptions used by management to determine the level of impairment provision required. BCC reviewed the approaches used and key assumptions adopted and agreed with the overall level of provisioning held. Following recommendation and approval from BCC, RACCC concluded the assumptions used to support management's judgement as to the adequacy of impairment provision were appropriate.

Valuation of Lifetime Mortgages and associated swap

The Group has a portfolio of Lifetime Mortgages that are accounted for at fair value through profit and loss to prevent an accounting mismatch with the associated swap which is also accounted at fair value. Changes in the fair value of the mortgages and associated swap are reported within other income and can give rise to significant volatility in reported income. The fair value of the mortgages is determined using discounted cash flow techniques and the use of actuarial tables to estimate redemptions. Cash flows are discounted using a discount rate with a number of constituent components requiring management judgement. During the year, the Society changed the basis of measurement of the portfolio through the implementation of a stochastic, Black Scholes model which incorporated the potential volatility of house prices over future time periods. The new valuation technique is in line with market practice and takes into account the potential volatility of the lifetime book. This is explained in the Strategic Report on pages 8 to 24. After reviewing these, and other reports presented by management, and after discussion with the Group's auditors, RACCC is satisfied that the financial statements appropriately address the critical judgement areas and that the significant assumptions used for determining the value of assets and liabilities have been subject to appropriate scrutiny, challenge and are sufficiently robust.

Fair, balanced and understandable

Taken in its entirety, RACCC is satisfied that the Annual Report and Accounts are fair, balanced and understandable.

Board Credit Committee

The Board Credit Committee, a committee of the Board comprises Non-Executive Directors and is chaired by Nick Treble (Vice Chairman). Members of the Executive are invited to attend as appropriate. The Committee reviews and approves the lending of customer facilities in excess of Credit Committee approval limits on a sole or aggregate basis and counterparty exposure limits in respect of Treasury activities as recommended by the Assets and Liabilities Committee. The Committee also reviews and approves levels of impairment including reviewing approaches used and key assumptions adopted in determining the level of provisions. The Committee meets four times a year and when necessary.

Directors' attendance 2018

Name	Board	Risk, Audit Compliance & Conduct Committee	Remuneration & Loans Committee	Nominations Committee	Board Credit Committee
Number of meetings held	6	7	2	3	5
J Ashmore	6	7	2	3	4
G Barr	6	7	2	2	5
G Dunn	6	7+	2	3	5
C Field	6	7*	2*	3	5*
D Garner	6	7*	n/a	n/a	5*
N Holden	6	7	1	3	5
S Howe	5	5*	n/a	n/a	4*
E Kelly	6	7	2	3	5
N Treble	5	6	2	2	4

*Executive directors attended by invitation (S Howe resigned as a director on 19.11.2018)
+Attended on a voluntary basis

The Society has also established three management committees which help the Executive Directors discharge their duties.

Management Committees

Assets and Liabilities Committee

The Committee comprises Executive Directors, the Chief Risk Officer, Head of Commercial Finance and the Treasurer. It recommends treasury and balance sheet risk management strategies, capital requirements in the context of the Society's policy statement concerning liquidity, funding and structural risk management policies. The Committee meets at least eleven times a year and is chaired by the Chief Financial Officer.

Credit Committee

The Committee comprises Executive Directors, the Chief Risk Officer and Head of Credit Risk. The Committee reviews lending propositions and loan performance as well as benchmark and trend data. It reviews and recommends to the Board changes to lending policy or limits. The Committee meets at least eleven times a year and is chaired by the Head of Credit Risk.

Executive Risk Committee

The Committee comprises Executive Directors and representatives from Risk and Compliance. Representatives from other departments may also attend by invitation. The Committee considers information regarding all principal risks faced by the Society as documented in the Enterprise Risk Management Framework (ERMF) to consider, review and challenge how existing risks in the business are being controlled and mitigated in accordance with stated risk appetite and consider new and emerging risks. The Committee provides regular reports and recommendation, where appropriate, to RACCC. The Committee meets at least ten times per year and is chaired by the Chief Risk Officer.

Product Management Committee

The Committee comprises Executive Directors and representatives from Risk, Finance, Product and Service departments. The Committee approves and monitors (in line with the defined principles, strategy and operating plan) all Society products and propositions (new and existing) including mortgage, retail and business savings, third party products and services. The Committee meets at least ten times a year.

Appointments to the Board

The Nominations Committee leads the process for Board appointments and makes recommendations to the Board. The Board maintains a succession plan and produces specification for vacancies to be filled. The Board advertises externally or uses an external search consultancy for candidates for Board appointments. Members can nominate their own candidates for appointment subject to Society rules. The appointment of Directors is based on objective criteria, including the ability to meet the requirements of the regulatory Senior Manager Regime. Board succession planning ensures that the appropriate mix of skills, experience, independence and knowledge of the business is represented on the Board and Committees to enable them to discharge their respective duties and responsibilities effectively. The recruitment of new Non- Executive Directors is delegated to the Nominations Committee, which ensures that Directors are able to commit the time required to effectively fulfil the role, at the time of appointment and on an ongoing basis.

CORPORATE GOVERNANCE REPORT

Diversity

The Board gives consideration to all aspects of diversity when reviewing the composition of the Board and in identifying suitable candidates for the position of Director. We recognise the importance of having a diverse Board and workforce generally, not least because this reflects the make-up of the Membership and the community at large.

The Board is committed to developing an inclusive culture and undertakes appropriate training to support this policy.

Directors' interests

Directors are required to disclose any relevant external interests that may be considered to conflict with their role at the Society, including any other Directorships that they may hold at recruitment. There is also a formal process which requires Directors to re-affirm their external interests annually. Furthermore, at each Board meeting Directors are required to disclose any changes to their external interests. In all cases the Board considers if a Director's ability to act in the best interests of the Society might be compromised. No Director is counted in a quorum in respect of any own conflict situation. Were a business relationship to exist between the Society and a company associated with a Non-Executive Director, all dealings would be undertaken at arms-length. The Board considers that all Non-Executive Directors are independent in character and judgement. Information and professional development Board reporting is of a high standard with an annual review of the scope and appropriateness of the information. More detailed reporting is provided to Board Committees and this is also provided to all Board members for information.

Induction and Development

Non-Executive Directors attend internal and external training sessions, including Building Societies Association seminars and conferences, and receive copies of industry circulars and regulatory publications to further their knowledge. Training is tracked and records are held centrally. An induction programme is in place for all new Non-Executive Directors to ensure that they can provide effective challenge as soon as possible after appointment. Training and development needs are identified as part of the annual review process undertaken by the Chairman. Non-Executive Directors have access to the Society Secretary and access to independent professional advice at the Society's expense.

Performance evaluation

The Board operates an annual appraisal scheme in which all Directors appraise the performance of each of their colleagues, including the Chairman, with the consolidated results also being used to evaluate any overall weaknesses. The results of the exercise inform the decision to recommend a Director for re-election. Board effectiveness is under constant review. The Board calendar includes a formal annual review of Board and Committee effectiveness.

Re-election policy

The Directors are subject to election at the first Annual General Meeting (AGM) after their appointment. A Non-Executive Director will normally serve for two terms of three years, with a maximum of three terms if there has been a significant change in role. The Nominations Committee reviews the performance of Directors before recommending them to stand for re-election. This includes a review of an individual's performance, and also considers if it is appropriate, to ensure the Board remains fresh and vigorous. The Chairman, Geoffrey Dunn was re-elected by Members in 2017 and has served eight years on the Board. He became Chairman in 2014. The Vice Chairman, Nick Treble and the Senior Independent Director, Neil Holden were re-elected at the 2017 AGM. Each has served five years on the Board. Liz Kelly, Jenny Ashmore and Darren Garner were elected at the 2016 AGM; each has served four years on the Board. Liz, Jenny and Darren are seeking re-election at the 2019 AGM and details setting out why they are deemed to be suitable for election have been included with the Notice of Annual General Meeting issued to all voting Members. Colin Field, and Gary Barr were re-elected at the 2018 AGM.

Accountability and Audit

Financial and business reporting

The Directors' responsibilities for financial reporting are described in the Statement of Directors' Responsibilities on pages 36 to 37.

Risk management and internal control

The Board is responsible for determining the risk appetite it is willing to take in achieving its strategic objectives and it reviews the processes and procedures to ensure sound risk management and internal control systems are in place. Senior management are responsible for designing systems to identify and control risk and ensure the Board is sighted on risk management through a quarterly review programme which is open to challenge. Our internal auditor, PwC, provides independent assurance to the Risk, Audit, Compliance and Conduct Committee (RACCC) that appropriate procedures are in place and are being followed. The Board receives a detailed update from the RACCC Chairman at each Board meeting on the effectiveness of systems and controls, in particular highlighting changes to the principal risks or breaches of risk appetite. During 2018, an issue within the financial reconciliation process was identified and reported to RACCC. A full investigation was carried out by management. The investigation process and financial reconciliation function was then reviewed by Internal Audit. Following this detailed review, RACCC and the Board are satisfied that the control environment is now effective. Notwithstanding this issue that was identified and resolved, the Board has satisfied itself that a strong culture of compliance operates and that the systems are effective and appropriate given the nature of the business activity undertaken.

Further details on risk appetite, culture, risk management frameworks, together with information on principal risks and uncertainties can be found in the Strategic Report on pages 8 to 24.

Audit engagement

The appointment or re-appointment of external auditors is recommended by RACCC and confirmed by the Board who re-appointed Deloitte LLP for the period ended 31 December 2018. The Society last tendered for external audit services in 2003 resulting in the appointment of the current auditor, Deloitte LLP. Following a qualifying selection procedure, Deloitte LLP were reappointed as auditor of the Society for the period ending 31 December 2017 and subsequent financial periods. RACCC conducts an annual assessment of auditor effectiveness and considers whether an audit tender is in the best interests of the Society.

Auditor independence

RACCC assesses annually the qualification, expertise, resources, independence and objectivity of the external auditor and conducts a review of auditor effectiveness. There is periodic rotation of the audit partner responsible for the audit engagement and each year the external audit firm confirms to RACCC that it considers itself to be independent as defined by the rules of the Institute of Chartered Accountants in England and Wales.

After serving a term of five years, Peter Birch of Deloitte stood down at the conclusion of the 2017 audit. The new audit partner Atif Yusuf of Deloitte LLP has conducted the 2018 audit.

RACCC also maintains a formal policy governing the engagement of the external auditor for non-audit services. The policy is designed to ensure that the provision of such services does not impact on the external auditor's independence or objectivity. The policy is reviewed annually by RACCC and is in accordance with EU regulations on the provision of non-audit services. Under the policy appointment of the external auditor for non-audit services can only be made with the appropriate authority of RACCC. The external auditor may also only provide such services where these do not conflict with their statutory responsibilities and ethical guidance. RACCC reviews a schedule of fees paid to the external auditor for non-audit services. During the year non-audit services totalling £7k (excluding VAT) have been provided by Deloitte LLP in respect of assurance services.

Remuneration

The Directors' Remuneration Report on pages 32 to 35 details the Board position on the UK Corporate Governance Code principles related to remuneration issues.

Member engagement

As a mutual the Society does not have shareholders but is responsible to its Members. In 2018 informal Member group meetings were hosted by the Executive Directors to meet with and gauge the views of Members on issues that affect them.

Members are invited to complete surveys via 'Service Tick' which is a customer survey tool and this feedback is taken into consideration to improve service levels.

Non-Executive Directors spend time in the branches and the Contact Centre to help them understand the Member perspective.

Annual General Meeting (AGM)

At the AGM, the Chief Executive and Chief Finance Officer give presentations on the previous year's trading, financial performance and on future plans. The meeting provides an opportunity for Members to question the Chairman, Chief Executive and other directors on the resolutions to be proposed at the meeting and on any other aspect of the Society's business.

Details of the AGM are sent to all Members eligible to vote who are encouraged to attend or to vote on resolutions. Members can vote online, by post or by attendance. Prepaid envelopes are included to enable Members to appoint a proxy to vote on their behalf if they are unable to attend. The proxy form provides the opportunity to formally abstain from resolutions should the member so wish. Information on voting is published on the Society website after the AGM. At the AGM the Chairman calls for a poll on all resolutions so that all proxy votes are recorded. A separate resolution is proposed on each issue including adoption of the Report and Accounts.

Society Rules

A copy of the rules is available on the Society's website www.saffronbs.co.uk, or may be obtained by a Member on request to the Secretary. Saffron Building Society Saffron House 1a Market Street Saffron Walden Essex, CB10 1HX.

DIRECTORS' REMUNERATION REPORT

The Board has an established Remuneration and Loans Committee which comprises all the Non-Executive Directors. This report illustrates how the Society has regard to the principles set out in the UK Corporate Governance Code relating to Directors' remuneration.

Remuneration and Loans Committee

The Committee is chaired by Nick Treble (Non-Executive Director and Vice Chairman) and is responsible for:

- Recommending to the Board the Society's remuneration policy;
- Remuneration packages for the Executive Directors;
- Approving loans to directors or connected persons; and
- Ensuring compliance with the Regulator's Remuneration Code and having regard to the UK Corporate Governance Code.

In reaching remuneration decisions the Committee reviews and takes into account benchmark data from the Building Societies Association remuneration survey. The Committee may from time to time review Society wide remuneration principles (other than those directly affecting Executive Directors) providing appropriate oversight to the Executive Team. Executive Directors are not involved in deciding their own levels of remuneration.

General remuneration principles

The principal aim of our Remuneration policy is to ensure the remuneration of our people is fair, reflects individual performance and competence and is competitive within the local financial services market. Our principles aim to attract, motivate, reward and retain people with appropriate skills and behavioural competencies, as well as promote and encourage the right behaviours to align with the Society's conduct, culture and risk management practices, avoiding incentives which could encourage inappropriate risk taking and detriment to our Members.

Most elements of remuneration are reviewed annually and take into account market conditions, local employment competition and Society financial performance. We use external market data to determine appropriate pay levels and our intention is to remunerate at median level which is the wage 'in the middle'. Our last external market review was carried out in January 2018. We meet the statutory National Minimum Wage and the voluntary Real Living Wage requirements.

Remuneration packages are made up of basic salary, core benefits, pension contribution, bonus and other benefits. There are elements of both individual recognition and organisational performance in our bonus payments. Our scheme is discretionary, subject to a review at least annually and paid out only when affordable.

Market Position

External benchmarking in 2018 showed we are behind median levels in some roles. Our aim is to be at median level.

CEO Comparison

Ratio of CEO basic pay to average 5:1
Ratio of CEO basic pay to lowest paid 11:1

Society Average Pay Awards of 5.65% (1.91% 2017)
Society Average Bonus Awards of 7.13% (8.31% 2017)

National Minimum Wage

All staff are paid (at least) the National Living Wage. We pay (at least) the Real Living Wage of £8.75 p.h. This increased to £9.00 p.h. in November and we will be adopting this rate from 1st April 2019, slightly ahead of the 6 month time limit.

Equality of Pay

Having carried out a review we are satisfied there is no gender pay gap issue between the remuneration of men and women. There is no requirement for us to publish a gender pay report.

DIRECTORS' REMUNERATION REPORT

Executive Directors' remuneration

Executive Directors' remuneration must fairly reflect responsibilities, expertise, experience and performance whilst being competitive enough to attract, motivate, reward and retain high quality Executive Directors. The Society continues to operate in a competitive environment, from a sector as well as a geographic perspective. Performance at a high level is expected, with rewards directly linked to appropriate risk management, financial performance, quality customer service and individual excellence. Executive Directors are designated as "Code Staff" under the Regulator's Remuneration Code due to their material impact on the Society's risk profile.

The remuneration package for Executive Directors is made up of the following components:

Component	Level	Basis
Basic salary	Salary level decisions are recommended to the Remuneration and Loans Committee	Based on job content, responsibilities and remuneration levels for similar positions in financial services
Pension	Employer pension contribution is 13.5% of basic salary paid monthly into a group personal pension plan unless otherwise requested to be payable as a cash alternative. For newly appointed Executives / Executive Directors from 1 December 2018 the employer contribution is 8.5% of basic salary	None of the Executive Directors are members of the (closed) final salary scheme
Bonus	Reward in the form of a bonus payment is linked to appropriate risk management, financial performance, capital management, quality customer service, operational fitness and people engagement. Organisational measures are reviewed by the Remuneration and Loans Committee each year For the 2018 performance year, no bonus was awarded	Earned on an annual basis and is determined by a combination of organisational and individual performance. For the 2018 performance year, deferral applies to individual amounts in excess of £5,000
Other benefits	Cash allowance (in lieu of a lease vehicle) of 10% of basic salary paid monthly through payroll. Income protection, death in service, private medical insurance and enhanced annual leave	Considered typical for the Sector

There is also an enhanced redundancy scheme. The scheme, which is non-contractual, could provide a maximum of 40 weeks' salary and is based on length of service. The scheme may be changed or withdrawn at any time.

Remuneration decisions in 2018

Pay awards, if made, generally apply from 1 April each year. In respect of the period commencing 1 April 2018, the annual pay review process itself saw basic salaries for the Chief Financial Officer and Chief Customer Officer held at current level as recommended by the Chief Executive Officer and agreed by the Board. The Chief Executive Officer received a 2.94% increase, the first change to basic salary since 2015, recommended by the Chairman and agreed by the Board. Bonus payments awarded to the Executive Directors and paid in 2018 related to performance for the financial year ended 31 December 2017. These totalled £43,625 (averaging 8.9% of basic pay) and were awarded based on overall contribution to Society performance and individual merit. Of this, £21,398 is deferred for payment until 2019. Deferred bonuses due from previous years totalling £20,333, were also paid.

There were no other changes to the other benefits or pension contributions for Executive Directors in 2018. From 1 December 2018 in accordance with the remuneration guidance set out in the UK Corporate Governance Code, the employer pension contribution for new Executive Directors (and other Executives) was reduced to 8.5% per annum in line with other staff.

Non-Executive Directors' fees

The Chief Executive Officer and Chairman review the level of fees paid to Non-Executive Directors each year. They take into account data on fees paid in similar positions in the mutual financial services sector as well as time commitments and levels of responsibility. Recommendations are made by the Chief Executive Officer to the full board for approval. In 2018 the fees increased for the first time since 2014. There are no bonus schemes or other benefits for Non-Executive Directors and they are not entitled to any pension from the Group.

Executive Directors' personal development

In order to facilitate the personal development of an Executive Director, it is Board policy that an Executive Director may undertake a Non-Executive role with a non-competing organisation. In principle approval is required from the Chief Executive (and in the case of the Chief Executive, in principle approval from the Chairman). Approval is required from the Nominations Committee following submission of a full proposal.

Any fees derived from the Non-Executive role are paid directly to the Society Community Fund. Executive Directors' will not benefit financially in any way from this arrangement.

Service contracts

All Executive Directors are employed on a permanent service contract. Details are included in the Annual Business Statement on page 94.

Non-Executive Directors are appointed by letter for a three year period and are generally expected to serve a second three year term. Appointment can be extended for a further three years if taking on a significant new role, for example Chairman or Vice Chairman.

Analysis of Directors' remuneration for 2018

The total remuneration of each Director is analysed and presented in Note 8 to the Accounts.

Approval

This report was approved by the Remuneration and Loans Committee and signed on its behalf by:

N J Treble
Chair of the Remuneration
and Loans Committee

DIRECTORS' REPORT

The Directors submit their Report prepared in the context of the UK Corporate Governance Code and in accordance with the requirements of the Building Societies Act. The Directors' Report should be read in conjunction with the Chairman's Statement, Chief Executive's Report and Strategic Report on pages 4 to 24.

Information presented in other sections

Certain information required to be included in a Directors' report can be found in the other sections of the Annual Report and Accounts as described below. All of the information to be presented in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

Business objectives and activities	Strategic Report (page 9)
Business review and future developments	Strategic Report (page 12)
Principal risks and uncertainties	Strategic Report (pages 21 to 23)
Financial risk management objectives and policies and risk exposures	Strategic Report (page 19)
Disclosure requirements under CRDIV country by country reporting	Note 32 to the Accounts

Results

Group reported profit before tax for the year ended 31 December 2018 was £1.6million (2017 restated: £4.3million).

The Group profit after tax transferred to general reserves was £1.3million (2017 restated: £4.2million).

Capital

Group gross capital at 31 December 2018 was £63.0million (2017 restated: £61.8million) being 6.7% of total shares and borrowings (2017 restated: 6.7%). Free capital at the same date was £47.8million (2017 restated: £44.7million) and 5.0% of total shares and borrowings (2017 restated: 4.8%). An explanation of these ratios can be found in the Annual Business Statement on page 94.

Mortgage arrears

At Group level at 31 December 2018 there were no properties (2017 restated none) where payments were 12 months or more in arrears. At 31 December 2018, the Group held 11 properties (2017 restated 12) in possession.

Supplier payment policy

The Group will discharge suppliers' invoices within agreed terms when they fully conform to the terms and conditions of the purchase.

As well as our branch network the Society operates a website www.saffronbs.co.uk. The maintenance and integrity of this site is the responsibility of the Directors. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Charitable and political donations

During the year the Society made donations totalling £20,384 (2017 restated £13,175) in support of charities and organisations. No contributions were made for political purposes (2017: nil).

Directors' responsibilities in respect of the Annual Report, Annual Business Statement, Directors' report and annual accounts

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:

- state of the affairs of the Society and the Group at the end of the financial year;
- income and expenditure of the Society and the Group for the financial year;
- details of Directors' emoluments in accordance with Part VIII of the Act and regulations made under it.

In preparing these 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 applicable UK accounting standards have been followed, subject to any material departures discussed and explained in the accounts;
- 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 its subsidiaries.

Directors' responsibilities for accounting records and internal controls

The Directors are responsible for:

- ensuring the Society and subsidiary undertakings keep accounting records in accordance with the Act;
- taking 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 Financial Conduct Authority under the Financial Services and Markets Act 2000;
- safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Going concern

In preparing the Group's Annual Report and Accounts the directors must carry out an appropriate assessment of going concern to satisfy themselves that it is reasonable to adopt the going concern basis, taking into account all available information about the future and factors likely to affect its future development, performance, position, liquidity and capital structure. The activities of the Group, its current operations and those factors like to affect its future results and development, together with a description of its financial position and funding position are described in the Chairman's Statement, Chief Executive's Report and Strategic Report. The Strategic Report also describes the principal risks and uncertainties affecting the Group and the steps taken to mitigate these risks.

Additional risk information can also be found in note 29 to the financial statements, "Financial Instruments". The Group meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources and is required to maintain a sufficient buffer over minimum regulatory capital requirements in order to continue to be authorised to carry on its business.

The impact of the revision to the valuation methodology for the equity release mortgage book and the restatement of the effective interest rate asset, coupled with the implementation of the additional capital conservation buffer in January 2019, has reduced the level of excess capital that the Society holds above the regulatory minimum. These factors together with the economic uncertainty facing the UK has meant that the Society has undertaken a cost review exercise which is designed to improve profit and therefore capital in order to carry sufficient capital in the future to manage any uncertainty.

Management are also looking to position their future product offerings to continue to attract and control the volume and net interest margins in line with the Group's internal risk appetite.

DIRECTORS' REPORT

Based on the above, together with available market information and the Director's knowledge and experience of the Group and markets in which it operates, after making the necessary enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue in business for at least twelve months from the date of signing the accounts. Accordingly, the going concern basis continues to be adopted in preparing the Annual Report and Accounts.

Viability statement

In addition to the annual financial planning process to consider going concern, the Society undertakes an annual Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP).

For the purposes of the viability statement, the Directors have determined the period to December 2021 or 2022 to be the most appropriate period to consider as this is based on the Society's approved corporate plan and stress testing scenarios set out in the Society's ICAAP document and, as such, represents the longest period over which the Board considers that it can form a reasonable view over the possible economic environment and drivers of Group performance.

Scenarios are also prepared under stressed but plausible operating conditions in order to consider the effect on the Group's business, financial position, capital and liquidity.

The ICAAP stress tests ensure the Group's future capital position and capital generation is sufficient to withstand stresses should operating conditions deteriorate. The stress tests incorporate annual assumptions published by the Bank of England that reflect a significant economic downturn. The capital is set aside and held in the form of buffers. The ILAAP stress tests ensure the Group holds adequate levels of liquid assets, of the required quality, to meet liquidity needs over a predetermined period to allow sufficient time for mitigating actions to recover the Group back to business as usual levels of liquidity. These stress tests incorporate the financing of the Society's FLS and TLS funding.

The Group also has a formal process of budgeting, reporting and review, which is used to ensure the adequacy of resources available to the Group to meet its business objectives. This process covers (amongst other things) the economic backdrop to the Group's activities, prospects for the mortgage market, the future path of interest rates, the Group's profitability and available liquid and capital resources.

Based on the assessment described above, the Directors have a reasonable expectation that the Group will continue in operation and meet its liabilities as they fall due over the period to December 2022 subject to unforeseen external stresses, most notably, but not limited to, the macro-economic environment, competitive environment and regulatory developments.

Our people

Once a year the Board reviews employment policies and ensures that they are designed to provide fair and effective employment conditions and equal opportunities. The Whistleblowing policy is accessible to all staff and is regularly monitored. The Society retains its commitment to the development of its staff and the alignment of individual goals to the Society's aims. We would like to thank all our staff for the hard work and support they have given the Society over the last twelve months.

Business associates

We would like to thank our solicitors, auditor and professional advisors for their continued support during the year.

Directors

The following served as Directors of the Society during the year and up to the date of signing the accounts except where indicated:

Executive Directors

C H Field (Chief Executive Officer)
D L Garner (Chief Financial Officer)
S A Howe (Chief Customer Officer) *

* Resigned as a Director 19 November 2018

Non-Executive Directors

G R Dunn (Chairman)
N J Treble (Vice Chairman)
J Ashmore
T G Barr
N J Holden (Senior Independent Director)
E Kelly

Being eligible, D L Garner, J Ashmore and E Kelly will stand for re-election.

Biographies of the Directors appear at pages 40 to 43. None of the Directors hold any shares in, or debentures of, any associated body of the Society.

Auditor

A resolution to re-appoint Deloitte LLP as auditor to the Group will be proposed at the Annual General Meeting.

Events since the year end

The Directors consider there has been no event since the end of the financial year which would have a material effect on the financial position of the Group as disclosed in the Annual Accounts.

Geoffrey Dunn
Chairman
On behalf of the Board 13 March 2019

DIRECTORS' BIOGRAPHIES

The Board of the Saffron Building Society is made up of Executive and Non-Executive Directors. The role of the Executive Directors is to deal with the day-to-day running of the Society, while Non-Executive Directors, who are from a range of different specialist areas, bring an outside perspective to the management of the Society and also represent the views of the Membership.

GEOFFREY DUNN, Chairman

Geoff lives in Suffolk and has more than 40 years' experience of financial management, in financial services and IT services. After Manchester Business School, he joined 3i pic and later worked in Corporate Finance at the merchant bank, S G Warburg. Subsequently, he was Deputy Treasurer of GKN plc, before he joined Midland Bank and became Head of Finance & Planning (ie Finance Director) of Midland Bank International. Later, he became Group Finance Director of the global financial broker, Exco International plc. A move to Brussels followed as Chief Financial Officer (CFO) of SWIFT sc – the global inter-bank messaging co-operative and network provider and then as CFO of the global telecoms operator, Global One. He returned to the UK as Group FD of Xansa, the FTSE listed IT company.

In the decade before joining Saffron, Geoff undertook a number of major interim and financial restructuring roles including: Finance Director of the Bank of England and also CFO of Northern Rock plc, for the reconstruction and split of Northern Rock in 2009. Subsequently, he was also appointed as a Non-Executive Director of Citadele Banka, the Latvian bank that had suffered a similar fate to Northern Rock, to help support their recovery programme. He was also a Fellow of the Association of Corporate Treasurers. Geoff joined the Board in May 2011 and was appointed Chairman of the Society in May 2014.

JENNY ASHMORE*, Non-Executive Director

Jenny is a marketing and commercial leader with over 25 years' experience spanning consumer goods, media and oil/utilities. Jenny studied Chemistry and later an MBA, leading to an early career in sales and marketing with British Gas and Shell Oil. She has served as a senior Commercial Leader and Chief Marketing Officer (CMO) in Procter & Gamble, Mars, Yell Group and SSE. She now consults across business and charitable sectors with a focus on marketing strategy, innovative propositions and the implications of digital marketing on sales, products and customer service. She also holds a breadth of Non-Executive roles including: Trustee for The Challenge Network, Non-Executive Director of Commonwealth Games England and AHI Group Ltd.

Jenny joined the Board in 2015 and sits on the Remuneration and Loans Committee, Board Credit Committee (BCC) and Risk, Audit, Compliance and Conduct Committee (RACCC).

*Married name Zaremba

GARY BARR, Non-Executive Director

Gary is an IT leader with over 25 years' experience in industry including retail, manufacturing, health and services. As IT Director at the National Blood Service (NBS) he led the successful implementation of the award winning Pulse programme which created a single system for managing the blood supply in England, from donor to hospital. After leaving the NBS he joined Welcome Break, the Motorway Services provider, completely refreshing and replacing the business systems. He then went on to lead the IT team at Sodexo UK & Ireland running a variety of systems over 2,000 sites. He started to work for WM Morrisons in 2006, as IT Director where he was key to the launching and leading of the Evolve programme, one of Europe's largest retail IT transformations. After leaving WM Morrisons he joined Dixons Group the electrical retailer as Group IT Director. In 2014 he decided that after 25 years in operational IT management it was time for a change and is pursuing a consulting and a non-executive career. He was a Governor at Bedfordshire University and the Lantern School Ely, and is a Director of Cambridge Rugby Union Football Club.

Gary joined the board in 2014 and sits on the Remuneration and Loans Committee, BCC and RACCC.

COLIN FIELD, Chief Executive Officer

Colin joined the Society in 2013. He was promoted to the role of Chief Executive Officer in September 2015 having previously been the Society Chief Financial Officer. He was appointed to the Board in May 2014, having joined Saffron as Group Financial Controller. Prior to joining Saffron, Colin has held a number of senior finance positions with Barclays, Caudwell Group and Willis Group having previously qualified with PwC. Colin is a Chartered Accountant (FCA) and lives in North Essex.

DIRECTORS BIOGRAPHIES

DARREN GARNER, Chief Financial Officer

Darren joined the Society as Chief Financial Officer in September 2015. Darren qualified as an accountant over 20 years ago and is a Fellow member of the Association of Chartered Certified Accountants. In his role as CFO, Darren chairs the Assets and Liabilities Committee (ALCO).

Darren has spent most of his career within the financial services industry, including senior finance roles with Abbey National Group, ING Direct and, more recently, as Group Finance Director for a Midlands-based building society. Immediately prior to joining the Society he was Group Finance Director and Executive Board member at the Chartered Insurance Institute, a company incorporated by Royal Charter. In July 2017 Darren was appointed a Trustee of Dementia Carers Count, a UK charity supporting carers of people with dementia.

NEIL HOLDEN, Non-Executive Director

Neil is a Chartered Accountant with 30 years' experience in financial services. After qualifying with Thomson McLintock & Co (now KPMG) he held a number of executive roles in financial services mainly in financial control and risk management with JP Morgan, Hambros Bank, Westdeutsche Landesbank and Standard Bank Group. After leaving Standard Bank in 2006 Neil set up his own risk and governance advisory business consisting of non-executive directorships and advisory work for other clients. Neil is a non-executive director of IntegraFin Holdings plc, Stanbic International Insurance Limited, Sberbank CIB (UK) Limited, and AlbaCo Limited and chairs various Board Committees in these companies. Neil chairs the Risk, Audit, Compliance and Conduct Committee and the Nominations Committee. He is a member of the Remuneration and Loans Committee.

Neil joined the Board in March 2014 and was appointed Senior Independent Director in March 2016.

LIZ KELLY, Non-Executive Director

Liz is an experienced strategic leader specialising in running legal, compliance and secretariat functions in financial services. After qualifying as a solicitor at Clifford Chance, she practised commercial law for six years following which she held a number of executive roles in industry leading legal and secretariat functions. She has extensive experience in financial services having worked at Nationwide Building Society for 13 years. For seven years she was the Group General Counsel at Nationwide where she was responsible for advising the Board and Executive Committee on all legal, compliance and secretariat issues (including the merger with Portman Building Society and the acquisition of parts of the Dunfermline Building Society). During this period she led a team of 150 professionals, developing and delivering a five year strategy which included implementing a transformation programme and initiating some innovative people development and efficiency programmes.

Liz joined the Board in May 2015 and is a member of Remuneration and Loans Committee. Liz chairs the Compliance and Conduct sub-committee of RACCC.

NICK TREBLE, Non-Executive Director

Nick has over 35 years' experience in financial services, working primarily in the areas of treasury, capital markets, risk management, retail and commercial banking. Most recently he was CEO of AIB Group (UK) plc (2009 to 2012), a retail and commercial bank operating in Great Britain as Allied Irish Bank GB and in Northern Ireland as First Trust Bank. Previously he was AIB plc Group Chief Risk Officer (2008) and Group Treasurer (2001 to 2008). From 1982 to 2001 he held a number of technical and managerial roles in treasury, asset and liability management, funding and trading for AIB plc. Nick retired from AIB in December 2012.

Nick is a Non-Executive Director of Bank Leumi (UK) plc, of Eskmuir Property Group and a Trustee for a major family settlement.

Nick joined the Board in March 2014 and was appointed Vice Chairman in May 2016. He chairs the Board Credit Committee and the Remuneration and Loans Committee; he is a member of RACCC and the Nominations Committee. He is a Member of the Association of Corporate Treasurers.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SAFFRON BUILDING SOCIETY

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of Saffron Building Society (the 'society') and its subsidiaries (the 'group'):

- **give a true and fair view of the state of the group's and the society's affairs as at 31 December 2018 and of the group's and the society's income and expenditure for the year then ended;**
- **have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland";**
- **have been prepared in accordance with the requirements of the Building Societies Act 1986.**

We have audited the financial statements of Saffron Building Society and its subsidiaries (the 'Group') which comprise:

- the Group and Society Income Statement;
- the Group and Society Statement of Comprehensive Income;
- the Group and Society Statement of Financial Position;
- the Group and Society Statements of Changes in Members' Interests;
- the Group Cash Flow Statement; and
- the related notes 1 to 31.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society.

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

Summary of our audit approach

	The key audit matters that we identified in the current year were as follows. Continuing from the prior year: • Revenue recognition • Loan loss provisioning (excluding lifetime mortgages) • Valuation of lifetime mortgages New: • Going concern
Materiality	The materiality that we used in the current year for the Group is £287,000, which was determined on the basis of 0.5% of Group net assets at 31 December 2018. The materiality that we used for the Society financial statements in the current year was £258,000 which was determined as 0.5% of Society net assets.
	Our Group audit scope involved performing full scope audits on the Society and its wholly owned subsidiary Crocus Home Loans Limited ('Crocus'). The Society and Crocus audits were performed directly by the Group audit team.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's or the Society's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

In the current period we identified one new key audit matter in relation to the going concern assumption.

The following areas considered key audit matters in the prior year have not been treated as such in the current period based on our risk assessment:

- Valuation of lifetime swap
- Hedge accounting

In making this assessment we took into account that there were no material issues identified in these areas in prior years and there were no changes in the Group's processes and applicable accounting requirements in the current year.

Revenue recognition

Key audit matter description	The Group's mortgage interest income is recognised on an effective interest rate basis in accordance with the requirements of IAS 39. This method involves the application of significant judgement to determine the quantum and timing of cash flows and the existence of errors or bias in the application of these assumptions could result in a material misstatement of revenue. Revenue recognition is therefore a fraud risk area. The loans and advances to customers held at amortised cost of £807.6m (2017: £775.8m) presented in Note 12 to the financial statements contain prepaid arrangement and procurement fees as well as accrued interest income which is spread over the behavioural life of the loans using the effective interest rate method. The key assumption in the effective interest rate models is the redemption rates used in the derivation of the cash flow run-off curves which determine the behavioural lives of the mortgages and timing of the expected future cash flows. During the audit it was identified that the model mechanics were not in line with the accounting policy adopted by the Group and the requirements of IAS 39, resulting in a misstatement in the current and prior years. The misstatement has been corrected by management in the current period and a prior period adjustment has been recognised, which resulted in a £4.2m reduction in loan receivables as at 31 December 2017. Refer to Note 1 for further details. The Risk, Audit, Conduct and Compliance Committee ('RACCC') report on page 28 refers to the risk around revenue recognition. Management's associated accounting policies are detailed on pages 57 to 58 with detail about judgements in applying accounting policies and critical accounting estimates on page 60.
How the scope of our audit responded to the key audit matter	We understood management's process for recognising revenue using the effective interest rate method and by undertaking a walk-through to identify the key controls and data flows. We assessed the design and implementation of key controls focused on management's review of the effective interest rate models and the governance review of key judgements. We adopted a fully substantive audit approach as a result of weaknesses identified in internal controls. We evaluated the nature of the misstatement in the model and whether correction through a prior year adjustment was appropriate. We independently rebuilt the revised model and compared the outcome of our calculation to the entity's records. This covered both the current balance and the prior period balances. We have also recalculated the prior year adjustment. We challenged the run-off curves used by management by independently estimating repayment profiles based on the Group's historical data and other observable market data. We assessed whether the revenue recognition policies adopted by the Group were in compliance with IAS 39. This included an assessment of the types of fees being spread within the effective interest rate models. We tested the completeness and accuracy of key model inputs by agreeing them back to underlying source data.
Key observations	We concluded that the EIR asset and interest revenue recognised are appropriate following the correction of the aforementioned misstatement in the current and prior years.

Loan loss provisioning (excluding lifetime mortgages)

Key audit matter description	The Group accounts for the impairment of loans and advances to customers (excluding lifetime mortgages) using an incurred loss model. In accordance with the recognition and measurement criteria of IAS 39, management has calculated two types of provisions. A specific provision is calculated for loans where there is an observable loss event. An Incurred But Not Reported ("IBNR") provision is recognised for loans which are impaired at the Statement of Financial Position date, and whilst not specifically identified, are known from experience to be present in any portfolio of loans. Estimating an appropriate loan loss provision requires significant judgement in determining the value and timing of future cash flows. In particular, the assumptions related to the cash flows expected to be received from the sale of property for impaired exposures have the most significant impact on the valuation of provision. We identified this as an increased area of fraud risk given the potential for management bias in the assumptions made in estimating future cash flows. As disclosed in Note 13, the Group holds £3.9m of impairment provisions at year end (2017: £3.9m). This comprises a specific provision of £3.5m (2017: £3.6m) and an IBNR provision of £0.4m (2017: £0.4m). The RACCC report on page 28 refers to the risk around loan loss provisioning. Management's associated accounting policies are detailed on page 58 with detail about judgements in applying accounting policies and critical accounting estimates on page 60.
How the scope of our audit responded to the key audit matter	We understood management's loan loss provisioning process by undertaking a walk-through to identify the key controls, data flows and procedures for identifying customers in financial distress. We assessed the design and implementation of key controls focused on management's review of the impairment models and the governance review of key judgements. We adopted a fully substantive audit approach as a result of weaknesses identified in internal controls. For a sample of exposures we tested the valuation of estimated cash flows from sale of collateral for impaired exposures. This was done by performing an independent assessment of the current property valuation using available market data and evaluating the appropriateness of other assumptions (such as time to sell and forced sale discount) based on the nature of the property and on the Group's historical experience. We tested the appropriateness of other key assumptions such as impairment triggers, indexed property valuations and probability of defaults through a combination of benchmarking against a relevant peer group, independent recalculations and agreeing inputs to external data sources. We tested the completeness and accuracy of key model inputs by agreeing them back to underlying source data. We reconciled the loan balances in the models to test whether the relevant loan populations were being considered for impairment.
Key observations	We concluded that provisions for loan losses (excluding lifetime mortgages) are appropriate.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SAFFRON BUILDING SOCIETY

Valuation of lifetime mortgages

Key audit matter description	The Group holds a portfolio of lifetime mortgages at a fair value of £58.8m (2017: £65.9m). Management has elected to account for the lifetime mortgage portfolio at fair value through profit or loss in order to prevent an accounting measurement mismatch which would exist if the mortgage portfolio were accounted for at amortised cost and the associated swap was accounted for at fair value, creating potential income statement volatility. The valuation of the lifetime mortgage portfolio is a complex exercise which requires a discounted cash flow technique using actuarial tables to predict voluntary and involuntary prepayment behaviour of borrowers. The resultant cash flows are discounted using a discount rate. The determination of the discount rate requires a significant level of judgement, and the overall portfolio valuation is highly sensitive to the discount rate assumption. In addition to the fair valuation of the lifetime mortgage portfolio, our work also focused on the valuation of the No Negative Equity Guarantee ("NNEG") provision which this requires a significant degree of management judgement in selection of the valuation model and key assumptions, including discount rate, mortality rates, voluntary prepayment rates and future long-term house price index ("HPI") expectations. We identified this as a potential area for fraud given there could be potential management bias in the assumptions. A new stochastic model has been implemented for valuation of the NNEG provision during the period, as opposed to a deterministic model that was used in prior years. Refer to Note 29 for further details. The RACCC report on page 28 refers to the risk around the valuation of lifetime mortgages. Management's associated accounting policies are detailed on page 58 with detail about judgements in applying accounting policies and critical accounting estimates on page 60.
How the scope of our audit responded to the key audit matter	We understood management's process for the valuation of the lifetime mortgage portfolio by undertaking a walk-through to identify the key controls and data flows. We assessed the design and implementation of key controls focused on management's review of the lifetime mortgage model and the governance review of key judgements. We adopted a fully substantive audit approach as a result of weaknesses identified in internal controls. We considered whether the new NNEG valuation model was appropriate and evaluated whether the impact of the change in model has been appropriately recognised in income statement for the current period. We engaged our internal valuation experts who designed and ran an independent NNEG and receivables valuation model and compared the outcome to the results that were produced by the entity using the new model. We challenged the discount rate used by management by estimating an acceptable range of the discount rate based using a range of methodologies based on observable market data. We benchmarked mortality rates against recent actuarial tables and compared HPI assumptions to our independent estimate derived from observable market data. We tested the completeness and accuracy of key model data inputs by agreeing them back to underlying source data.
Key observations	We concluded that the valuation of the lifetime mortgage portfolio is appropriate following the adjustment of certain assumptions used in the valuation to bring them within a supportable range.

Going concern

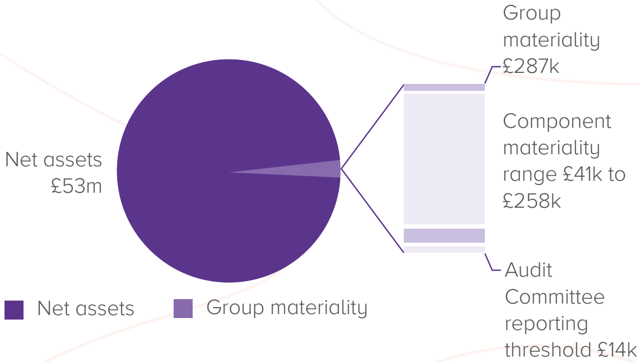
Key audit matter description	When preparing financial statements, the management of an entity is required to make an assessment of the entity's ability to continue as a going concern. An entity is a going concern unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the date when the financial statements are authorised for issue. Management has adopted the going concern basis of accounting in the preparation of the financial statements and concluded that there is no material uncertainty in the adoption of the going concern basis of accounting. The Group's capital position on 1 January 2019 is close to the Group's total capital requirements set by the regulator including additional buffers. This leads to an increased risk of the Group's capital falling below regulatory capital requirements, which, under certain circumstances, could result in further supervisory measures. The Director's report on page 37 and the note 1 to the financial statements refer to the assessment of the going concern assumption for the Group and Society and point out the corresponding risks.
How the scope of our audit responded to the key audit matter	In concluding whether there is a material uncertainty, our audit procedures included assessing the reasonableness of the assumptions within management's forecasts for capital, liquidity and profitability, based on past business performance. We engaged our regulatory capital specialists as part of our audit in order to assess the Group's approach to determining its regulatory capital. We challenged management's evaluation of the principal risks and uncertainties which could adversely impact the Group's capital base, for example a decline in the residential property market which may be caused by a disorderly Brexit. We assessed the reasonableness and viability of the options available to the directors to improve the Group's capital position as set out in Group's capital improvement plan prepared by management, referred to on page 9. Finally, we held discussions with the Prudential Regulation Authority ("PRA") supervision team at a number of points in the audit cycle to share updates on various matters and to understand the regulator's approach to supervision of the Group. This involved discussion of both the current capital position of the Group and the capital improvement plan, including an understanding of the regulator's perspectives thereon.
Key observations	We concur with management's adoption of the going concern basis of accounting and we have nothing material to report, add or draw attention to in respect of this matter.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as follows:

	Group financial statements	Society financial statements
Materiality	£287,000	£258,000
Basis for determining materiality	0.5% of Group net assets at 31 December 2018.	0.5% of Society net assets at 31 December 2018.
Rationale for the benchmark applied	The majority of the Group's operations are carried out by the Society so the same basis for determining materiality has been used for both. The overall capital base is a key focus area for the Society's members and the Prudential Regulatory Authority, given that the Society's strategy is centred around maintaining a stable capital base. Net assets has also historically been a consistent base.	



We agreed with the RACCC that we would report to the Committee all audit differences in excess of £14,300, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the RACCC on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level.

The Group is made up of the Society and its wholly owned subsidiaries. The only subsidiary within our audit scope is Crocus Home Loans Limited, with the remaining subsidiaries all being dormant companies. The Society and Crocus Home Loans Limited account for 100% of the Group's net assets, 100% of the Group's revenue and 100% of the Group's profit before tax.

Full audits were performed for the Society and Crocus Home Loans Limited and these were performed directly by the Group audit team and executed at levels of materiality applicable to each individual entity which were lower than Group materiality and was £41,000 and £258,000 for Crocus Home Loans Limited and the Society, respectively.

We also performed testing over the consolidation which is prepared at the Society level only.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SAFFRON BUILDING SOCIETY

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

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

Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- enquiring of management, internal audit and the RACCC, including obtaining and reviewing supporting documentation, concerning the Group's policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations, including the operation of the RACCC;
- discussing among the engagement team and involving relevant internal specialists, regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the following areas: revenue recognition, loan loss provisioning, valuation of lifetime mortgages; and
- obtaining an understanding of the legal and regulatory framework that the Group operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the Group. The key laws and regulations we considered in this context included the UK Building Societies Act, Prudential Regulation Authority ("PRA") and Financial Conduct Authority ("FCA") regulations, pensions legislation and tax legislation.

Audit response to risks identified

As a result of performing the above, we identified revenue recognition, loan loss provisioning and valuation of Lifetime Mortgages as key audit matters. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of management, the audit committee and in-house legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with the PRA and the FCA; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Building Societies Act 1986

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

- The annual business statement and the directors' report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- The information given in the directors' report for the financial year for which the financial statements are prepared is consistent with 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.

In the light of the knowledge and understanding of the Group and the Society and their environment obtained in the course of the audit, we have not identified any material misstatements in the directors' report.

Opinion on other matter prescribed by the Capital Requirements (Country-by-Country Reporting) Regulations 2013

In our opinion the information given on page 92 for the financial year ended 31 December 2018 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

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

- Adequate accounting records have not been kept by the Society; or
- The Society's 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 nothing to report in respect of these matters.

Other matters

Auditor tenure

Following the recommendation of the RACCC, we were appointed by the Board of Directors on 1 June 2004 to audit the financial statements for the year ending 31 December 2004 and subsequent financial periods. Following a qualifying selection procedure, we were reappointed as auditor of the Company for the period ending 31 December 2017 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 15 years, covering the years ending 31 December 2004 to 31 December 2018.

Consistency of the audit report with the additional report to the RACCC

Our audit opinion is consistent with the additional report to the RACCC we are required to provide in accordance with ISAs (UK).

Use of our report

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

Atif Yusuf FCA
(Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
13 March 2019

THE ACCOUNTS

Income Statement
for the year ended 31 December 2018

		2018 (£000)		Restated 2017 (£000)	
	Notes	Group	Society	Group	Society
Interest receivable and similar income	3	30,763	30,083	31,076	30,562
Interest payable and similar charges	4	(9,018)	(9,018)	(9,023)	(9,023)
Net interest income		**21,745**	**21,065**	**22,053**	**21,539**
Fees and commissions receivable	-	717	725	653	659
Fees and commissions payable	-	(595)	(571)	(842)	(818)
Other operating income	16,28	239	239	285	285
Net fair value movements	5	(3,599)	(1,317)	(639)	(229)
Total net income		**18,507**	**20,141**	**21,510**	**21,436**
Administrative expenses	6	(14,062)	(14,061)	(13,932)	(13,933)
Depreciation and amortisation	15,17	(2,621)	(2,621)	(2,757)	(2,757)
Other operating charges	28	(112)	(112)	(63)	(63)
Operating profit before impairment losses and provisions		**1,712**	**3,347**	**4,758**	**4,683**
Income from investments	-	-	100	-	800
Impairment losses on loans and advances	13	(139)	(114)	(356)	(311)
Provisions for liabilities	27	45	45	(76)	(76)
Operating profit		**1,618**	**3,378**	**4,326**	**5,096**
Loss on disposal of property, plant and equipment	-	-	-	-	-
Profit before tax		**1,618**	**3,378**	**4,326**	**5,096**
Tax	9	(353)	(563)	(82)	(175)
Profit for the financial year		**1,265**	**2,815**	**4,244**	**4,921**

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

Statement of comprehensive income
for the year ended 31 December 2018

		2018 (£000)		Restated 2017 (£000)	
	Notes	Group	Society	Group	Society
Profit for the financial year	-	1,265	2,815	4,244	4,921
Available for sale reserve					
-Valuation (losses)/gains taken to reserves	24	(124)	(124)	(100)	(100)
-Amount transferred to income statement	3	15	15	(185)	(185)
Net actuarial gain/(loss) recognised in the defined benefit pension scheme	28	(19)	(19)	901	901
Tax relating to components of other comprehensive income	9	(49)	(49)	(167)	(167)
Total comprehensive income for the period		**1,088**	**2,638**	**4,693**	**5,370**

Group
Statement of financial position
for the year ended 31 December 2018

	Notes	2018 (£000) Group	Restated December 2017 (£000) Group	Restated 1 January 2017 (£000) Group
Assets				
Liquid assets				
-Cash in hand and balances with the Bank of England	-	49,819	59,197	90,636
-Loans and advances to credit institutions	10	26,309	28,722	30,803
-Debt securities	10	76,362	66,593	106,731
Derivative financial instruments	11	3,092	2,817	3,036
Loans and advances to customers	12	862,243	838,335	855,634
		1,017,825	995,664	1,086,840
Investments in subsidiary undertakings	14	-	-	-
Investment properties	16	2,840	2,785	2,680
Property, plant and equipment	15	4,586	4,743	5,254
Intangible assets	17	8,230	10,020	10,668
Other assets	18	1,429	1,295	2,065
Current tax asset		350	1,014	-
Deferred tax asset	23	874	1,453	1,926
Pension asset	28	76	207	-
Total assets		**1,036,210**	**1,017,181**	**1,109,433**
Liabilities				
Shares	19	784,034	802,289	903,475
Amounts owed to credit institutions	20	93,341	35,706	21,395
Amounts owed to other customers	-	69,278	85,833	91,486
Derivative financial instruments	11	23,385	27,312	31,596
Other liabilities	21	1,744	2,544	2,388
Provision for liabilities	27	167	248	357
Deferred tax liability	23	724	802	365
Pension liability	28	-	-	615
Subordinated liabilities	22	10,270	10,268	10,270
Total liabilities		**982,943**	**965,002**	**1,061,947**
Reserves				
General reserves	-	53,010	51,764	46,765
Available for sale reserve	24	(123)	35	341
Revaluation reserve	25	380	380	380
Total reserves and liabilities		**1,036,210**	**1,017,181**	**1,109,433**

Further information is provided in Note 1c to the Accounts
These accounts were approved by the Board of Directors on 13 March 2019 and were signed on its behalf by:

G R Dunn
(Chairman)

C H Field
(Chief Executive Officer)

N J Holden
(Director)

THE ACCOUNTS

Society
Statement of financial position
for the year ended 31 December 2018

	Notes	2018 (£000) Society	Restated December 2017 (£000) Society	Restated 1 January 2017 (£000) Society
Assets				
Liquid assets				
-Cash in hand and balances with the Bank of England	-	49,819	59,197	90,636
-Loans and advances to credit institutions	10	25,939	28,146	30,589
-Debt securities	10	76,362	66,593	106,731
Derivative financial instruments	11	3,092	2,817	3,036
Loans and advances to customers	12	820,021	791,491	801,747
		975,233	948,244	1,032,739
Investments in subsidiary undertakings	14	42,471	45,657	51,563
Investment properties	16	2,840	2,785	2,680
Property, plant and equipment	15	4,586	4,743	5,254
Intangible assets	17	8,230	10,020	10,668
Other assets	18	1,429	1,294	2,056
Current tax asset		330	902	-
Deferred tax asset	23	637	1,444	1,926
Pension asset	28	76	207	-
Total assets		**1,035,832**	**1,015,296**	**1,106,886**
Liabilities				
Shares	19	784,034	802,289	903,475
Amounts owed to credit institutions	20	93,341	35,706	21,395
Amounts owed to other customers	-	69,278	85,833	91,486
Derivative financial instruments	11	23,385	27,312	31,596
Other liabilities	21	1,701	2,544	357
Provision for liabilities	27	167	248	2,403
Deferred tax liability	23	724	802	365
Pension liability	28	-	-	615
Subordinated liabilities	22	10,270	10,268	10,270
Total liabilities		**982,900**	**965,002**	**1,061,962**
Reserves				
General reserves	-	52,675	49,879	44,203
Available for sale reserve	24	(123)	35	341
Revaluation reserve	25	380	380	380
Total reserves and liabilities		**1,035,832**	**1,015,296**	**1,106,886**

Further information is provided in Note 1c to the Accounts
These accounts were approved by the Board of Directors on 13 March 2019 and were signed on its behalf by:

G R Dunn
(Chairman)

C H Field
(Chief Executive Officer)

N J Holden
(Director)

Statement of changes in Members' interests

Group 2018

	Notes	General reserve	Available for sale reserve	Revaluation reserve	Total
		(£000)			
Balance as at 1 January 2018		54,699	35	380	55,144
Net effect of prior year adjustment	1	(2,935)	-	-	(2,935)
Restated balance at 1 January 2018		51,764	35	380	52,179
Profit for the financial year		1,265	-	-	1,265
Other comprehensive income/(loss) for the year	24,25	(19)	(158)	-	(177)
Total comprehensive income/(loss) for the year		1,246	(158)	-	1,088
Balance as at 31 December 2018		**53,010**	**(123)**	**380**	**53,267**

Group 2017

	Notes	General reserve	Available for sale reserve	Revaluation reserve	Total
Balance as at 1 January 2017		51,678	341	380	52,399
Net effect of prior year adjustment		(4,913)	-	-	(4,913)
Restated balance at 1 January 2017		46,765	341	380	47,486
Profit for the financial year		4,244	-	-	4,244
Other comprehensive income/(loss) for the year	24,25	755	(306)	-	449
Total comprehensive income/(loss) for the year		4,999	(306)	-	4,693
Balance as at 31 December 2017		**51,764**	**35**	**380**	**52,179**

Society 2018

	Notes	General reserve	Available for sale reserve	Revaluation reserve	Total
Balance as at 1 January 2018		52,823	35	380	53,238
Net effect of prior year adjustment		(2,944)	-	-	(2,944)
Restated balance at 1 January 2018		49,879	35	380	50,294
Profit for the financial year		2,815	-	-	2,815
Other comprehensive income/(loss) for the year	24,25	(19)	(158)		(177)
Total comprehensive income/(loss) for the year		2,796	(158)	-	2,638
Balance as at 31 December 2018		**52,675**	**(123)**	**380**	**52,932**

Society 2017

	Notes	General reserve	Available for sale reserve	Revaluation reserve	Total
Balance as at 1 January 2017		49,198	341	380	49,919
Net effect of prior year adjustment		(4,995)	-	-	(4,995)
Restated balance at 1 January 2017		44,203	341	380	44,924
Profit for the financial year		4,921	-	-	4,921
Other comprehensive income/(loss) for the year	24,25	755	(306)	-	449
Total comprehensive income/(loss) for the year		5,676	(306)	-	5,370
Balance as at 31 December 2017		**49,879**	**35**	**380**	**50,294**

Group cash flow statements
for the year ended 31 December 2018

	Notes	2018 (£000) Group	2017 (£000) Group
Cash flows from operating activities			
Profit before tax		1,618	4,326
Interest on subordinated liabilities	22	632	632
Gains on disposal of debt securities	10	(158)	(120)
Net fair value movements	5	(3,599)	(639)
Loss on disposal of property, plant and equipment		-	-
Depreciation and amortisation	15,17	2,622	2,757
Increase in impairment of loans and advances	13	139	357
Decrease in loans and advances to credit institutions		1,220	1,585
(Increase)/decrease in loans and advances to customers		(24,723)	13,496
Decrease in prepayments, accrued income and other assets		177	381
Decrease in shares		(10,027)	(108,519)
Increase in amounts owed to credit institutions		57,542	14,628
Decrease in amounts owed to other customers		(16,558)	(5,622)
(Increase)/Decrease in accruals, deferred income and other liabilities		(8,751)	6,944
Net tax received/(paid)		495	52
Net cash outflow from operating activities		**629**	**(69,742)**
Cash flows from investing activities			
Purchase of debt securities		(66,110)	(94,710)
Disposal of debt securities		56,217	134,748
Purchase of property, plant and equipment		(349)	(17)
Purchase of intangible fixed assets		(326)	(1,581)
Net cash generated from investing activities		**(10,568)**	**38,440**
Cash flows from financing activities			
Interest on subordinated liabilities		(632)	(632)
Net (decrease)/increase in cash and cash equivalents		**(10,571)**	**(31,934)**
Cash and cash equivalents at beginning of the year		**61,120**	**93,054**
Cash and cash equivalents at end of the year (2)		**50,549**	**61,120**

Notes:
1) All cash flows are stated inclusive of VAT where applicable.
2) Cash and cash equivalents comprise cash in hand and balances with the Bank of England of £496,000 (2017:£765,000) and loans and advances to credit institutions repayable on call and short notice of £50,053,000 (2017:£60,355,000).

NOTES TO THE ACCOUNTS

1. Accounting policies

The significant accounting policies adopted in preparation of these financial statements are set out below.

a) General information and basis of preparation:
Saffron Building Society is a mutual, governed by the Building Society Act 1986. The address of the registered office is given on the back cover of this report. The nature of the Group's operations and its principal activities are set out in the Directors' report on page 36.

The accounts have been prepared and approved by the Directors in accordance with Financial Reporting Standard 102: The Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS102) and the Building Societies (Accounts and Related Provisions) Regulations 1998. In applying FRS102, the Society has elected to apply the recognition and measurement provisions of IAS39 Financial Instruments: Recognition and measurement (as adopted for use in the EU).

The accounts have been prepared under the historical cost convention as modified by the fair value revaluation of financial instruments and investment property.

The accounts have been prepared on the going concern basis as set out in the Director's Report on page 36.

The preparation of these accounts in conformity with FRS102 requires management to make judgements and estimates and use assumptions in the application of these policies that affect the values of reported assets, liabilities, income and expenditure. Although these estimates are based on management judgement and best knowledge of the events, actions or amounts, taking into account historical evidence and any other relevant factors, actual results may differ from these estimates.

The functional currency of Saffron Building Society is considered to be pounds sterling because that is the currency of the primary economic environment in which the Society operates. The consolidated financial statements are also presented in pounds sterling.

The Society has taken advantage of the exemption in FRS102, which provides that where a company is a member of a group and a Consolidated Cash Flow Statement is published, the Society does not have to prepare a Cash flow statement.

b) Basis of consolidation:
The Group accounts consolidate the accounts of the Society and its subsidiary undertakings. In the Society accounts, investments in the subsidiary undertakings are stated at cost less impairment.

c) Prior year restatement:
During the audit of the current year financial statements, there were two areas identified which required restating in prior periods, details of these adjustments are as follows:

Effective Interest Rate accounting
The Group recognises mortgage income for loans and advances to customers held at amortised cost on an effective interest rate basis. The effective interest rate includes the related fees and commissions received and paid, in accordance with the requirements of IAS 39 Financial Instruments. During the year, it was identified that the Effective Interest Rate (EIR) model implemented in 2015 (upon adoption of FRS 102) contained a modelling error, which resulted in an inaccurate EIR calculation, and was not in accordance with IAS 39 requirements.

The EIR model was re-developed in accordance with IAS 39 requirements, as a result an asset and corresponding revenue adjustment have been made in relation to prior periods for these loans and advances.

The adjustment now accurately reflects the asset position at 1 January 2017 with the necessary adjustment made to the income statement in respect of EIR mortgage interest income.

Embedded Derivative
In 2013, the Society entered into FTSE linked return deposits. These instruments contained an equity linked element within a debt host contract and therefore required splitting out an embedded derivative to reflect this. The Society also entered into equity swaps with a matching payoff structure to hedge the cash flows on these deposits which also contained a floating rate leg.

This resulted in a transaction with the economics of a deposit paying a rate linked to LIBOR, however as the risks and rewards of both transactions lie with the Society, FRS 102 requires that these are recognised as a separate derivative transaction and funding liability.

In order to value the embedded derivative in these debt hosts, the Society applied an equal valuation to the equity swaps used to hedge them. However as these equity swaps contained a LIBOR element not included in the payoff structure of the deposits the valuation is not identical and the day one fair value of the options needs to be separated from the host contracts and unwound through interest expense.

While the net impact of these adjustments is immaterial, this has resulted in a classification error between elements of the income statement which affect the key metric of net interest margin and those which do not and therefore a restatement has been made.

NOTES TO THE ACCOUNTS (continued)

As this error was made in a reporting period prior to the comparative period, the balance sheet for the period ended 31 December 2016 was restated as follows:

Statement of financial position extract

	£000s	2016 as published	Correction of prior period error	2016 restated
	Group			
Assets	Loans and advances to customers	862,812	(7,178)	855,634
	Other assets	1,917	148	2,065
	Deferred tax asset	-	1,926	1,926
	Total assets	1,114,537	(5,104)	1,109,433
Liabilities	Amounts owed to credit institutions	21,586	(191)	21,395
Reserves	General reserves	51,678	(4,913)	46,765
	Total reserves and liabilities	1,114,537	(5,104)	1,109,433
	Society			
Assets	Loans and advances to customers	809,007	(7,260)	801,747
	Other assets	1,908	148	2,056
	Deferred tax asset	-	1,926	1,926
	Total assets	1,112,072	(5,186)	1,106,886
Liabilities	Amounts owed to credit institutions	21,586	(191)	21,395
Reserves	General reserves	49,198	(4,995)	44,203
	Total reserves and liabilities	1,112,072	(5,186)	1,106,886

Restatement of financial statements for the comparative year Income statement

£000s	2017 as published	Correction of prior period error	2017 restated
Group			
Interest receivable and similar income	28,119	2,957	31,076
Interest payable and similar charges	(8,524)	(499)	(9,023)
Net interest income	19,595	2,458	22,053
Net fair value movements	(1,007)	368	(639)
Tax	765	(847)	(82)
Profit for the financial year	2,266	1,978	4,244
Society			
Interest receivable and similar income	27,533	3,029	30,562
Interest payable and similar charges	(8,524)	(499)	(9,023)
Net interest income	19,009	2,530	21,539
Net fair value movements	(598)	369	(229)
Tax	672	(847)	(175)
Profit for the financial year	2,870	2051	4,921

Statement of financial position extract	£000s	2017 as published	Correction of prior period error	2017 restated
	Group			
Assets	Loans and advances to customers	842,490	(4,155)	838,335
	Other assets	2,331	(1,036)	1,295
	Current tax	-	1,014	1,014
	Deferred tax asset	-	1,453	1,453
	Total assets	1,019,905	(2,724)	1,017,181
Liabilities	Amounts owed to credit institutions	35,767	(61)	35,706
	Other liabilities	3,074	(530)	2,544
	Deferred tax liabilities	-	802	802
Reserves	General reserves	54,699	(2,935)	51,764
	Total reserves and liabilities	1,019,905	(2,724)	1,017,181
	Society			
Assets	Loans and advances to customers	795,677	(4,186)	791,491
	Other assets	2,199	(905)	1,294
	Current tax	-	902	902
	Deferred tax asset	-	1,444	1,444
	Total assets	1,018,041	(2,745)	1,015,296
Liabilities	Amounts owed to credit institutions	35,767	(61)	35,706
	Other liabilities	3,086	(542)	2,544
	Deferred tax liabilities	-	802	802
Reserves	General reserves	52,823	(2,944)	49,879
	Total reserves and liabilities	1,018,041	(2,745)	1,015,296

Deferred tax asset

Following the two fore-mentioned adjustments which have been reflected in the prior periods, a deferred tax asset arose relating to the adjustment in previously reported results. Due to the material size of these assets, this balance has been restated for the 2017 reporting period.

Cash in hand

In previously issued financial statements, the cash in hand balance did not include the balances held with the Bank of England, which are highly liquid, instant access funds. Management have therefore restated this balance, removing the balance which had previously been included in loans and advances to credit institutions. Balances restated from loans and advances to credit institutions to cash in hand were £58,432k in 2017 and £90,006k in 2016.

d) Interest income and expense:

Interest income and interest expense for all interest bearing financial instruments is recognised in “Interest receivable and similar income” and “Interest payable and similar charges”, respectively, using the effective interest rates of the financial assets or financial liabilities to which it relates. The effective interest rate is the rate that discounts the expected future cash flows, over the expected life of the financial instruments, to the net carrying amount. Interest on impaired financial assets is recognised at the effective interest rate, applied to the carrying amount as reduced by any allowance for impairment.

e) Fees and commissions:

Fees and commissions receivable or payable that are an integral element of the effective interest rate of the financial instrument are recognised as an adjustment to the effective interest rate and recorded within “Interest receivable and similar income” and “Interest payable and similar charges”. Any other fees and commissions receivable are recognised when the Society has fulfilled all contractual obligations. Fees and commissions payable not included within the effective interest rate are recognised on an accruals basis when the underlying service has been provided.

f) Cash and cash equivalents:

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with an original maturity date of less than three months from acquisition in respect of cash, treasury and other bills and loans and advances to credit institutions. The cashflow statements have been prepared using the indirect method.

g) Derivative financial instruments (“derivatives”) – hedge accounting:

The Society uses derivatives solely for the purposes of risk management. Derivatives are measured and recorded in the Statement of financial position at fair value and classified as assets when the fair value is positive and as liabilities when the fair value is negative. Fair values are obtained by applying quoted market rates to discounted cash flows. Certain derivatives held for risk management purposes are held as hedging instruments in qualifying hedging relationships. To designate as being in a hedging relationship, the Society formally documents the relationship between the hedging instrument and the hedged item, including the strategy and risk management objective for undertaking the hedge together with a description of the methodology that will be used to determine the effectiveness of the hedging relationship. An assessment is made at the inception of the hedge relationship and on an ongoing basis throughout the hedging relationship to ensure the hedge is, and remains, highly effective in offsetting changes in the fair value of the hedged items during the period for which the hedge is designated. A hedge is considered to be highly effective where the results of the hedge effectiveness testing are within a range of 80% to 125%.

Fair value hedges
A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, for example fixed rate mortgages or savings products. Changes in the fair value of the derivatives are immediately recognised in the Income statement together with changes in the fair value of the hedged items attributable to the hedged risk. Hedge accounting is discontinued prospectively if the derivative expires, is sold, terminated or exercised or if the hedge no longer satisfies the criteria for hedge accounting or the hedge designation is revoked. Any cumulative adjustment to the hedged item is amortised to the Income statement over its expected remaining life.

h) Financial assets:
The Group classifies non-derivative financial assets as loans and receivables, available for sale assets or at fair value through profit or loss. No financial assets are classified as held-to-maturity.

i) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinate payments that are not quoted in an active market. The Group's loans and advances to customers (except for a portfolio of equity release mortgages) are classified as loans and receivables, measured at amortised cost less impairment provisions. Initial costs may include certain upfront costs and fees such as procurement fees or arrangement fees, which are recognised over the expected life of the mortgage assets. Mortgage discounts are also recognised over the expected life of the mortgage assets as part of the effective interest rate. The expected life of the mortgage assets is reviewed at each statement of financial position date with any changes recognised in interest receivable and similar income and reflected in the carrying value of the mortgage assets.

ii) Available for sale
Available for sale assets are non-derivative financial assets which the Group intends to hold for an indefinite amount of time but which may also be sold in response to needs for changes in liquidity or interest rates. The Group's debt securities are classified as available for sale assets, measured at fair value (see also Note 24). Subsequent changes in fair value are recognised through the Statement of comprehensive income until sale or maturity of the assets, following which the cumulative gains or losses are removed from the Statement of other comprehensive income and recycled to the Income statement.

iii) Fair value through profit and loss
All other non-financial derivative assets are measured at fair value with subsequent changes in fair value recognised in the Income statement. The Group's portfolio of equity release mortgages are classified as at fair value with the Directors electing to take the fair value option available under IAS39 on the basis that it prevents an accounting measurement mismatch.

i) Impairment of financial assets not measured at fair value:
Throughout the year and at each statement of financial position date individual assessments are made of all loans and advances against properties which are in possession or in arrears by more than three months of the outstanding loan balance. Individual impairment provision is made against these loans where, in the opinion of the Directors, it is considered there is evidence of impairment. Such evidence includes significant financial difficulty of the borrower, deterioration in payment status or any other information discovered that suggests a likely loss. If there is such evidence, the amount of loss is calculated as the difference between the asset's carrying amount and the present value of the estimated cash flows discounted at the effective interest rate. In estimating future cash flows, account is taken of expected movements in house prices, any discounts to reflect a forced sale and any anticipated sales costs. For all other loans and advances, collective assessment is also made as to whether there is evidence to suggest the portfolio is likely to be impaired. Collective assessment requires each category of financial asset to be separated into groups of assets with similar credit characteristics and impairment loss calculated by applying expected loss factors based on the Group's experience of default and the effect of movements in house prices less any adjustment for a forced sale value. Any resultant impairment loss is recognised immediately in the Income statement with a corresponding reduction in the value of the financial asset recognised as a provision. The Group uses forbearance measures to assist borrowers who have difficulties in meeting their obligations (see also Note 29). Where the Group considers that a loss may arise in these cases, a charge for impairment will be made in accordance with the above policy.

j) Financial liabilities:
Non-derivative financial liabilities, which includes the Group's share balances and wholesale borrowings, are measured at amortised cost with interest recognised using the effective interest method.

k) De-recognition of financial instruments:
The Group derecognises a financial asset when the

contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred. The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

l) Property, plant and equipment:
Freehold properties comprise branches and office buildings, and are stated at revalued amounts, being the fair value, determined by market based evidence, at the date of the valuation less any subsequent accumulated depreciation and subsequent impairment. Full valuations are completed every five years followed by interim valuations three years later. The Directors review the valuations to confirm that they remain appropriate in the intervening years. Increases in valuations of freehold buildings are credited to the Revaluation reserve except where they reverse decreases for the same assets previously recognised in the Income statement, in which case the increase in the valuation is recognised in the Income statement. Decreases in valuations are recognised in the Income statement except where they reverse amounts previously credited to the Revaluation reserve for the same asset, in which case the decrease in valuation is recognised in the Revaluation reserve.

Assets are depreciated on a straight-line basis over their estimated useful lives as follows:

Freehold premises – 50 years
Short leasehold premises – over the remainder of the lease
Computer equipment – four years
Motor vehicles – six years
Other equipment, fixtures and fittings – 10 years

m) Investment properties:
Investment properties include those portions of freehold land and buildings owned by the Society that are held to achieve rental income, capital appreciation or both. Investment properties are initially recognised at cost and subsequently carried at fair value, determined by independent professional valuers on an open-market value basis. Changes in fair values are recognised in the Income statement. The cost of renovations or improvements is capitalised and the cost of maintenance, repairs and minor improvements is recognised in the Income statement when incurred. No depreciation is charged on investment properties. On disposal of an investment property, the difference between the disposal proceeds and the carrying amount is recognised in the Income statement.

n) Intangible assets:
Purchased software and costs directly attributable to the development of software are capitalised and recognised as Intangible assets where the software is expected to generate future economic benefits and where attributable costs can be reliably measured. Intangible assets are recognised at cost less accumulated amortisation and any impairment charges. Amortisation commences when the software first becomes available for operational use and is charged to the Income statement on a straight-line basis over the expected useful life of the software, currently between four and seven years. Amortisation periods are reviewed annually to ensure they remain appropriate. The carrying value of Intangible assets is reviewed for impairment at each statement of financial position date or whenever events or changes in circumstances indicate that the carrying value may not be recoverable with the carrying amount immediately reduced to its recoverable amount where required.

o) Retirement benefits:
The Society operates a final salary pension scheme administered by trustees, the funds of which are separate from those of the Society. The defined benefit scheme is funded by contributions partly from the employees and partly from the Society at rates assessed by independent actuaries. The scheme assets are measured at market value at each statement of financial position date and liabilities are measured using the projected unit valuation method, discounted using a corporate bond rate. Re-measurement comprising actuarial gains and losses and the return on scheme assets (excluding interest) are recognised in the Statement of comprehensive income. The Society also operates a stakeholder pension scheme and the Society contributions for this scheme are charged to the Income statement.

p) Operating leases:
Rentals under operating leases are charged to administrative expenses in the Income statement on a straight line basis over the life of the lease.

q) Taxation:
Taxation comprises amounts for current and deferred tax and is recognised in either the Income statement or Statement of comprehensive income to match with the related item(s) and is determined using the rates of taxation substantively enacted at the Statement of financial position date. Current tax represents the expected tax payable on profit adjusted for tax purposes. Deferred tax reflects temporary timing differences between the amounts determined for accounting purposes and amounts determined for taxation purposes. Tax relating to the fair value re-measurement of available for sale assets, which is charged or credited directly to the Statement of comprehensive income, is also charged or credited to the Statement of comprehensive income and subsequently recognised in the Income statement to match with the subsequent recognition of the deferred gain or loss in the Income statement.

r) Funding for Lending Scheme (FLS) and Term Funding Scheme (TFS):
In order for the Society to access funding from the Governments's FLS and TFS it has to pledge mortgage assets as collateral to the Bank of England. As the risk and reward of ownership of the mortgage assets remains with the Society, these assets are retained on its balance sheet. The interest receivable on these assets continues to be the Society's and is accounted

NOTES TO THE ACCOUNTS (continued)

for as earned on an accruals basis. Treasury bills borrowed under the FLS are not recognised on the balance sheet as substantially all the risks and rewards of the ownership remain with the lender. The interest cost of borrowing the treasury bills is accrued in the accounts on a straight line basis over the drawdown period. If treasury bills are lent or sold subject to a commitment to repurchase, the new proceeds received are recognised as cash on the balance sheet together with a corresponding liability.

2. Critical accounting judgements and key sources of estimation uncertainty.

In applying the Group's accounting policies, the Group is required to make estimates and apply judgements that can have a material effect on the carrying amounts of assets and liabilities. Such estimates and judgements are continually evaluated and are based on historical experience and expectations of future events believed to be reasonable under current circumstances. The key sources of estimation uncertainty are described below:

a) Effective interest rate – expected mortgage life:

The calculation of an effective interest rate requires judgements regarding the expected life of the underlying mortgage assets. The expected life of mortgage assets is derived using a combination of historical data and management judgement and is reviewed periodically throughout the year and reassessed against actual performance. Any changes to the expected life would result in an adjustment to the carrying value of the mortgages, calculated as the present value of the revised cashflows discounted at the original effective interest rate, recognised immediately in the income statement. To demonstrate the volatility of the Effective Interest Rate accounting for the expected mortgage life, we are running the life of the mortgages to a maximum of 12 years based on historical data available and knowledge of the book. If we assume that the mortgages will all repay within 10 years, this would require a further £551k charge to the income statement, likewise, if we assume that these run to a maximum contractual term, this would generate a further £138k income to the income statement.

b) Impairment losses on loans and advances to customers:

i) Specific Provisions

Specific provisions are calculated by determining the expected cash flows from the loan, including those from the realisation of collateral. Significant judgement is required to determine the timing and amounts of cash flows as well as in determining whether indicators of impairment exist for a particular loan.

ii) Collective Provisions

Collective provisions are calculated using credit modelling techniques. This involves estimation of probabilities of default as well as recoverability and values of collateral leading to significant estimation uncertainty. Probabilities of default are determined using a combination of credit metrics and amounts of arrears and recoverability is based on historical experience. Collateral values are estimated by applying regional HPI indexes to the most recent formal valuation. Sensitivities to the recoverable value of collateral and default probability are as follows.

A 15% downturn in house price would lead to an additional provision for impairment of £659k while an improvement in house price of 15% would lead to a reduction in provision of £286k. If probability of default on our loan book increased by 25%, our provision would increase by £97k, however if the probability of default decreased by 25%, our provision would fall by £97k.

c) Financial assets at fair value through profit and loss - Equity release mortgages:

Loans and advances to customers include a portfolio of equity release mortgages. All such loans were originated or purchased before 2011 and the Society no longer offers such mortgages. Under the product terms interest is capitalised within the loan balance and becomes repayable on redemption of the loan through sale of the property. Borrowers are not required to make monthly repayments. The mortgage contract for these loans contains a No Negative Equity Guarantee ("NNEG") clause where the Society cannot pursue a borrower in the event that the proceeds from the sale of the property is less than the contractual loan balance. The NNEG exposes the Society to the risk that the Society may not fully recover expected redemption balances. Estimation uncertainty surrounds the measurement of the NNEG liability since redemptions may not occur for many years in the future.

The fair value of the portfolio of equity release mortgages, which is calculated using an internal variant of the Black Scholes option pricing model, takes into account an explicit provision in respect of the NNEG.

The principal assumptions underlying the valuation include mortality or entry into long-term care, Discount rate and No Negative Equity Guarantee. Further information on these assumptions, together with sensitivity analysis, is provided in Note 29 to the Accounts.

d) Retirement benefits:

Significant judgements on areas such as future interest rates, future inflation or mortality rates have to be exercised in estimating the value of the assets and liabilities of the Society's final salary pension scheme. The assumptions used are set out in Note 28 to the accounts. The value of the pension scheme liabilities is most sensitive to the discount rate used. A 0.1% increase in the discount rate would reduce the defined benefit obligation by £0.1m.

3. Interest receivable and similar income

	2018 (£000)		**Restated 2017** (£000)	
	Group	Society	Group	Society
On assets held at amortised cost				
Loans fully secured on residential property	29,744	29,329	30,490	30,166
Loans to subsidiaries	-	1,249	-	1,419
Other loans	-	-	156	156
Other liquid assets / cash and short term funds	902	902	701	701
On available for sale securities				
Liquid assets	77	77	106	106
Gains on disposal	(15)	(15)	185	185
On financial instruments held at fair value through the income statement				
Loans fully secured on residential property	2,634	1,120	2,753	1,144
Derivatives	(2,579)	(2,579)	(3,315)	(3,315)
	30,763	**30,083**	**31,076**	**30,562**

Gains arising on the disposal of financial instruments comprise net profits from the sale of treasury instruments. Amounts restated for the correction of the prior period error set out in Note 1c to the Accounts.

4. Interest payable and similar charges

	2018 (£000)		**Restated 2017** (£000)	
	Group	Society	Group	Society
On liabilities held at amortised cost				
Shares held by individuals	7,163	7,163	7,314	7,314
Subordinated liabilities	633	633	632	632
Deposits and other borrowings	1,294	1,294	1,026	1,026
On financial instruments held at fair value through the income statement				
Derivatives	(72)	(72)	51	51
	9,018	**9,018**	**9,023**	**9,023**

5. Net fair value movements

	2018 (£000)		**Restated 2017** (£000)	
	Group	Society	Group	Society
Derivatives in designated fair value hedge relationships	900	900	1,388	1,388
Adjustments to hedged items in fair value hedge accounting relationships	(765)	(765)	(1,329)	(1,329)
Derivatives not in designated fair value hedge relationships	2,104	1,097	691	(708)
(Decrease)/increase in fair value of assets and liabilities	(5,838)	(2,549)	(1,389)	420
	(3,599)	**(1,317)**	**(639)**	**(229)**

NOTES TO THE ACCOUNTS (continued)

The net losses from derivative financial instruments represents the net fair value movement on derivative instruments that are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges. The movement is primarily due to timing differences in income recognition between derivative instruments and the hedged assets or liabilities. Amounts reported as changes in the fair value of assets and liabilities principally comprise movements in the fair value of the Group's portfolio of equity release mortgages. Derivatives are held to match the risk exposure of these assets but are not held in a qualifying hedge accounting relationship.

6. Administrative expenses

	2018 (£000)		**Restated 2017** (£000)	
	Group	Society	Group	Society
Staff costs (Note 7)	7,286	7,286	7,724	7,724
Remuneration of auditors:				
- audit of the Society's accounts	140	140	102	102
- audit of the Society's subsidiary pursuant to legislation	5	5	5	5
- all other services	12	12	21	21
Operating lease rentals	268	268	275	275
Other administrative expenses	6,351	6,350	5,805	5,806
	14,062	**14,061**	**13,932**	**13,933**

Note: all audit fees are borne by the Society.

7. Staff numbers and costs The average number of persons employed by the Society (including the Executive Directors) during the year was:

	2018		**2017**	
	Group	Society	Group	Society
Principal office	113	113	113	113
Branch offices	49	49	55	55
	162	**162**	**168**	**168**

	2018 (£000)		**Restated 2017** (£000)	
The aggregate costs of these persons were as follows:	Group	Society	Group	Society
Wages and salaries	6,145	6,145	6,793	6,793
Social security costs	685	685	587	587
Other pension costs (Note 28)	456	456	344	344
	7,286	**7,286**	**7,724**	**7,724**

8. Remuneration of and transactions with Directors

Analysis of Directors' emoluments:	Salary/ fees	Bonus paid (1)	Other benefits	Pension/ Pension allowance	2018 (£000) Total	2017 (£000) Total
Executive						
C H Field	174	20	18	24	**236**	231
S A Howe*	158	21	17	21	**217**	210
D L Garner	158	8	17	20	**203**	219
	490	**49**	**52**	**65**	**656**	660
Non-Executive						
G R Dunn	52				**52**	48
T G Barr	32				**32**	30
N J Treble	42				**42**	38
N J Holden	42				**42**	38
J A Ashmore	32				**32**	30
E Kelly	32				**32**	30
	232				**232**	214
Total 2018	**722**	**49**	**52**	**65**	**888**	-
Total 2017	696	64	50	64	-	874

Notes:
1) Bonus paid in 2018 comprises £26k earned and accrued in 2017 plus £15k payment of bonus deferred from 2016 and £8k of previously deferred bonus to Mrs Howe on leaving. A further £21k of bonus earned remains deferred to be paid in 2019 and £3k in each of 2020 and 2021 subject to the approval of the Remuneration and Loans Committee. The bonus arrangements for Executive Directors are explained in full in the Directors' Remuneration Report.

*Mrs Howe resigned as a director on 19 November 2018 and left the Society on 31 December 2018.

NOTES TO THE ACCOUNTS (continued)

9. Taxation on profit on ordinary activities

The tax charge comprises:	**2018** (£000) Group	Society	**Restated 2017** (£000) Group	Society
Current tax on profit on ordinary activities				
UK corporation tax	-	-	50	32
Adjustments in respect of prior periods	(147)	(165)	(891)	(776)
Total current tax	**(147)**	**(165)**	**(841)**	**(744)**
Deferred tax				
Origination and reversal of timing differences	-	-	-	-
Adjustments in respect of prior periods	500	728	923	919
Effect of tax rate change on opening balance	-	-	-	-
Total deferred tax	**500**	**728**	**923**	**919**
Total tax credit on profit on ordinary activities	**353**	**563**	**82**	**175**
Tax charge/(credit) recognised in other comprehensive income	49	49	167	167
Total current and deferred tax credit	**402**	**612**	**249**	**342**

The standard rate of Corporation Tax was from 1 April 2017, giving effective tax rates of 19% for the year ended 31 December 2018 and 19.25% for the year ended 31 December 2017. During 2016 a reduction in the corporation tax rates to 17% from 1 April 2020 was substantively enacted into legislation. These changes will reduce the Society's future current tax charges accordingly. All deferred tax balances have been recognised at 17%, being the rate enacted at the balance sheet date at which the balances are materially expected to reverse. Tax adjustments in respect of prior years in 2017 and 2018 relate to Research and Development tax credit claims in respect of the financial year ended 31 December 2017.

The Group and Society's current tax credit for the year ended at 31 December 2017 reflects a tax deduction of £433k which relates to periods prior to 2017. The Group and Society consider the deduction to be appropriate although as it is subject to review and confirmation by HMRC, there remains a risk that additional tax could be payable by the Group and Society in future periods.

The differences between the total tax charge shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	2018 Group	2018 Society	2017 Group	2017 Society
Profit on ordinary activities before tax	1,618	3,378	4,326	5,096
Tax on profit on ordinary activities at standard UK corporation tax rate of 19% (2017:19.25%)	308	642	833	981
Effects of:				
Fixed asset differences	36	36	43	43
Non-taxable expense/(income)	9	(10)	(68)	473
Impact of rate change	(33)	(61)	(44)	(44)
Adjustments to tax charge in respect of previous years	-	-	(681)	(1,278)
Other	33	(44)	(1)	-
Total tax credit for the period recognised in the income statement	**353**	**563**	**82**	**175**

10. Liquid assets

	2018 (£000)		Restated 2017 (£000)	
	Group	Society	Group	Society
Loans and advances to credit institutions:				
Repayable on call and short notice	730	360	1,923	1,347
Placements with credit institutions	25,579	25,579	26,799	26,799
	26,309	**25,939**	**28,722**	**28,146**

As at 31 December 2018 £25,574k (2017:£26,345k) of cash has been deposited by the Group and Society as collateral against derivative contracts.

	2018 (£000)		Restated 2017 (£000)	
	Group	Society	Group	Society
Debt securities:				
Gilts	22,791	22,791	8,893	8,893
Treasury bills	20,416	20,416	3,994	3,994
Bonds	33,155	33,155	53,706	53,706
	76,362	**76,362**	**66,593**	**66,593**

The Society has pledged £nil of debt securities with the Bank of England for the Term Funding Scheme and Funding for Lending Scheme (2017:£21,070k).

	2018 (£000)
	Group & Society
Movements during the year of debt securities are analysed as follows:	
At 1 January	66,593
Additions	66,110
Disposals	(56,217)
Net gains from changes in fair value recognised in Statement of comprehensive income	(124)
At 31 December	**76,362**

NOTES TO THE ACCOUNTS (continued)

11. Derivative financial instruments

	Group & Society (£000)		
	Contract/ notional amount	Fair values – Assets	Fair values – Liabilities
As at 31 December 2018			
a) Unmatched derivatives – Interest rate swaps	52,843	1,905	(22,910)
b) Derivatives designated as fair value hedges – Interest rate swaps	252,500	1,187	(475)
Total recognised derivative assets / (liabilities)	**305,343**	**3,092**	**(23,385)**
As at 31 December 2017			
a) Unmatched derivatives – Interest rate swaps	62,418	1,808	(26,058)
b) Derivatives designated as fair value hedges – Interest rate swaps	225,500	1,009	(1,254)
Total recognised derivative assets / (liabilities)	**287,918**	**2,817**	**(27,312)**

Unmatched derivatives include an interest rate swap with a notional value of £41.1million (2017:£42.2million) designed to protect the Society against the interest rate risk presented by its portfolio of equity release mortgages. This swap is structured within upper and lower bands and is designed to reflect the projected balances of the portfolio, incorporating underlying assumptions on property values and prepayments and actuarial assumptions on mortality.

Unmatched derivatives also include interest rate swaps with a total notional value of £5million, which the Society has elected to de-designate from their hedging relationship at 31 December 2018 (2017:£12million).

12. Loans and advances to customers

	2018 (£000)		2017 (£000) (restated)	
	Group	Society	Group	Society
Loans fully secured on residential property				
Held at amortised cost (2)	805,841	795,687	773,065	761,939
Held at fair value through the income statement	58,819	26,648	65,905	30,109
Other loans - loans fully secured on land	1,875	1,875	2,748	2,748
	866,535	824,210	841,718	794,796
Provision for impairment losses on loans and advances (Note 13)	(3,875)	(3,772)	(3,936)	(3,858)
	862,660	820,438	837,782	790,938
Fair value adjustment for hedged risk	(417)	(417)	553	553
	862,243	**820,021**	**838,335**	**791,491**

Notes

(1) The Society has pledged £15million of mortgage loan pools with the Bank of England for the Term Funding Scheme and Funding for Lending Scheme (2017:£87.4million Funding for Lending Scheme).

(2) Amounts restated for the correction of the prior period error set out in Note 1c to the Accounts.

13. Impairment losses on loans and advances

	(£000)		
	Individual	Collective	Total
Group			
At 1 January 2018	3,562	374	3,936
Charge for the year	108	31	139
Amounts utilised in the period	(184)	(16)	(200)
At 31 December 2018	**3,486**	**389**	**3,875**
Society			
At 1 January 2018	3,485	373	3,858
Charge for the year	89	25	114
Amounts utilised in the period	(184)	(16)	(200)
At 31 December 2018	**3,390**	**382**	**3,772**

14. Investments in subsidiary undertakings

	2018 (£000)	**Restated 2017** (£000)
	Society	Society
Shares in subsidiary undertakings	86	86
Loans to subsidiary undertakings	42,385	45,571
	42,471	**45,657**

Movement during the year of loans to subsidiary undertakings:

Cost		
At 1 January	45,571	51,477
Repayments received	(4,588)	(7,627)
Loans advanced	1,402	1,721
At 31 December	**42,385**	**45,571**

The Society holds 100% of the ordinary share capital of Crocus Home Loans Limited, for the purpose of secured lending on residential property. The share capital authorised and issued is £1,000.

The following 100% owned subsidiaries were not carrying on business at the end of the financial year:

	Share Capital
Saffron Independent Financial Advisers Limited	£85,000
Saffron Walden Investment Services Limited	£2
Saffron Walden Property Developments Limited	£2
Saffron Walden Property Sales Limited	£2

All subsidiary undertakings are registered in England and Wales and operate within the United Kingdom.

NOTES TO THE ACCOUNTS (continued)

15. Property, plant and equipment

	Group & Society (£000)			
	Land and buildings freehold	Land and buildings short leasehold	Equipment, fixtures, fittings and vehicles	Total
Cost or valuation				
At 1 January 2018	4,427	1,190	2,756	8,373
Additions	-	-	349	349
At 31 December 2018	**4,427**	**1,190**	**3,105**	**8,722**
Depreciation				
At 1 January 2018	845	497	2,288	3,630
Charged in year	152	112	242	506
At 31 December 2018	**997**	**609**	**2,530**	**4,136**
Net book value				
At 31 December 2018	**3,430**	**581**	**575**	**4,586**
At 31 December 2017	3,582	693	468	4,743

Freehold Land and Buildings are held at valuation and were professionally valued by Derrick Wade Waters, Chartered Surveyors, on an existing use basis as at 31 December 2016. This valuation was £3,765,000 compared to a net book value of £3,385,000. Had these assets been carried at historic cost, the net book value at 31 December 2018 would be £2,475,000 (2017:£2,475,000).

Land and buildings freehold includes non-depreciable land held by the Society for its own activities with a net book value of £735,000 (2017:£735,000).

16. Investment properties

	2018 (£000)
	Group & Society
At 1 January 2018	2,785
Revaluation gain	55
At 31 December 2018	**2,840**

Investment properties are generally offices and retail premises ancillary to the Society's branches and head office and are not used by the Society. Investment properties are held at valuation and were professionally valued by Derrick Wade Waters, Chartered Surveyors, on an open market value basis as at 31 October 2018. The property rental income earned, all of which is leased out under operating leases, amounted to £185k (2017:£196k) and has been recognised within other operating income.

The total future minimum lease payments due to the Society under non-cancellable operating leases are as follows:	Group £000s	
	2018	2017
Not later than one year	185	189
Later than one year and not later than five years	493	494
Later than five years	337	404

17. Intangible assets

	(£000)
	Group & Society
Cost	
At 1 January 2018	15,834
Additions	326
Disposals	-
At 31 December 2018	**16,160**
Amortisation	
At 1 January 2018	5,814
Charged in year	2,116
Disposals	-
At 31 December 2018	**7,930**
Net book value	
At 31 December 2018	**8,230**
At 31 December 2017	10,020

Intangible assets at 31 December 2018 comprise the costs of investment in new mortgages and savings platforms to meet the future needs of the Society and include £296,115 (2017:nil) of assets in the course of construction. Amortisation is charged against these assets when they become ready for use by the business over estimated useful lives of between four and seven years.

18. Other assets

	2018 (£000)		**Restated 2017** (£000)	
	Group	Society	Group	Society
Other assets	16	16	13	11
Prepayments and accrued income	1,413	1,413	1,282	1,283
	1,429	**1,429**	**1,295**	**1,294**

19. Shares

	2018 (£000)		**2017** (£000)	
	Group	Society	Group	Society
Held by individuals	784,021	784,021	802,109	802,109
Fair value adjustment for hedged risk	13	13	180	180
	784,034	**784,034**	**802,289**	**802,289**

20. Amounts owed to credit institutions

	2018 (£000)		**2017** (£000)	
	Group	Society	Group	Society
Amounts owed to credit institutions	91,483	91,483	34,000	34,000
Embedded derivative	1,858	1,858	1,706	1,706
	93,341	**93,341**	**35,706**	**35,706**

NOTES TO THE ACCOUNTS (continued)

21. Other liabilities

	2018 (£000)		**Restated 2017** (£000)	
	Group	Society	Group	Society
Corporation tax	18	-	-	-
Social Security	196	196	173	173
Other creditors	825	825	913	913
Other accruals	705	680	1,458	1,458
	1,744	**1,701**	**2,544**	**2,544**

22. Subordinated liabilities

	2018 (£000)		**Restated 2017** (£000)	
	Group	Society	Group	Society
Fixed Rate 6.32% Subordinated Debt 2028	10,270	10,270	10,268	10,268

The Society entered into a subordinated liabilities issue during 2003. The issue is for £10,000,000 denominated in sterling, and the loan is repayable at maturity. The rights of repayment of the holders of this issue are subordinated to the claims of all depositors, all creditors and Members holding shares in the Society, as regards the principal of their shares and interest due to them.

23. Deferred taxation assets and liabilities

	2018 (£000)		**Restated 2017** (£000)	
	Group	Society	Group	Society
Deferred tax assets				
Balance 1 January	1,453	1,444	1,940	1,926
Tax value of losses carried forward	(579)	(807)	(482)	(482)
Other			(5)	-
Balance 31 December	**874**	**637**	**1,453**	**1,444**
Deferred taxation liabilities				
Balance 1 January	802	802	365	365
Income statement charge	(127)	(127)	270	270
Charge/(Credit) recognised directly in equity	49	49	167	167
Fixed asset timing differences	792	792	792	792
Other timing differences	(22)	(22)	(35)	(35)
Capital gains	-	-	23	23
Other	(46)	(46)	22	22
Liability at 31 December	**724**	**724**	**802**	**802**

During 2015 and 2016 reductions in the corporation tax rates to 19% from 1 April 2017 and 17% from April 2020 were substantively enacted into legislation. All deferred tax balances have been recognised at 17%, being the rate enacted at the balance sheet date at which the balances are materially expected to reverse.

24. Available for sale reserve

	2018 (£000)		Restated 2017 (£000)	
	Group	Society	Group	Society
Reserve at start of the year	35	35	341	341
Realised gains	15	15	(185)	(185)
Net changes in fair value	(124)	(124)	(100)	(100)
Tax relating to components of other comprehensive income	(49)	(49)	(21)	(21)
Reserve at end of the year	**(123)**	**(123)**	**35**	**35**

25. Revaluation reserve

	2018 (£000)		Restated 2017 (£000)	
	Group	Society	Group	Society
Revaluation reserve at start of the year	380	380	380	380
Unrealised valuation gains on property, plant and equipment	-	-	-	-
Revaluation reserve at end of the year	**380**	**380**	**380**	**380**

26. Financial commitments

	2018 (£000)		Restated 2017 (£000)	
	Group	Society	Group	Society
a) Total future minimum lease payments under non-cancellable operating leases are as follows:				
Not later than one year	234	234	273	273
Later than one year and not later than five years	803	803	896	896
Later than five years	115	115	253	253

b) At 31 December 2018, the Group had capital commitments of nil (2017: nil) which were contracted but not provided for.

27. Provisions for liabilities

	Group & Society (£000)		
	Financial Services Compensation Scheme Levy	Dilapidations	Total
2018			
At 1 January 2018	96	152	248
Charge for the year	(45)	-	(45)
Provision utilised	(36)	-	(36)
At 31 December 2018	**15**	**152**	**167**
2017 (Restated)			
At 1 January 2017	205	152	357
Charge for the year	76	-	76
Provision utilised	(185)	-	(185)
At 31 December 2017	**96**	**152**	**248**

NOTES TO THE ACCOUNTS (continued)

27. Provisions for liabilities (continued)

Financial Services Compensation Scheme Levy

In common with other regulated UK deposit takers the Society pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it. Levies are typically charged to the Society on an annual basis. During 2008 and 2009 claims were triggered against the FSCS in relation to a number of financial institutions including Bradford & Bingley plc, Kaupthing Singer & Friedlander, Heritable Bank plc, Landsbanki hf and Dunfermline Building Society. The FSCS meets these claims by way of loans received from HM Treasury and has in turn acquired rights in the realisation of the assets of the banks. The FSCS is liable to pay interest on these loans, and may have a further liability if there are insufficient funds from the realisation of the assets of the bank to fully repay these loans. The term of these loans was interest only for the first three years, with the FSCS recovering the interest cost, together with its own ongoing management expenses, through annual management levies on its Members. By virtue of it holding deposits protected under the FSCS scheme at 31 December 2017, the Society had an obligation to pay levies in respect of the interest cost for 2017/18. This was settled during 2018 at an amount lower than provided.

Dilapidations

Provision for dilapidations represents expected costs on the Society's leasehold properties, based on third party estimates, of the restoration costs for each of the properties. The amount can be further analysed between:

	(£000)
Principal offices	52
Branch offices	100

These costs will be incurred when the Society vacates the premises.

28. Group pensions

Defined contribution scheme

The amounts charged to the Income statement in respect of contributions to the Group's defined contribution stakeholder pension scheme represents the contribution payable in the year. The amounts paid into the scheme amounted to £572,000 (2017:£344,000).

Defined benefit scheme

The Society operates a defined benefit pension scheme covering its longer serving employees. The scheme closed to staff who joined the Society after 4 August 2003 and closed to future accrual from 1 January 2008. Members who remain employed by the Society retain a link to pensionable salary. The assets of the scheme are held in a managed fund independent of the Society's finances.

The funding of the scheme is based upon regular triennial actuarial valuations, the most recent being as at 30 April 2017. The principal assumptions relate to the rate of return on investments, then assumed to be 3.8% (2014: 5.4%) per annum for the pre-retirement period and 3.8% (2014: 4.0%) for the post-retirement period. The rate of increase in salaries was assumed to be 2.9% (2014: 3.6%) per annum. At the date of the latest actuarial valuation, the market value of the assets was £13,351,000 (2014: £10,741,000) which was sufficient to cover 110% (2014: 101%) of the value of the benefits that had accrued to Members at that date plus a reserve for future expenses of £992,000 (2014: £725,000).

As at 31 December 2018 the scheme is shown in the Statement of financial position as a pension asset of £76,000 (2017:asset of £207,000) before allowance for deferred tax. Based on an actuarial valuation, consistent with the methods prescribed in accounting standard FRS102, a net surplus on the Society scheme has been identified as follows:

Future funding obligation
The actuarial valuation of the scheme revealed a funding surplus of £1.2million. As the scheme was in surplus no contributions are required by the Society. The Society expects to make no payments to the scheme during the financial year ending 31 December 2019.

28. Group pensions (continued)

	Date of fund valuation	
	31 December 2018	31 December 2017
Main assumptions		
Rate of increase in salaries	2.2%	2.1%
Rate of increase in pensions in payment	3.1%	3.0%
Rate of increase in pensions in payment after 05.04.05	2.3%	2.3%
Discount rate	2.8%	2.5%
RPI inflation assumptions	3.2%	3.1%
CPI inflation assumptions	2.2%	2.1%

These assumptions used by the actuary are the best estimates, chosen from a range of possible assumptions which may not be borne out in practice.

	(£000)		
Reconciliation of scheme's assets and defined benefit obligation:	Assets	Defined benefit obligation	Total
At 1 January 2018	14,251	(14,044)	207
Benefits paid	(434)	434	-
Administration expenses	(60)	-	(60)
Past service cost	-	(56)	(56)
Net interest income/(expense)	351	(347)	4
Re-measurement gains			
- Actuarial gain	-	605	605
- Return on assets excluding interest income	(624)	-	(624)
At 31 December 2018	**13,484**	**(13,408)**	**76**

The scheme liabilities were valued in accordance with the guidelines set out in Section 28 of FRS102 using a discount rate of 2.8% per annum, which is derived from the yields available on high quality sterling corporate bonds at durations appropriate to the duration of liabilities.

Fair value of the assets of the Scheme	**2018** (£000)	**2017** (£000)
Equities and other growth assets	9,216	9,888
Liability Driven Investments	3,401	3,430
Cash	26	16
Annuities	841	917
	13,484	**14,251**

NOTES TO THE ACCOUNTS (continued)

28. Group pensions (continued)

Demographic assumptions	31 December 2018	31 December 2017
Mortality (Pre-retirement)	Nil deaths	Nil deaths
Mortality (Post-retirement)	S2PA CMI2017	S2PA CMI2016

	31 December 2018		31 December 2017	
Life expectancies (in years)	Males	Females	Males	Females
For an individual aged 65 in 2018	21.9	23.8	22.1	23.9
At age 65 for an individual aged 45 in 2018	23.3	25.4	23.5	25.4

Analysis of other pension costs charged in arriving at operating profit: Analysis of amounts included in other operating charges	2018 (£000)	2017 (£000)
Administration expenses	(60)	(63)
	(60)	**(63)**
Analysis of amounts included in pension finance income		
Net interest (expense)/income	4	(16)
	4	**(16)**
Analysis of amount recognised in the Statement of comprehensive income		
Actual return on assets less interest	(624)	314
Actuarial (loss)/gain on defined benefit obligation	605	587
Total actuarial gain/(loss) recognised in the Statement of comprehensive income	**(19)**	**901**

29. Financial instruments

A financial instrument is a contract which gives rise to a financial asset of one entity and a financial liability of another entity. The Group is a retailer of financial instruments in the form of mortgage and savings products and uses wholesale financial instruments to invest liquid asset balances, raise wholesale funding and manage risks arising from its operations.

The Group has a formal structure for managing risk, including establishing risk appetite, risk limits, reporting lines, mandates, policies and other control procedures. This structure is reviewed regularly by the Assets and Liabilities Committee (ALCO), which is charged with the responsibility for managing and controlling the Statement of financial position and the use of financial instruments for risk management purposes. Further oversight of risk management is provided by the Risk, Audit, Compliance and Conduct Committee (RACCC).

Instruments used for risk management purposes include derivative financial instruments (derivatives), which are contracts or agreements whose value is derived from one or more of underlying price, rate or index inherent in the contract or agreement, such as interest rates.

Derivatives are only used by the Society in accordance with the Building Societies Act 1986 (as amended by the Building Societies Act 1997) to reduce the risk of loss arising from changes in interest rates or other factors specified in the legislation.

Derivatives are not used in trading activity or for speculative purposes.

29. Financial instruments (continued)

The Group reduces its exposure to interest rate risk applying fair value hedging techniques, as follows:

Activity	Risk	Fair value
Fixed rate mortgage	Increase in interest rates	Group pays fixed, receives variable
Fixed rate savings bond	Decrease in interest rates	Group receives fixed, pays variable

The fair value of derivative financial instruments held at 31 December 2018 is shown in Note 11.

The table below provides a summary of the terms and conditions of the Group's financial instruments and description of respective accounting policies.

Financial instrument	Terms and conditions	Accounting policy
Loans and advances to credit institutions	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Loans and receivables at amortised cost Accounted for at settlement date
Debt securities	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Available-for-sale at fair value through other comprehensive income Accounted for at settlement date
Loans and advances to customers	Secured on residential property or land Standard contractual term of 25 years Fixed or variable rate interest	Loans and receivables at amortised cost* Accounted for at settlement date
Shares	Fixed or variable term Fixed or variable interest rates	Amortised cost Accounted for at settlement date
Amounts owed to credit institutions	Fixed or LIBOR linked interest rate; FTSE linked return Fixed term Short to medium term maturity	Fair value through profit and loss or at amortised cost Accounted for at settlement date
Amounts owed to other customers	Fixed or variable interest rate Fixed or variable term Short to medium term maturity	Amortised cost Accounted for at settlement date
Subordinated liabilities	Fixed interest rate Fixed term	Amortised cost Accounted for at settlement date
Derivative financial instruments	Fixed interest received/paid converted to variable interest paid/received Based on notional value of the derivative	Fair value through profit and loss Accounted for at trade date

* Excluding portfolio of equity release mortgages accounted for at fair value through profit and loss.

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

NOTES TO THE ACCOUNTS (continued)

29. Financial instruments (continued)

Carrying values by category as at 31 December 2018	Group (£000) Held at amortised cost: Loans and receivables	Held at amortised cost: Financial assets and liabilities at amortised cost	Available-for-sale	Held at fair value: Financial assets and liabilities	Held at fair value: Derivatives designated as fair value hedges	Held at fair value: Unmatched derivatives	Nonfinancial assets and liabilities	Total
Financial assets								
Cash in hand	-	49,819	-	-	-	-	-	49,819
Loans and advances to credit institutions	26,309	-	-	-	-	-	-	26,309
Debt securities	-	-	76,362	-	-	-	-	76,362
Derivative financial instruments	-	-	-	-	1,187	1,905	-	3,092
Loans and advances to customers	803,423	-	-	58,820	-	-	-	862,243
Other assets	-	-	-	-	-	-	18,385	18,385
	829,732	**49,819**	**76.362**	**58,820**	**1,187**	**1,905**	**18,385**	**1,036,210**
Financial liabilities								
Shares	-	784,034	-	-	-	-	-	784,034
Amounts owed to credit institutions	-	91,483	-	1,858	-	-	-	93,341
Amounts owed to other customers	-	69,278	-	-	-	-	-	69,278
Derivative financial instruments	-	-	-	-	475	22,910	-	23,385
Provisions for liabilities	-	-	-	-	-	-	167	167
Other liabilities	-	-	-	-	-	-	2,468	2,468
Subordinated liabilities	-	10,270	-	-	-	-	-	10,270
	-	**955,065**	**-**	**1,858**	**475**	**22,910**	**2,635**	**982,943**
Financial assets Carrying values by category as at 31 December 2017 (restated)								
Cash in hand	-	59,197	-	-	-	-	-	59,197
Loans and advances to credit institutions	28,722	-	-	-	-	-	-	28,722
Debt securities	-	-	66,593	-	-	-	-	66,593
Derivative financial instruments	-	-	-	-	1,009	1,808	-	2,817
Loans and advances to customers	772,430	-	-	65,905	-	-	-	838,335
Other assets	-	-	-	-	-	-	21,517	21,517
	801,152	**59,197**	**66,593**	**65,905**	**1,009**	**1,808**	**21,517**	**1,017,181**
Financial liabilities								
Shares	-	802,289	-	-	-	-	-	802,289
Amounts owed to credit institutions	-	33,879	-	1,827	-	-	-	35,706
Amounts owed to other customers	-	85,833	-	-	-	-	-	85,833
Derivative financial instruments	-	-	-	-	1,254	26,058	-	27,312
Provisions for liabilities	-	-	-	-	-	-	248	248
Other liabilities	-	-	-	-	-	-	3,346	3,346
Subordinated liabilities	-	10,268	-	-	-	-	-	10,268
	-	**932,269**	**-**	**1,827**	**1,254**	**26,058**	**3,594**	**965,002**

There have been no reclassifications during the year.

29. Financial instruments (continued)

	Society (£000)							
	Held at amortised cost		Held at fair value					
Carrying values by category as at 31 December 2018	Loans and receivables	Financial assets and liabilities at amortised cost	Available-for-sale	Financial assets and liabilities	Derivatives designated as fair value hedges	Unmatched derivatives	Nonfinancial assets and liabilities	Total
Financial assets								
Cash in hand	-	49,819	-	-	-	-	-	49,819
Loans and advances to credit institutions	25,939	-	-	-	-	-	-	25,939
Debt securities	-	-	76,362	-	-	-	-	76,362
Derivative financial instruments	-	-	-	-	1,187	1,905	-	3,092
Loans and advances to customers	793,373	-	-	26,648	-	-	-	820,021
Investments in subsidiary undertakings	42,471	-	-	-	-	-	-	42,471
Other assets	-	-	-	-	-	-	18,128	18,128
	861,783	**49,819**	**76,362**	**26,648**	**1,187**	**1,905**	**18,128**	**1,035,832**
Financial liabilities								
Shares	-	784,034	-	-	-	-	-	784,034
Amounts owed to credit institutions	-	91,483	-	1,858	-	-	-	93,341
Amounts owed to other customers	-	69,278	-	-	-	-	-	69,278
Derivative financial instruments	-	-	-	-	475	22,910	-	23,385
Provisions for liabilities	-	-	-	-	-	-	167	167
Other liabilities	-	-	-	-	-	-	2,425	2,425
Subordinated liabilities	-	10,270	-	-	-	-	-	10,270
	-	**955,065**	**-**	**1,858**	**475**	**22,910**	**2,592**	**982,900**
Financial assets Carrying values by category as at 31 December 2017 (restated)								
Cash in hand	-	59,197	-	-	-	-	-	59,197
Loans and advances to credit institutions	28,146	-	-	-	-	-	-	28,146
Debt securities	-	-	66,593	-	-	-	-	66,593
Derivative financial instruments	-	-	-	-	1,009	1,808	-	2,817
Loans and advances to customers	761,382	-	-	30,109	-	-	-	791,491
Investments in subsidiary undertakings	45,657	-	-	-	-	-	-	45,657
Other assets	-	-	-	-	-	-	21,395	21,395
	835,185	**59,197**	**66,593**	**30,109**	**1,009**	**1,808**	**21,395**	**1,015,296**

NOTES TO THE ACCOUNTS (continued)

29. Financial instruments (continued)

Carrying values by category as at 31 December 2018	Society (£000) Held at amortised cost: Loans and receivables	Held at amortised cost: Financial assets and liabilities at amortised cost	Held at fair value: Available-for-sale	Held at fair value: Financial assets and liabilities	Held at fair value: Derivatives designated as fair value hedges	Held at fair value: Unmatched derivatives	Nonfinancial assets and liabilities	Total
Financial liabilities								
Shares	-	802,289	-	-	-	-	-	802,289
Amounts owed to credit institutions	-	33,879	-	1,827	-	-	-	35,706
Amounts owed to other customers	-	85,833	-	-	-	-	-	85,833
Derivative financial instruments	-	-	-	-	1,254	26,058	-	27,312
Provisions for liabilities	-	-	-	-	-	-	248	248
Other liabilities	-	-	-	-	-	-	3,346	3,346
Subordinated liabilities	-	10,268	-	-	-	-	-	10,268
	-	**932,269**	**-**	**1,827**	**1,254**	**26,058**	**3,594**	**965,002**

There have been no reclassifications during the year.

Fair value hierarchy classification

Valuation techniques

The following is a description of the determination of fair value for financial instruments which are accounted for at fair value using valuation techniques. The fair value hierarchy set out in FRS102 splits the source of input when deriving fair values into three levels, as follows:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2 – inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly

Level 3 – inputs for the asset or liability that are not based on observable market data

The main valuation techniques employed by the Group to establish fair value of the financial instruments disclosed above are set out below:

Debt securities

Level 1 – Market prices have been used to determine the fair value of listed debt securities.

Loans fully secured on residential property

Level 3 – included within Loans and advances to customers is the Group's portfolio of equity release mortgages which are accounted for at fair value and is calculated using an internal variant of the Black Scholes option pricing model. The key assumptions used as part of the valuation calculation include:

Mortality or Entry into Long Term Care

This is based on the expected death or entry into long term care of the customer or longest surviving customer for a joint borrowing. Mortality assumptions have been adjusted with reference to the CMI 2017 mortality improvement projection model from the S2XPA base tables.

Early Repayments

There is limited market information around these assumptions and therefore they have been derived from the Group's own experience of the product.

Discount Rate

The discount rate applied to the mortgage cash flows is determined using a long term interest rate, derived from quoted interest rates using generally observable market data in similar time bandings to match the expected cash flows of the mortgages, together with an adjustment to reflect the cost of funding, illiquidity and other risks. Any variables not explicitly modelled are also captured within these other risks. The discount rate used at 31 December 2018 was 3.11% (2017: 2.76%). The Group has determined, based on observable market rates that the discount rate has a range between 3.05% and 5.33% given the characteristics of the lifetime mortgage portfolio.

No-Negative Equity Guarantee (NNEG)

The key assumptions used to derive the value of the no-negative equity guarantee include house price inflation and volatility. The Group uses a variant of the Black-Scholes options pricing model. House price inflation is derived by reference to historical HPI data with an under-performance assumption. The property growth and volatility assumed at 31 December 2018 were 4% and 10% respectively. The value of the no-negative equity guarantee as at 31 December 2018 was £3.5m (2017: £0.6m).

Interest rate swaps

Level 2 – Except for the swap hedging the Group's portfolio of equity release mortgages, the valuation of interest rate swaps is also based on the 'present value' method. Expected interest cash flows are discounted using the prevailing SONIA yield curves. The SONIA yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the interest cash flows and maturities of the instruments. All swaps are collateralised and therefore no adjustment is required for credit risk in the fair value of derivatives.

Level 3 – A counterparty valuation is used for the swap hedging the group's portfolio of equity release mortgages, derived from their internal modelling techniques. The Society corroborates the counterparty valuations provided through its own internal calculations.

29. Financial instruments (continued)

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

As at 31 December 2018	(£000)			
Financial assets	Level 1	Level 2	Level 3	Total
Debt securities	76,362	-	-	76,362
Loans fully secured on residential property	-	-	58,820	58,820
Derivative financial instruments	-	3,092	-	3,092
	76,362	**3,092**	**58,820**	**138,274**
Financial liabilities				
Amounts owed to credit institutions	-	1,858	-	1,858
Derivative financial instruments	-	475	22,910	23,385
	-	**2,333**	**22,910**	**25,243**

As at 31 December 2017	(£000)			
Financial assets	Level 1	Level 2	Level 3	Total
Debt securities	66,593	-	-	66,593
Loans fully secured on residential property	-	-	65,905	65,905
Derivative financial instruments	-	2,817	-	2,817
	66,593	**2,817**	**65,905**	**135,315**
Financial liabilities				
Amounts owed to credit institutions	-	1,872	-	1,872
Derivative financial instruments	-	1,254	26,058	27,312
	-	**3,126**	**26,058**	**29,184**

Amounts stated are for Group and Society except for loans fully secured on residential property which includes £32,171,583 (2017:£35,795,243) held within the Society's subsidiary Crocus Home Loans.

NOTES TO THE ACCOUNTS (continued)

Reconciliation of opening and closing balances of Level 3 assets:	**2018** (£000)	**Restated 2017** (£000)
At 1 January	**65,905**	71,289
Amounts taken to income statement		
- Interest rolled up	**2,634**	2,753
- Fair value losses	**(5,872)**	(2,058)
Redemptions	**(3,847)**	(6,079)
At 31 December	**58,820**	65,905

Changes to the assumptions used to determine fair value of level 3 assets could give rise to significant valuation changes. The table below shows the range of values used for those significant inputs together with an estimate of the impact on profit before tax arising from changing the assumptions from those used at 31 December 2018.

Sensitivity Analysis
Changes to the assumptions used to determine fair value of lifetime mortgage assets could give rise to valuation changes.

The table below demonstrates the sensitivity to changes in assumptions as at 31 December 2018 with an estimate of the impact on profit before tax.

Input	Sensitivity		Profit Impact	
Discount rate	-0.25%	+0.25%	+£2.0m	(£1.9m)
HPI Growth	+0.5%	-0.5%	+£0.9m	(£1.0m)
HPI Volatility	-1.0%	+1.0%	+£0.6m	(£0.6m)
Collateral Values	-5.0%	+5.0%	+£0.5m	(£0.6m)

The analysis has been prepared for a change in each variable with other assumptions remaining constant. In reality, such an occurrence is unlikely due to correlation between the assumptions and other factors. It should also be note that these sensitivities are non-linear and larger or smaller impacts cannot be precisely interpolated or extrapolated from these results. The sensitivity factors take into consideration that the Group's assets and liabilities are actively managed and may vary at the time that any actual market movement occurs. In addition, the Society has an interest rate swap that protects the Society against the interest rate risk presented by the portfolio which will mitigate some of the sensitivities to movements in interest rates disclosed above.

Credit Risk

Credit risk refers to the potential risk that arises from customers (or counterparties) failing to meet their obligations as they fall due. Credit risk arises primarily from loans to our retail customers, loans to our commercial mortgage customers and from liquid assets. The Credit Committee is responsible for reviewing the Group's lending policy and monitoring the exposures in accordance with this policy, including exposures to individual counterparties and sector concentration. The Credit Committee recommends lending policy for approval by the Board Credit Committee. ALCO is responsible for recommending limits on treasury counterparties, country exposures and types of financial instruments for approval by the Board Credit Committee. The Group's maximum credit risk exposure is shown below:

	2018 (£000)		**Restated 2017** (£000)	
	Group	Society	Group	Society
Cash in hand	49,819	49,819	59,197	59,197
Loans and advances to credit institutions	26,309	25,939	28,722	28,146
Debt securities	76,362	76,362	66,593	66,593
Derivative financial instruments	3,092	3,092	2,817	2,817
Loans and advances to customers	862,243	820,021	838,335	791,491
	1,017,825	**975,233**	**995,664**	**948,244**
Lending commitments (off balance sheet)	41,196	41,196	55,443	55,443
Maximum credit exposure	**1,059,021**	**1,016,429**	**1,051,107**	**1,003,687**

Loans and advances to credit institutions and Debt securities

ALCO is responsible for recommending limits that the Board approves by sector, country, instrument type and individual counterparty. Compliance against these limits is monitored daily by the Society's Treasury team and reviewed monthly by ALCO. Changes to counterparties or individual limits are made by ALCO according to strict criteria and ratified by the Board. Any changes in the credit risk ratings of counterparties are reported at ALCO and action taken where appropriate.

The Group's treasury asset concentration is shown in the table below:	**2018** (£000)	**Restated 2017** (£000)
Central banks	26,309	28,429
Multinational development banks	33,155	38,776
Central Government	43,207	28,110
Other	-	-
	102,671	**95,315**

Concentration by credit grading	**2018** (£000)	**2017** (£000)
AAA	33,156	28,429
AA	65,805	38,776
A	3,710	28,110
Unrated	-	-
Total	**102,671**	**95,315**

NOTES TO THE ACCOUNTS (continued)

29. Financial instruments (continued)

Loans and advances to customers The table below shows information on the Group's loans and advances to customers by geographical concentration:	**2018** %	**2017** %
Greater London	30	30
South East	31	31
South West	9	9
East Anglia	5	5
West Midlands	5	5
East Midlands	5	5
North West	6	6
Yorkshire & Humberside	5	5
Wales	2	2
North	2	2

The following table analyses the loan to value (LTV) of the mortgage portfolio	**2018** %	**2017** %
0% - 50%	39	39
50.01% - 75%	41	40
75.01% - 80%	6	8
80.01% - 85%	3	3
85.01% - 90%	5	4
90.01% -95%	4	4
>95%	2	2

29. Financial instruments (continued)

Not impaired	2018 (£000)	2017 (£000)
Neither past due nor impaired	833,079	811,997
Up to three months overdue but not impaired	18,245	15,763
Over three months but not impaired	3,887	3,254
Possessions / receiver of rents	161	386
Impaired		
Up to three months overdue	-	-
Between three and six months overdue	-	-
Between six and twelve months overdue	-	-
Possessions / receiver of rents	6,871	6,935
	862,243	**838,335**

Value of collateral held: Indexed	2018 (£000)	2017 (£000)
Neither past due nor impaired	1,908,069	1,887,771
Either past due or impaired	39,373	53,400
	1,947,442	**1,941,171**

Forbearance

Forbearance is where the Group enters into an arrangement with a borrower(s) when they have financial or other difficulties in meeting their obligations under the terms of their mortgage. Where appropriate for customers' needs, the Group applies a policy of forbearance and may grant a concession to borrowers. This may be applied where actual or apparent financial stress of the customer is deemed short term with a potential to be recovered. Incurred losses on forbearance cases are covered by existing provisions. The Group will always try to work with borrowers to achieve the best outcome for both parties in these circumstances and to this end its policy on forbearance has three basic principles:

- the borrower's best interests and establishing a payment plan with the borrower which is practical in the terms of the borrower's circumstances and their ability to pay but which meets the needs of both parties;
- that the Group will continue to work with the borrower to bring the mortgage back onto sustainable terms within a time frame appropriate to their circumstances; and
- the Group will only initiate repossession proceedings when all other reasonable attempts to resolve the problem have failed.

The principal forbearance tools used are interest-only concessions and arrangements to repay arrears over a period which is practical in terms of the circumstances of the borrower. The majority of borrowers who require assistance are aided by one or other of these methods. The table below gives details of the loans subject to interest-only concessions and arrangements at 31 December 2018.

NOTES TO THE ACCOUNTS (continued)

29. Financial instruments (continued)

	Interest only		Arrangements	
2018	Account balances £000	Number of accounts	Account balances £000	Number of accounts
Society	143	1	2,183	18
Crocus Home Loans	42	1	671	5
Group total	**185**	**2**	**2,854**	**23**
2017				
Society	175	2	1,643	12
Crocus Home Loans	-	-	489	4
Group total	**175**	**2**	**2,132**	**16**

Other forbearance measures offered by the Group include a change to the date of payment each month, payment holidays, permanent change to mortgage type, mortgage term extensions and capitalisation of mortgage arrears. Capitalisation of mortgage arrears is only offered where all other forbearance options have been exhausted and only when it is the right option for the customer. The Group policy, after obtaining the customer's consent, is to capitalise arrears once the customer has made at least six consecutive contractual monthly mortgage repayments following the instance of non-payment. The types of forbearance offered during the year are detailed below:

	2018	2017
	Number of accounts	Number of accounts
Capitalisations		-
Payment holidays	6	-
Mortgage term extensions	1	-
Interest rate concessions	1	1
	8	**1**

During the year ended 31 December 2018, no new properties were taken into possession by the Society (2017: nil) or by Crocus Home Loans (2017: nil).

At the end of 2018 the Society had 11 properties in possession (10 of which where the Group is a Receiver of Rents)

These represent capital balances of £1.4m which is 0.2% of the total Society book (2017:0.2%).

The Group also engages a Receiver of Rents to manage properties on behalf of the customer, where the customer is unable to do so effectively. Where this occurs, interest concessions might be applied, including interest waivers.

At the end of 2018 the Group was a Receiver of Rents on 15 properties (2017:17) representing capital balances of £7.0m (2017:£7.2m), which is 0.8% of the total Group book (2017: 0.9%). Of these properties 11 were also in possession (2017: 11), included in the values for possession cases specified above, representing capital balances of £1.4m (2017:£1.6m). This portfolio of Receiver of Rent portfolios is reviewed on an ongoing basis to ensure that potential losses to the Society are managed and mitigated. Notwithstanding the active management of the portfolio, at 31 December 2018 provisions of £3.9m were maintained (2017:£3.9m).

29. Financial instruments (continued)

Liquidity Risk

The Group's liquidity policy is to maintain sufficient assets in liquid form at all times to ensure that the Group can meet all its liabilities as they fall due and also meet all regulatory liquidity requirements.

The Group manages this risk on a continuous basis through ALCO and by ensuring compliance with the Liquidity and Financial Risk Management Policies approved by the Board. In practice this results in the Group holding a significant amount of highly liquid assets, mainly UK gilts, Treasury bills, multilateral development bank securities and deposits with the Bank of England, which are eligible to meet its required liquidity buffer set by the regulator. The Society also holds a separate pool of such assets for use as collateral with derivative counterparties.

In addition the Group maintains deposits placed on call or overnight with the Bank of England and major banks to meet its operational needs without drawing on its buffer requirements.

The table below analyses the Group's assets and liabilities into relevant maturity groupings, based on the remaining period to contractual maturity at the statement of financial position date. This is not representative of the Group's management of liquidity. Loans and advances to customers rarely run their full course. The actual repayment profile is likely to be significantly different from that shown in the analysis. For example most mortgages have a contractual maturity of around 25 years but are generally repaid much sooner. Conversely, retail deposits repayable on demand generally remain on balance sheet much longer.

	Group residual maturity as at 31 December 2018 (£000)					
Financial assets	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Total
Cash in hand	49,819	-	-	-	-	49,819
Loans and advances to credit institutions	25,575	734	-	-	-	26,309
Debt securities	-	6,705	38,488	22,590	8,579	76,362
	75,394	7,439	38,488	22,590	8,579	152,490
Derivative financial instruments	-	1,106	843	1,143	-	3,092
Loans and advances to customers	-	5,988	10,332	168,574	677,349	862,243
Other assets	2,680	1,313	827	8,312	5,253	18,385
	78,074	**15,846**	**50,490**	**200,619**	**691,181**	**1,036,210**
Financial liabilities and reserves						
Shares	572,111	45,376	124,747	41,800	-	784,034
Amounts owed to credit institutions	-	22,219	26,121	45,001	-	93,341
Amounts owed to other customers	68,458	37	733	50	-	69,278
Derivative financial instruments	-	4	245	155	22,981	23,385
Provisions for liabilities	-	-	-	-	167	167
Other liabilities	-	1,694	165	-	609	2,468
Subordinated liabilities	-	270	-	-	10,000	10,270
Reserves	-	-	-	-	53,267	53,267
	640,569	**69,600**	**152,011**	**87,006**	**87,024**	**1,036,210**
Net liquidity gap	**(562,495)**	**(53,754)**	**(101,521)**	**113,613**	**604,157**	**-**

NOTES TO THE ACCOUNTS (continued)

29. Financial instruments (continued)

Financial assets	Group residual maturity as at 31 December 2017 (£000) (Restated)					
	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Total
Cash in hand	59,197	-	-	-	-	59,197
Loans and advances to credit institutions	28,269	453	-	-	-	28,722
Debt securities	-	5,066	35,742	16,892	8,893	66,593
	87,466	**5,519**	**35,742**	**16,892**	**8,893**	**154,512**
Derivative financial instruments	-	83	323	2,263	148	2,817
Loans and advances to customers	-	11,584	25,166	128,938	672,647	838,335
Other assets	-	1,118	783	4,066	15,550	21,517
	87,466	**18,304**	**62,014**	**152,159**	**697,238**	**1,017,181**
Financial liabilities and reserves						
Shares	593,907	30,672	151,235	26,475	-	802,289
Amounts owed to credit institutions	2,260	9,067	8,084	16,295	-	35,706
Amounts owed to other customers	85,547	61	189	36	-	85,833
Derivative financial instruments	-	17	127	1,193	25,975	27,312
Provisions for liabilities	-	-	115	-	133	248
Other liabilities	-	2,319	165	-	862	3,346
Subordinated liabilities	-	268	-	-	10,000	10,268
Reserves	-	-	-	-	52,179	52,179
	681,714	**42,404**	**159,915**	**43,999**	**89,149**	**1,017,181**
Net liquidity gap	**(594,248)**	**(24,100)**	**(97,901)**	**108,160**	**608,089**	**-**

29. Financial instruments (continued)

The following is an analysis of gross contractual cash flows payable under financial liabilities:

	Group & Society as at 31 December 2018 (£000)					
	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Total
Shares	571,200	46,311	126,111	43,000	-	786,622
Amounts owed to credit institutions	-	21,562	24,905	46,169	-	92,636
Amounts owed to other customers	65,162	39	742	52	-	65,995
Derivative financial instruments	-	233	1,032	5,308	18,844	25,417
Subordinated liabilities	-	319	313	2,528	12,847	16,007
Total liabilities	**636,362**	**68,464**	**153,103**	**97,057**	**31,691**	**986,677**

	Group & Society as at 31 December 2017 (£000)					
Shares	592,127	30,996	153,429	27,953	-	804,505
Amounts owed to credit institutions	2,260	9,076	8,206	15,707	-	35,249
Amounts owed to other customers	85,545	61	192	38	-	85,836
Derivative financial instruments	-	814	1,964	7,105	21,535	31,418
Subordinated liabilities	-	319	313	2,528	13,479	16,639
Total liabilities	**679,932**	**41,266**	**164,104**	**53,331**	**35,014**	**973,647**

The analysis of gross contractual cash flows differs from the analysis of residual maturity due to the inclusion of interest accrued at current rates, for the average period until maturity on the amounts outstanding at the statement of financial position date.

Market Risk

Market risk is the risk of changes to the Society's financial condition caused by market interest rates or early redemption of assets. The Society is exposed to market risk in the form of changes (or potential changes) in the general level of interest rates, changes in the relationship between short and long-term interest rates and divergence of interest rates for different balance sheet elements (basis risk). The Society has adopted the 'Matched' approach to interest rate risk, as defined by the PRA, which aims to undertake the hedging of individual transactions within an overall strategy for structural hedging, based on a detailed analysis of the statement of financial position.

The management of interest rate risk is based on a full statement of financial position gap analysis. The statement of financial position is subjected to a stress test of a 2% rise in interest rates on a weekly basis and the results are reported to the monthly ALCO meeting. In addition management reviews interest rate basis risk, including under stressed scenarios. Both sets of results are measured against the risk appetite for market risk which is currently set at a maximum of 4% of capital. These are in turn reviewed monthly by the ALCO and reported to the RACCC.

NOTES TO THE ACCOUNTS (continued)

29. Financial instruments (continued)

The table below summarises the Group's exposure to interest rate risk. Included in the table are Group assets and liabilities, including derivative financial instruments which are principally used to reduce exposure to interest rate risk, categorised by repricing date.

	As at 31 December 2018 (£000)					
Financial assets	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Non-interest bearing	Total
Cash in hand	49,819	-	-	-	-	49,819
Loans and advances to credit institutions	25,575	734	-	-	-	26,309
Debt securities	12,672	38,467	16,569	8,654	-	76,362
Derivative financial instruments	-	-	-	-	3,092	3,092
Loans and advances to customers	484,083	57,266	250,831	51,703	18,360	862,243
Other assets	-	-	-	-	18,385	18,385
Total Financial assets	**572,149**	**96,467**	**267,400**	**60,357**	**39,837**	**1,036,210**
Financial liabilities and reserves						
Shares	616,228	125,951	41,855	-	-	784,034
Amounts owed to credit institutions	64,849	27,487	1,005	-	-	93,341
Amounts owed to other customers	69,278	-	-	-	-	69,278
Derivative financial instruments	-	-	-	-	23,385	23,385
Provisions for liabilities	-	-	-	-	167	167
Other liabilities	-	-	-	-	2,468	2,468
Subordinated liabilities	-	-	-	10,000	270	10,270
Reserves	-	-	-	-	53,267	53,267
Total Financial liabilities and reserves	**750,355**	**153,438**	**42,860**	**10,000**	**79,557**	**1,036,210**
Impact of derivative instruments	280,082	(37,404)	(192,235)	(50,443)	-	-
Interest rate sensitivity gap	**101,876**	**(94,375)**	**32,305**	**(86)**	**(39,720)**	**-**
Sensitivity to profit and reserves:						
Parallel shift of + 1%	(293)	531	(1,034)	111	-	(685)
Parallel shift of + 2%	(585)	1,063	(2,067)	221	-	(1,368)

29. Financial instruments (continued)

	As at 31 December 2017 (£000) (restated)					
Financial assets	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Non-interest bearing	Total
Cash in hand	59,197	-	-	-	-	59,197
Loans and advances to credit institutions	28,269	453	-	-	-	28,722
Debt securities	5,076	35,769	16,926	8,822	-	66,593
Derivative financial instruments	-	-	-	-	2,817	2,817
Loans and advances to customers	517,812	22,978	211,054	63,223	23,268	838,335
Other assets	-	-	-	-	21,517	21,517
Total Financial assets	**610,354**	**59,200**	**227,980**	**72,045**	**47,602**	**1,017,181**
Financial liabilities and reserves						
Shares	624,179	151,420	26,510	-	180	802,289
Amounts owed to credit institutions	10,852	13,149	10,000	-	1,705	35,706
Amounts owed to other customers	85,833	-	-	-	-	85,833
Derivative financial instruments	-	-	-	-	27,312	27,312
Provisions for liabilities	-	-	-	-	248	248
Other liabilities	-	-	-	-	3,346	3,346
Subordinated liabilities	-	-	-	10,000	268	10,268
Reserves	-	-	-	-	52,179	52,179
Total Financial liabilities and reserves	**720,864**	**164,569**	**36,510**	**10,000**	**85,238**	**1,017,181**
Impact of derivative instruments	218,910	(557)	(152,700)	(65,653)	-	-
Interest rate sensitivity gap	**108,400**	**(105,926)**	**38,770**	**(3,608)**	**(37,636)**	**-**
Sensitivity to profit and reserves:						
Parallel shift of + 1%	(293)	565	(799)	226	-	(301)
Parallel shift of + 2%	(586)	1,130	(1,598)	453	-	(601)

At 31 December 2018, the Group had an interest rate swap with a notional value of £41.1m (2017:£42.2m) designed to protect the Society against the interest rate risk presented by its equity release mortgages. This swap is structured within upper and lower bands and is designed to reflect the projected balances of the portfolio contained, incorporating underlying assumptions on property values and prepayments and actuarial assessments on mortality.

All financial assets and liabilities are presented on a gross basis in the statement of financial position as the Society does not have both an enforceable right to set off and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

The Society has entered into Credit Support Annexes (CSAs) for its derivative instruments which typically provide for the exchange of collateral on a daily basis to mitigate net mark to market credit exposure.

NOTES TO THE ACCOUNTS (continued)

29. Financial instruments (continued)

The following table shows the impact on derivative financial instruments and repurchase agreements after collateral:

	(£000)		
2018 Financial assets	Gross amounts*	Financial collateral**	Net amounts
- Derivative financial instruments	3,092	(1,900)	1,192
Total Financial assets	**3,092**	**(1,900)**	**1,192**
Financial liabilities			
- Derivative financial instruments	23,385	(24,840)	(1,455)
Total Financial assets	**23,385**	**(24,840)**	**(1,455)**
2017 Financial assets			
- Derivative financial instruments	2,817	(2,260)	557
Total Financial assets	**2,817**	**(2,260)**	**557**
Financial liabilities			
- Derivative financial instruments	27,312	(26,335)	977
Total Financial assets	**27,312**	**(26,355)**	**977**

*As reported in the Statement of financial position.
** Financial collateral disclosed is limited to the amount of the related financial asset and liability.

30. Capital

The Board's policy is to continue to grow its capital base to further strengthen the confidence Members and other stakeholders have in the Society as well as support future growth. The Group's capital requirements are set and monitored by the Prudential Regulatory Authority (PRA) in the form of Internal Capital Guidance (ICG). The Society operates a formal Internal Capital Adequacy Assessment Process (ICAAP) to determine and demonstrate how these requirements are met. The ICAAP also sets out the framework for the Society's internal governance and oversight of its risk and capital management policies and is used to assist with the management of capital and risk exposures. The Society's actual and forecasted capital positions are reviewed against a risk appetite that requires capital to be maintained at a specific minimum level above the agreed ICG. There were no reported breaches of capital requirements during the year. There have been no material changes to the Society's management of capital in the year.

The table below reconciles the Group's reserves to its total capital position:	Notes	**2018** (£000)	**2017** (£000) (restated)
General reserves		53,010	51,764
Available for sale reserve	24	(123)	35
Revaluation reserve	25	380	380
Pension fund adjustments[1]		(76)	(207)
Prudent valuation adjustment		(161)	(138)
Deductions for intangible assets[2]	17	(8,230)	(10,020)
Total Common Equity Tier 1 Capital		**44,800**	**41,814**
Collective impairment losses	13	389	374
Subordinated liabilities	22	10,000	10,000
Total Tier 2 Capital		**10,389**	**10,374**
Total regulatory capital		55,189	52,188
Risk weighted assets (UNAUDITED)		384,436	373,504
Capital ratios (UNAUDITED)			
Common equity tier 1 ratio		11.7%	11.2%
Total capital ratio		14.4%	14.0%
Leverage ratio		4.3%	4.1%

Notes:

(1) Amounts restated for the correction of the prior period error set out in Note 1c to the Accounts.

(2) CRD IV does not permit a pension fund deficit to be added back to regulatory capital but requires a surplus, net of any deferred tax liabilities, to be deducted from Tier 1 capital.

(3) CRD IV regulations requires intangible fixed assets, net of any deferred tax liabilities, to be deducted from Tier 1 capital.

A detailed analysis of the Group's capital position and disclosures is provided in the Group's Pillar 3 Disclosures for 2017 which are available on our website.

NOTES TO THE ACCOUNTS (continued)

31. Related party transactions

a) Subsidiary, parent and ultimate controlling party

The Group is controlled by the Saffron Building Society, the ultimate parent and ultimate controlling party, which is registered in England and Wales. Note 14 contains details of subsidiary undertakings and of any loans to subsidiary undertakings.

b) Key management compensation

The Directors of the Society are considered to be the Key Management Personnel, as defined by FRS102.

Total compensation for key management personnel for the year ended 31 December 2018 was £888,000. (2017: £874,000). Further information on compensation for key management personnel can be found in Note 8 and in the Directors' Remuneration Report.

c) Transactions between key management personnel and their connected persons

	2018		2017	
Shares and deposits	Number of key management personnel	Amounts £000	Number of key management personnel	Amounts £000
Balance at 1 January	9	96	11	155
Net movements in the year	-	(29)	(2)	(59)
Balance at 31 December	9	67	9	96

	2018		2017	
	Number of connected persons	Amounts £000	Number of connected persons	Amounts £000
Balance at 1 January	1	-	2	11
Net movements in the year	-	-	(1)	(11)
Balance at 31 December	1	-	1	-

Amounts deposited by key management personnel and their connected persons earn interest at the same commercial rates and terms and conditions as applicable to all other employees and Members of the Society.

d) Directors' loans and transactions

At 31 December 2018, there were no outstanding mortgage loans granted in the ordinary course of business to Directors and their connected persons.

32. Country-by-country reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 introduced reporting obligations for institutions within the scope of the European Union's Capital Requirements Directive (CRD IV).

Article 89 of CRD IV requires credit institutions and investment firms in the EU to disclose annually, specifying, by Member State and by third country in which it has an establishment, the following information on a consolidated basis for the year ended 31 December 2018:

Name, nature of activities and geographical location:

The Society has five subsidiaries and operates only in the United Kingdom. The Society is a Credit institution whose principal activities are deposit taking and mortgage lending

Total number of employees: The total number of employees of the Society at December 2018 was 178.

Annual turnover: Equivalent to total net income and, along with profit before tax, is as disclosed in the income statement on page 50.

Corporation tax paid: As disclosed in the cash flow statement on page 50

Public subsidies: There were none received in the year

ANNUAL BUSINESS STATEMENT

for the year ended 31 December 2018

1. Statutory percentages	Ratio at 31 December 2018	Statutory limit
	%	%
Lending limit	1.3	25
Funding limit	17.2	50

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986.

The lending limit measures the proportion of business assets other than in the form of loans fully secured on residential property. Business assets are the Total assets of the Group plus Impairment losses on loans and advances less Liquid assets, Investment properties, Property, plant and equipment and Intangible assets.

The funding limit measures the proportion of shares, deposits and debt securities not in the form of shares held by individuals.

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

2. Other percentages	Ratio at 31 December 2018	Ratio at 31 December 2017
	%	%
As a percentage of shares and borrowings:		
Gross capital	6.7	6.7
Free capital	5.0	4.8
Liquid assets	16.1	16.7
As a percentage of mean total assets:		
Profit after taxation	0.12	0.40
Management expenses	1.62	1.57

The above percentages have been prepared from the Group accounts:

'Shares and borrowings' represent the total of Shares, Amounts owed to credit institutions and Amounts owed to other customers, in each case including accrued interest and fair value adjustments.

'Gross capital' represents the aggregate of General reserves, Available for sale reserve, Revaluation reserve and Subordinated liabilities.

'Free capital' represents the aggregate of Gross capital and collective impairment losses on loans and advances less Investment properties, Property, plant and equipment and Intangible assets.

'Liquid assets' represent the total of Cash in hand and balances with the Bank of England, Loans and advances to credit institutions and Debt securities.

'Mean total assets' represent the average of Total assets at the beginning and the end of he financial year.

'Management expenses' represent the sum of Administrative expenses plus Depreciation and amortisation shown in the Income statement.

ANNUAL BUSINESS STATEMENT

for the year ended 31 December 2018

3. Information relating to the Directors and other officers as at 31 December 2018

Name of Director	Date of Birth	Date of Appointment	Occupation	Other Directorships
Jenny Ashmore	16.1.1971	19.5.2015	Director	Crocus Home Loans Limited The Challenge Network Commonwealth Games England Jazz-works Limited Fitness Over Fifty Limited AHI Group Limited
T Gary Barr	22.11.1962	10.04.2014	Director	Crocus Home Loans Limited IT Range Limited Cambridge Rugby Union Football Club Limited
Geoffrey R Dunn	10.07.1949	26.05.2011	Director	Crocus Home Loans Ltd
Colin H Field	24.11.1973	1.05.2014	Chief Executive Officer	Crocus Home Loans Ltd
Darren L Garner	29.9.1971	14.9.2015	Chief Financial Officer	Crocus Home Loans Ltd
Sarah A Howe	28.05.1965	1.05.14 Resigned 19.11.2018	Chief Customer Officer	Crocus Home Loans Limited Resigned 19.11.2018
Neil J Holden	7.12.1959	27.03.2014	Director	Crocus Home Loans Limited IntegraFin Holdings plc Integrated Financial Arrangements Limited Integralife UK Limited Stanbic International Insurance Limited AlbaCo Limited Sberbank CIB (UK) Limited
Liz Kelly	14.8.1965	19.5.2015	Director	Crocus Home Loans Limited MHS (Holdings) Limited St James's Place Corporate Secretary Limited Cirenco Limited SJPC Corporate Investments Limited St James's Place International Assurance Limited Willsher Consulting Limited
Nick J Treble	24.08.1959	27.03.2014	Director	Crocus Home Loans Limited Batesons Consulting Limited Eskmuir Group: Eskmuir Properties Limited Eskmuir Investments Limited Eskmuir Securities Limited Eskmuir (Thayer Street 1) Limited Eskmuir (Thayer Street 2) Limited Bank Leumi (UK) plc Trustee – Sir Kirby Laing Principal and Residual Trusts

Documents may be served on the above named Directors at the following address:
Saffron Building Society, Saffron House, 1a Market Street, Saffron Walden, CB10 1HX

Other Officers	Occupation
A Bush	IT Director
C Moore	Chief Risk Officer Resigned 31.12.2018

4. Directors' service contracts

As at 31 December 2018, C H Field and D L Garner had service contracts with the Society which could be terminated by either party giving six months' notice.

Saffron Building Society

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