Saffron Building Society

Always there for our Members. Since 1849

ANNUAL REPORT & ACCOUNTS 2017

CONTENTS

2017 **HIGHLIGHTS**

PROFIT AFTER TAX
£2.3M
(2016: £1.3M)

NET INTEREST MARGIN
1.84%
(2016: 1.77%)

IMPROVED CORE EQUITY TIER 1 CAPITAL
12.0%
(2016: 10.6%)

3
NATIONAL AWARDS FOR SAVINGS PRODUCTS

258
APPEARANCES IN 'BEST BUY' TABLES

SAVINGS BALANCES
£888M
(2016: £995M)

GROSS MORTGAGE ADVANCES
£146M
(2016: £170M)

NUMBER OF FIRST TIME BUYERS HELPED TO BUY THEIR FIRST PROPERTY
177

MORTGAGE BALANCES
£842M
(2016: £863M)

CHARITABLE DONATIONS OF
£13,175

DELIVERED 'ECONOMIC WELLBEING' TALKS TO 682 YEAR 6 STUDENTS ACROSS 19 SCHOOLS

OVERALL CUSTOMER SATISFACTION
93.5%
(2016: 92.9%)

CHAIRMAN'S STATEMENT

Geoffrey Dunn

Another year of significant progress for the Society and its Members.

In 2017, the Society finally entered the 21st Century, following the migration of all of our savings Members to our new banking platform, concluding the most significant period of change that the Society has carried out for many years. The new platform will provide the ability to offer all our Members an integrated approach to managing their savings accounts and their mortgages with us. Over time, this will allow Members to manage their savings or mortgage business online, or they can call our Contact Centre or they can use the tried and trusted route of using our branch network. The platform will enable the Society to achieve the aim of providing all products through all channels and with the same level of service.

This is a really important step forward in how we meet our Members' needs and here I must thank all of our staff for their fantastic and sustained efforts to get Saffron to this position. It was also a most important development, as it helps ensure that Saffron continues to remain a strong and secure place, where you can reliably place savings and arrange mortgages.

This big effort did, however, have an impact in terms of our ability to write as much business as we might have wished, as such big system changes generally require extended periods with no changes and system lockdown, whilst all the migrations are completed.

Savings and Mortgages

In 2017, despite the system changes referred to above, we have still managed to grow the number of savings accounts held with the Society. We understand that for many, the Best Buy tables published in the broadsheets are a clear endorsement of our products and services. In total we have appeared in Best Buy tables 258 times this year across mortgages and savings products. Our Children's Regular Saver has won 3 awards across the year. We have been nominated for 7 other awards, as well as achieving Moneyfacts outstanding and excellence awards. In terms of mortgage lending, we have pleasingly had a good year in lending to First Time Buyers, which we passionately support, as a mutual society that supports helping local people getting onto the housing ladder for the first time. These achievements matter to us because we believe that a good society is one that is truly customer focused, looking after both its Members' savings and also helping those wanting to finance a new home.

Saffron also ventured into a partnership with Zopa, who are a well-respected peer-to-peer unsecured loans provider. We believe that to bring new customers to the Society, this type of product offering will be important, as well as being able to offer a wider range of services to our current Members.

Interest rates

We have also been consistent in our actions when external changes have affected Members. For the first time in many years, in other words, since the financial crisis of 2008, the Bank of England decided to raise interest rates - albeit by only 0.25%. We reduced our rates when the Bank of England dropped the Base Rate in 2016 and in the vast majority of cases, we put the rates back up for our savings members, as soon as we were able, after the Bank of England Autumn 2017 announcement. The Society also decided not to increase the standard variable rate for mortgage customers.

Future Vision

As I explained above, we have now completed the migration of all of our customer accounts for mortgages and savings to our new operational platform. This means that for the first time ever, the Society is able to have a single view of all of a customer's products which will help us to improve the service delivery for our customers. Looking forward, we aim to deliver more integrated products including intergenerational solutions, offer more ways of accessing our services through multiple channels of delivery and to make the customer experience more relevant and pleasurable by anticipating more effectively what might be our customers' likely needs and how they might wish to receive such services from Saffron.

Outlook

The next twelve months or so look very challenging for the UK with considerable uncertainty over the eventual form of Brexit and the size of its impact on our economy. It's likely (but far from certain when) we shall see a further small upward movement in interest rates, which will help our Members who depend on income from their savings.

On behalf of all our Members, I would like to thank all our staff for their commitment, loyalty and hard work. It's what distinguishes a member-owned society, such as yours, from other financial services institutions.

Geoffrey Dunn, Chairman

CHIEF EXECUTIVE'S REPORT

Colin Field

I am proud of the progress that the Society has made in 2017.

For those of you who have been Members for some time, you will probably be aware that the Society has been engaged in a significant infrastructure refresh programme. The ongoing ability to adapt and change is as vital for Saffron as for every successful business, but in May we reached a huge milestone by migrating all of our customer accounts to one banking platform. This represents the culmination of a huge amount of work, which involved nearly every member of our staff.

The extent of this change work did have a direct influence on our ability to complete business as usual. Impact was felt most in our Mortgage team, where we were restricted in our ability to launch new products, which resulted in sluggish new business performance over the first half of the year.

In the second half of the year and with the platform migration behind us, new mortgage activity increased. This, combined with retention activity being better than anticipated, resulted in both the mortgage book returning to growth and the development of a healthy pipeline that has been carried into 2018.

I started my report on the subject of significant change, because it is an important factor to consider when assessing the trading and financial performance for the year. Mortgage balances reduced during the year, due to the reasons outlined above and the average yield on the mortgage book also fell (reducing by 0.29%) as a direct consequence of the competitive trading environment. Continuing our strategy to maintain margin, the Society responded to the fall in mortgage rates by reducing rates to savers, however once the Bank of England increased Bank Base Rate to 0.5%, the full margin benefit was returned to our savings Members.

We continue to strive to contain our expenses at a time when providing additional capability and delivering strong operational resilience place increasing cost demands on the Society. Omitting cost of change and charges incurred to obtain a significant research and development tax credit, the costs of running the business again fell year on year.

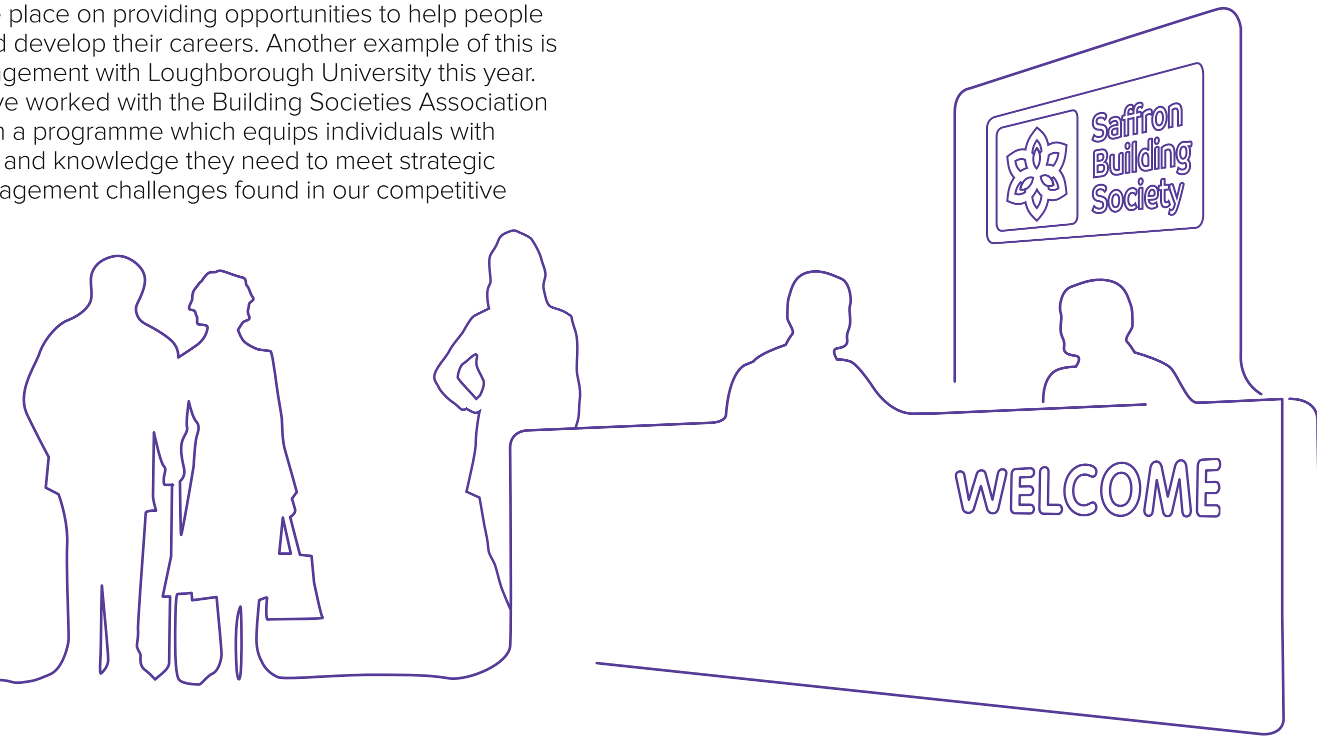
The complexity of modern accounting standards makes any comparison of underlying performance between years difficult and I would like to draw your attention to the analysis in the Strategic Report that explains all aspects of our financial performance in detail.

Financial performance is important, because it provides additional capital reserves that are vital to support the stability and growth of Saffron, in a period where regulatory capital requirements are increasing significantly. Looking beyond the headline profit number I am very satisfied with the substantial progress that has been made to strengthen this capital base, with the ratio of Core Equity Tier 1 Capital increasing to 12.0% from 10.6% in 2016. The focus on developing capital strength is essential to ensure that the Society's capital remains well in excess of regulatory capital requirements as the new requirements are phased in.

Ultimately, the outcomes that really matter are those that demonstrate that we are meeting our aims of providing great service to our Members and Customers; secure employment and development opportunity to our people and also the difference that we make to the communities in which we operate.

The feedback we receive from our Members continues to be very strong, supported by excellent customer satisfaction and Net Promotor Scores. In addition to this, we have also received recognition from a number of external bodies – winning awards for the Society's Children's Savings products.

Our people strategy continues to be both to develop and support our people, especially in challenging times - areas in which I believe we excel. For 2017, 80% of our vacancies were filled by internal applicants. This was significantly ahead of the goal we set ourselves and testament to the value we place on providing opportunities to help people grow and develop their careers. Another example of this is our engagement with Loughborough University this year. They have worked with the Building Societies Association to design a programme which equips individuals with the skills and knowledge they need to meet strategic and management challenges found in our competitive and highly regulated market. Our first two candidates on the programme are already benefiting hugely from this fantastic opportunity, as are we. Our people are the life blood of the Society and it is my aim that we stand out as an employer of choice in our communities.



I am immensely proud of the time and effort that our people contribute to community activity. For 2017, Saffron partnered with Colchester Night Shelter to provide financial information and training to help the vulnerable people that they support. The Society also continues to support good causes through its Essex Community Foundation endowment fund, where grants are decided by a panel comprised of both Saffron Members and staff. Finally, to boost the fund raising efforts of our Staff for those causes most important to them, in 2017 the Society reintroduced matched funding.

Looking forward

Whilst The Monetary Policy Committee increased Bank Base Rate to 0.5% in November the consensus view of most economic commentators is that whilst bank base rate will rise, it is likely to be steadily and over an extended period.

The economic environment remains challenging for the UK, resulting in the Office for Budget Responsibility reducing their economic growth forecast significantly. Despite unemployment being at an all-time low, UK productivity remains low in comparison to other G8 nations, a result of an extended period of low private sector investment. Whilst the most recent economic indicators released by the Office for National Statistics appear more positive, the political and economic uncertainty is likely to continue, with the agenda continuing to be dominated by Brexit. In light of the uncertainty, the Society will continue to maintain a cautious outlook.

Following another excellent year of Member service, in 2018 we will seek to maintain these levels – whether in Branch, on the phone or online. Commercially, I am optimistic that the Society will continue to grow in a controlled and balanced manner as we seek to help people to achieve their goals. Returning to the subject of change, whilst we now have a significant change milestone behind us, we have a significant amount of change to complete in 2018, driven in part by regulation but also by our continued restlessness to provide better propositions and service. Finally, I would like to thank all of our Members and staff for your continued support.

Colin Field, Chief Executive

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.

Economic environment

In the immediate period following the outcome of the EU Referendum vote, held in June 2016, a slowdown in economic growth was widely expected. This concern manifested itself in many ways including a reduction in Bank Rate to 0.25% in August 2016. The decision to leave the EU has had noticeable impact on the economy through 2017. Consumption growth has been sluggish, impacted by the squeeze on households' real income. Investment by businesses has, in contrast, demonstrated resilience supported by global growth and depreciation in sterling. CPI inflation grew steadily to peak at 3.1% in November 2017. In November 2017 the Bank of England stated some withdrawal of monetary stimulus would be appropriate to return inflation to target, resulting in the UK Bank Rate being raised to 0.5%.

The housing market slowed in the first half of 2017 however, mortgage approvals picked up later in the year and house price inflation was stronger than widely expected. Competition for mortgages was strong throughout the year, driving mortgage rates lower. Demand from first time buyers was particularly robust, as was demand for competitively priced buy-to-let mortgages, notwithstanding the impact of recent policy changes affecting landlords, most notably stricter affordability criteria, additional stamp-duty land tax and changes to interest tax relief.

Conditions remain difficult for savers with savings rates under continued pressure throughout the year, driven by a mix of competition, views on long-term interest rates and continued availability of low-cost wholesale funding, including the Bank of England's Term Funding Scheme. Coupled with the fall in mortgage rates these conditions continued to place pressure on the Society's net interest income.

The Group's business and strategy

The Society exists to help people purchase property and to provide a secure home for their savings. Our wide range of savings products include instant access, fixed-term, tax-free and regular savings as well as accounts designed especially for children's savings.

Our 'Everyday Situations' range includes a choice of competitive mortgages that are ideal for customers buying a home, wanting to get onto the property ladder or seeking a mortgage for a buy-to-let property. Our 'Special Situations' range can accommodate customers requiring something out of the ordinary: contractors or self-employed, young professionals, those renovating a property or 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. Working with our selected partners, we are able to offer financial advice, annuities, funeral planning, estate planning, inheritance tax planning and financial products. In 2017 we also partnered with Zopa to act as an introducer. Zopa are an established UK company providing personal loans at competitive rates of interest.

A summary of products offered across our network is shown below:

	Channel		
Mortgages	Phone	On-line	In branch
Residential	●		●
Buy-to-let	●		●
Self-Build	●		●
Development	●		●

	Channel		
Savings	Phone	On-line	In branch
ISAs	●		●
Deposits		●	●
Children's accounts			●

	Channel		
Other	Phone	On-line	In branch
Financial Planning			●
Unsecured Loans		●	●
Protection	●	●	●

The Group has assets of £1,020million and operates from its head office in Saffron Walden, Essex and Customer Service Centre in Little Chesterford together with eleven branches across three counties, employing 168 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.

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 2017.

A key element of the strategy is the financial stability of the Society, and in particular improving capital strength. This is achieved through the following:

- Generating capital through appropriate levels of profitability
- Effective liquidity management, arranging appropriate and sustainable funding sources
- Effective customer service
- Careful risk management, including vigilance in underwriting processes
- Investment in technology and processes
- Control of operating costs
- Strong and clear set of cultures and values throughout the Society

The Board recognise that the pursuit of some of the above strategies may have an adverse impact on other measures in the short-term. The core systems and infrastructure of the Society are critical to providing long-term value to members and to strengthening the Society's overall risk profile. This is why the Society has invested heavily in upgrading its core mortgage and savings systems and strengthening the resilience of our Information Technology to the ever-present threat from cyber-attack that all businesses face today. However, these investments are treated as immediate deductions to regulatory capital and therefore impact on reported capital ratios.

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). These are presented in the table below together with explanatory comment.

	2017	2016
Trading performance		
Gross mortgage advances	£146m	£170m
Total mortgage balances	£842.5m	£862.8m
People experience		
Engagement	69%	74%
Member experience		
Net promoter score	+57.3	+54.9
Customer satisfaction	93.5%	92.9%
Financial sustainability		
Profit before tax	£1,501k	£1,231k
Net interest margin	1.84%	1.77%
Management expenses ratio	1.56%	1.44%
Core Equity Tier 1 Ratio	12.0%	10.6%
Liquidity Coverage Ratio	151%	202%

	Strategic objective(s)	Measurement
Trading performance	To maintain sufficient quality mortgage assets to meet demand and profitability and capital targets	Financial
People experience	To make Saffron a great place to work with high levels of staff engagement, motivation and commitment	Annual survey of all employees
Member experience	To look after our members and deliver good value products and services and provide consistently good service	Results from surveys completed by customers visiting the branches or transacting online
Financial sustainability	Generate sufficient profitability to improve capital strength. Maintain appropriate levels of liquidity	Financial

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	2017	2016	2015
Net interest income	**19.6**	19.9	21.4
Other income and charges	**(1.0)**	(0.2)	(0.2)
Administrative expenses	**(13.9)**	(14.0)	(15.3)
Depreciation and amortisation	**(2.8)**	(2.2)	(1.5)
Impairment (losses)/gains	**(0.3)**	(2.1)	0.3
Other provisions	**(0.1)**	(0.2)	(0.6)
Operating profit	**1.5**	1.2	4.1
Loss on disposal of fixed assets	**-**	-	-
Profit before tax	**1.5**	1.2	4.1
Tax	**0.8**	0.1	(0.8)
Profit after tax	**2.3**	1.3	3.3

Profit after tax of £2.3million compares with £1.3million for 2016. Results for both years have been impacted by volatility caused through accounting fair value adjustments. In addition, the results for the year ended 2016 included a significant impairment charge against the Society's Receiver of Rents loans and profit on the disposal of a Treasury instrument as part of its liquidity and risk management objectives. Adjusting for the volatility created by these items shows the underlying performance of the Society.

STRATEGIC REPORT

	Group		
£millions	2017	2016	2015
Profit before tax	1.5	1.2	4.1
Treasury investment gains	(0.2)	(0.6)	(1.1)
Impairment charges/(releases)	0.3	2.1	(0.3)
Fair value adjustments	0.9	0.3	0.1
Profit before tax (adjusted)	2.5	3.0	2.8

More detailed explanation of financial performance is provided below.

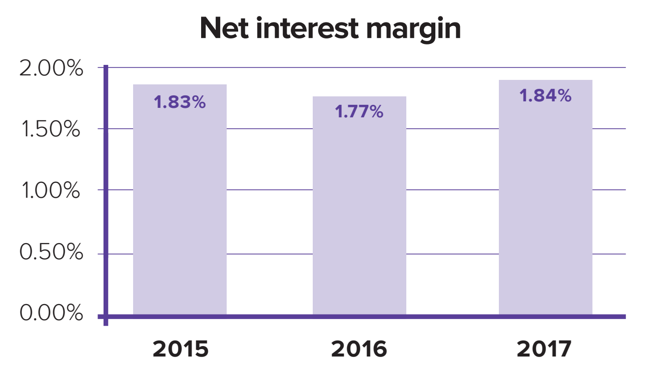
Income

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 2017 was 1.84% (2016: 1.77%).

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.



The year ended 31 December 2017 saw a continuation of downward pressure on residential mortgage rates. The Society took a balanced approach to lending in the year and deliberately chose not to compete on price at certain times during the year. Gross mortgage advances of £146million (2016: £170million), resulted in a slight reduction in overall mortgage assets from £862.8million to £842.5million. The smaller mortgage assets, coupled with downward rate pressure contributed to a fall in interest receivable to £28.1million (2016: £32.6million) which was not fully recovered through lower retail funding costs as the Society sought to protect, as far as possible, our savings Members from the continued low interest rate environment.

However, the Society was required to take actions to manage savings rates payable in order to balance savings flows with mortgage requirements. As a consequence, net interest income for the year ended 31 December 2017 reduced to £19.6million (2016: £19.9million) and includes the transfer of a £0.2million gain from reserves on disposal of treasury instruments (2016: £0.6million).

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.

Net fair value movements

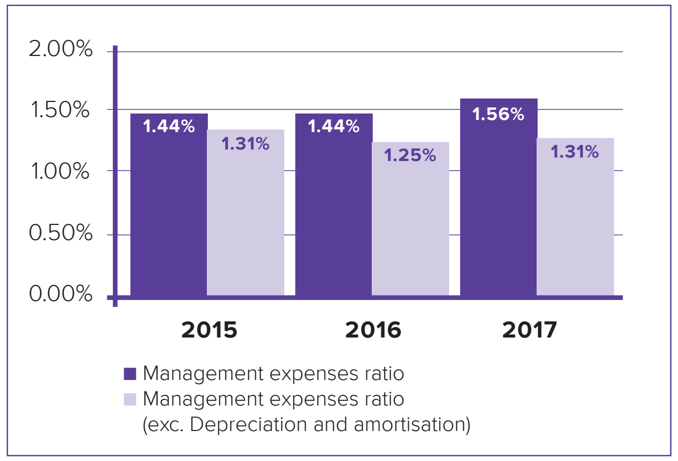
This income category comprises income from the use of derivative financial instruments (Derivatives). Derivatives are used solely for risk management purposes and are an important tool for the Society in managing exposure to changes in interest rates arising from the Group's portfolio of fixed rate mortgages and savings products. Although entirely used for managing risk, not all derivatives are in qualifying hedge accounting relationships. The net expense of £1.0million (2016: expense of £0.5million), analysed below, reflects a combination of hedge ineffectiveness, together with the aggregate of changes in the fair value of derivatives not in qualifying hedge accounting relationships and changes in the fair value of certain assets and liabilities, principally arising from further reductions in long-term interest rates and redemption activity in the Group's portfolio of equity release mortgages.

	Group	
£000	2017	2016
Net income from hedge accounting differences	60	(374)
Fair value movement in derivatives not in qualifying hedge accounting relationships	952	(6,541)
Change in fair value of assets and liabilities not in qualifying hedge accounting relationships	(2,019)	6,381
	(1,007)	(534)

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 remains a key focus for the Group as part of the wider objective to grow the Group's capital position. Administrative expenses of £13.9million compare with £14.0million in 2016. As described elsewhere in this report the Group has undertaken a programme of significant IT investment in recent years. These costs are amortised through the income statement over a period of between four and seven years and explains the increase in the charge for depreciation and amortisation from £2.1million to £2.8million. The Group's management expenses ratio expresses total group administrative expenses as a percentage of average group assets and has been shown both inclusive of and excluding depreciation and amortisation charges.



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.

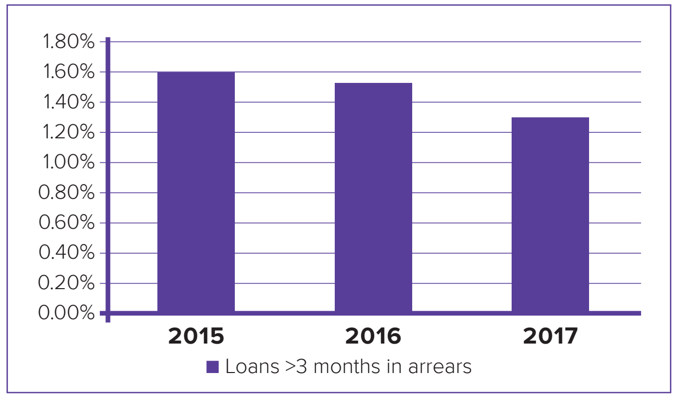
Impairment charges

	Group	
£000	2017	2016
Collective impairment charge/(release)	65	(233)
Individual impairment charge	291	2,332
	356	2,099

The Group is a Receiver of Rents on 17 properties (2016:29) representing capital balances of £7.2million (2016: £9.0million) 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. A further 12 properties were disposed of in the year ended 31 December 2017.

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 £0.3million.

The arrears ratios (number of loans >3 months in arrears) as a percentage of the total loan book has improved further to 1.29% at 31 December 2017 (2016: 1.53%).



Further information on the quality of the Group's loan portfolio, including information on loan forbearance activities can be found in Note 28 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. In 2017 the Society has recognised a charge of £0.1million in respect of the Scheme year ending March 2018. (2016: £0.2million for Scheme year ended March 2017).

Taxation

The statutory rate of corporation tax has been 20% since 1 April 2015 but was reduced to 19% with effect from 1 April 2017, giving an effective tax rate of 19.25% (2016: 20%). The Group corporation tax credit in the year of £765,000 (2016: £35,000 credit) includes adjustments for Research and Development tax credit claims and other timing differences. A reconciliation of the effective rate to the statutory rate of taxation is provided in Note 8 to the Accounts.

Overview of Statement of financial position

The Group generates new assets principally through the origination of new mortgage loans secured on residential property. The balance sheet reduced in size to £1,020million at 31 December 2017, compared with £1,115million at 31 December 2016.

STRATEGIC REPORT

	Group		
£millions	2017	2016	2015
Liquid assets	154.5	228.2	243.0
Loans and advances to customers	842.5	862.8	869.5
Fixed and other assets	22.9	23.5	20.5
Total assets	1,019.9	1,114.5	1,133.0
Shares	802.3	903.4	897.6
Borrowings	121.6	113.1	142.9
Other liabilities	30.6	35.3	30.9
Subordinated liabilities	10.3	10.3	10.3
Total liabilities	964.8	1,062.1	1,081.7
Reserves	55.1	52.4	51.3
Total liabilities and reserves	1,019.9	1,114.5	1,133.0

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.

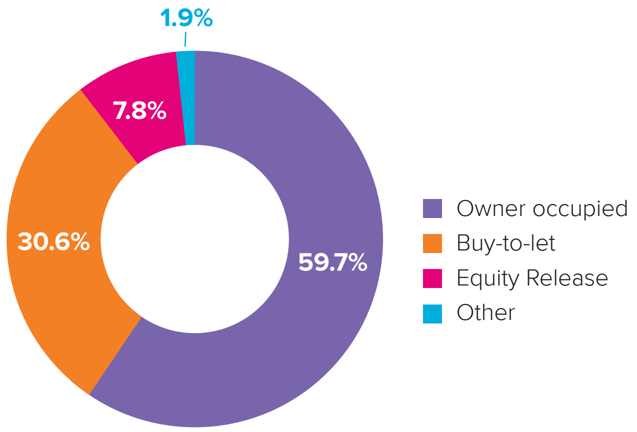
At 31 December 2017 the Group's portfolio of liquid assets totalled £153.7million (2016: £227.5million) and comprised of the following:

	Group	
£millions	2017	2016
Bank of England	58	90
UK Government debt	13	62
Other bank deposits	29	31
Non-UK Government debt	15	16
Supranational debt	39	12
Bonds and Certificates of Deposit	-	5
Other	-	11
	154	227

At 31 December 2017 the ratio of liquid assets to shares and deposits stood at 16.7% (2016: 22.4%). A key measure of liquidity under CRD IV is the Liquidity Coverage Ratio (LCR). At 31 December 2017 the Group's LCR was 151% (2016: 202%), comfortably above regulatory requirements.

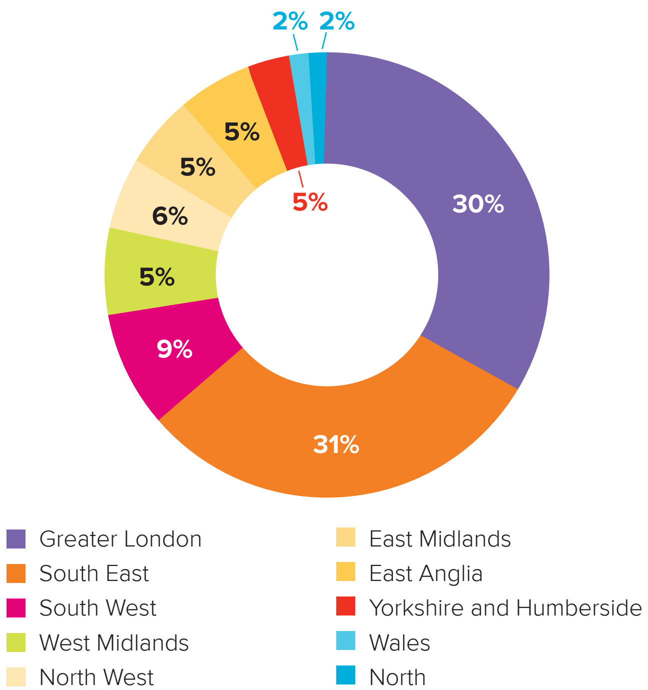
Mortgages

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.



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. Gross lending of £146million (2016: £170million) did not fully mitigate the impact of mortgage repayments, voluntary redemptions and other movements. As a result, total loans and advances to customers (net of impairment) at 31 December 2017 was £842.5million, compared with £862.8million at 31 December 2016.

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.

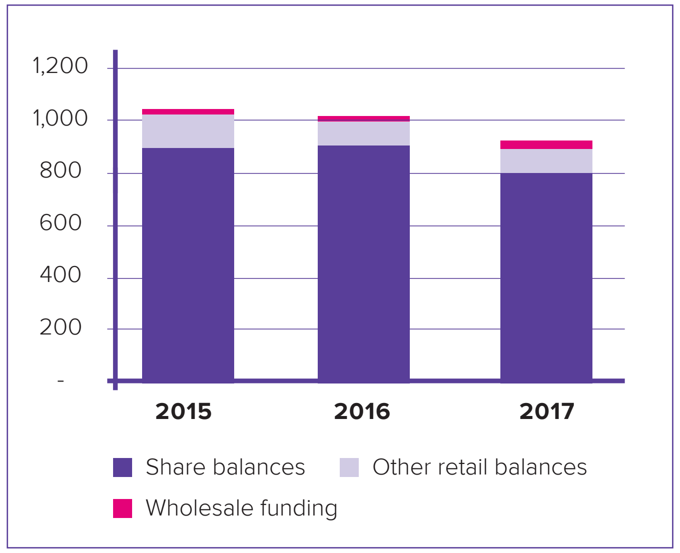


Funding the business

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

During the year ended 31 December 2017 the Society experienced a net outflow of shares and other deposit balances of almost £107million, ending the year with balances of £888.1million (2016: £995.0million). 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. The Society also has to balance the levels of retail inflows it attracts with the Society's overall liquidity position and mortgage funding requirements. Accordingly the fall in net mortgage balances, coupled with the low cost of wholesale funding accessed through the Bank of England's Sterling Monetary Framework, resulted in a lower requirement for retail balances. Over the last twelve months the average rate paid on our share accounts has been 0.86% (2016: 1.22%).

Wholesale funding

In 2015 the Society was granted access to the Funding For Lending Scheme (FLS) providing access to an additional source of liquidity held with the Bank of England. The Society made a drawdown from this facility in 2016. In October 2017 the Society was granted access to the Bank of England's Term Funding Scheme (TFS), providing cash secured against eligible collateral with a four year maturity and made a drawdown of £5m in December 2017 and of a further £35m in January and February 2018. TFS is now closed to future drawdown.

Asset encumbrance

The Group uses certain assets as collateral to support the raising of secured funding under the terms of the Bank of England schemes in which the Society participates. The Society enters into derivative financial contracts as part of its management of interest rate risk for which collateral is also posted. As at 31 December 2017, 11.6% of the Group's assets were encumbered (2016: 8.9%) representing £70.8million of residential mortgage assets (2016: £70.8million) and £47.4million of other assets (2016: £28.4million).

Capital

The Group's capital position is a key indicator of financial strength. The Group holds capital to protect its Members from the effect of shocks or stresses, whether to the economy, the financial sector as a whole or the Society specifically. The amount of capital required to be held is assessed in relation to the risk profile and appetite of the Society, with minimum amounts mandated through regulation. The Group's capital requirements are set and monitored by the Prudential Regulatory Authority (PRA) in the form of Internal Capital Guidance (ICG). As at 31 December 2017 the Group's ICG amounted to £39.8million. All the Society's capital ratios remained in excess of regulatory requirements throughout the year.

The Board's policy is to continue to grow the capital base to further strengthen the confidence Members and other stakeholders have in the Society as well as support future growth.

Capital consists of general reserves (accumulated profits and losses), the available for sale reserve plus collective provisions for impairment and the revaluation reserve in respect of the Society's freehold properties. The Society also has in issue subordinated liabilities that expire in December 2028. Capital regulations require intangible assets and pension scheme surpluses to be deducted from available capital.

After regulatory deductions, the Group's regulatory capital increased from £52.0million to £55.3million as a result of the reported profit after tax together with improvements in the Society's defined benefit Scheme liability and reduction in the level of intangible assets. Further details on the capital position, including reconciliation to Group reserves, is provided in Note 29 to the Accounts.

A measure of capital strength commonly reported amongst financial institutions is Common Equity Tier 1 (CET1) ratio and, since it comprises group reserves, represents the strongest form of capital.

The Group's CET1 ratio of 12.0% increased from the 10.6% reported at 31 December 2016 driven by a combination of higher levels of capital measured against a reduction in total assets. Gross capital (which includes Tier 2 capital such as subordinated liabilities) as a percentage of shares and borrowings, increased from 6.2% to 7.0%.

The Society is also required to set out its capital position, risk exposures and risk assessment processes in its Pillar 3 disclosure document. This can be obtained from the Society's website.

STRATEGIC REPORT

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 which 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

Further details on the Committees can be found in the Corporate Governance Report on pages 18 to 22.

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 has a Board-approved Recovery and 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 and Resolution Plan document is 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, equity prices, currency or commodity prices. The Society's principal exposure to market risk is interest rate risk and prepayment risk within the Group's portfolio of equity release mortgages recorded at fair value.

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 eliminated entirely.

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 28 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.

STRATEGIC REPORT

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 has put in place 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 has followed a programme of significant investment in technology, which includes cyber-risk reduction initiatives and further progress towards attainment of Information Security industry standards. Further investment will continue in 2018.

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 danger 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 when implemented.

Capital buffers
Under CRD (IV) the Capital Conservation buffer is to be built up from 1.25% of risk-weighted assets on 1 January 2017 to 2.5% from 1 January 2019. A countercyclical buffer (CCyB) may also be used to adjust the resilience of the banking system to the changing scale of risks expected to be faced. As at 31 December 2017 the CCyB was set at 0% of risk-weighted assets however, the Financial Policy Committee of the Bank of England announced that this will increase to 0.5% from June 2018 and 1% from November 2018. These measures will require the Society to hold significantly greater levels of capital for regulatory purposes.

General Data Protection Regulations (GDPR)
GDPR represents a significant change in data protection legislation. Its principal aim is to strengthen and unify data protection for individuals within the European Union. The UK Regulator (ICO) expects businesses to proceed with GDPR irrespective of the UK's decision to leave the EU. The Society must demonstrate compliance by May 2018.

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 conditions

The general economic factors affecting the Group going forward, together with the steps taken by the Group's management to address these issues, are described in the Chairman's Statement and Chief Executive's Report. The outlook for 2018 remains uncertain on a number of fronts with the full impact of the UK's exit from the EU yet still unknown, particularly as the terms of exit remain unclear.

Despite the Bank of England raising rates in November 2017 for the first time in almost ten years, interest rates remain historically low with any future increases in Bank Rate expected to be at a gradual pace and to a limited extent. UK House prices have demonstrated resilience throughout 2017, however the outlook remains subdued and, in the near term, both house price inflation and housing activity are projected to remain below average. As a long-established Building Society Saffron's business model is heavily reliant on the UK housing market and, despite robust underwriting processes and strong credit risk management, a worsening of the UK market combined with steep or rapid increases in interest rates could impact on mortgage affordability and, in turn, adversely impact our future financial performance.

The prospect of low interest rates will remain a source of disappointment to savers and continue to impact on the Society's ability to generate adequate returns from its free capital. Margins from mortgage lending came under pressure in 2017 however, following the modest increase in interest rates and expectation for further increases coupled with the closure of the Term Funding Scheme and expected launch of several additional "challenger banks", competition for retail deposits is expected to intensify, in turn leading to liability-driven margin compression.

There remain considerable risks to the overall outlook related to the process of EU withdrawal. Throughout these uncertain times, the Society will maintain its approach as a responsible lender and continue to take decisions in the best long-term interests of the Society and its Members.

Darren Garner

Chief Financial Officer
On behalf of the Board

5 March 2018

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.

Leadership

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, a Chief Executive Officer and six Non-Executive Directors (including a Chairman). The Board met seven times in 2017 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 Executive Directors are expected to manage the Society under the strategic direction of the Board as a whole.

Effectiveness

Composition of the board
The names of the directors together with brief biographical details are provided on pages 29 to 31. 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 through the Society website or on request from the Society Secretary.

Board Committees

Remuneration and Loans Committee
This Committee comprises all the Non-Executive Directors and is chaired by Nick Treble (Non-Executive Director and 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.

Nominations Committee
This Committee 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 focuses on 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. The percentage of females on the Society's Board is 33%.

Risk, Audit, Compliance and Conduct Committee
This Committee comprises nominated Non-Executive Directors, excluding the Chairman, and is chaired by Neil Holden (approved Non-Executive Director and Senior Independent Director). Members of the Executive and senior management are invited to attend as appropriate. In 2017 a sub-committee focussing on compliance and conduct risk was established to ensure a balanced and proportionate approach was being 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.

During 2017 the Committee met eight 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 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 basis, which includes the deferral of related fees and commissions paid and received. RACCC reviewed the EIR methodology used by management to determine the behavioural life of the mortgages and income. RACCC agreed with the assumptions used and concluded that revenue was fairly stated.

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. Cash flows are discounted using a discount rate with a number of constituent components requiring management judgement. RACCC considers each quarter a report from management setting out the cash flows and judgements applied in valuing the mortgages and is satisfied that the methodology is appropriate and has been consistently applied.

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

CORPORATE GOVERNANCE REPORT

Board Credit Committee
The Committee comprises Non-Executive Directors and is chaired by Nick Treble (Non-Executive Director and 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.

Name	Board	Risk, Audit Compliance and Conduct Committee	Remuneration & Loans Committee	Nominations Committee	Board Credit Committee
Number of meetings held	7	8	3	2	6
Jenny Ashmore	5	8	3	1+	5
Gary Barr	7	7	2	2+	3
Geoffrey Dunn	7	8+	2	2	4
Colin Field	7	8*	3*	2	6*
Darren Garner	7	8*	n/a	n/a	6*
Neil Holden	6	8	2	2	6
Sarah Howe	7	8*	n/a	n/a	6*
Liz Kelly	7	6	3	2+	4
Nick Treble	5	7	3	2	6

*Executive Directors attended by invitation.
+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 Chief Risk Officer.

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 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 and is chaired by the Chief Customer Officer.

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 a 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.

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. 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. An external review of Board effectiveness is commissioned periodically, the last one being in 2014.

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 seven 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 four years on the Board. Liz Kelly and Jenny Ashmore were elected at the 2016 AGM, each has served three years on the Board. The CEO, Colin Field, the Chief Customer Officer, Sarah Howe and Non-Executive Director, Gary Barr are seeking re-election at the 2018 AGM. 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 Members in the AGM mailing documentation.

Accountability and Audit

Financial and business reporting
The Directors' responsibilities for financial reporting are described in the Statement of Directors' Responsibilities on pages 26 and 27.

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. 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 14 to 17.

Audit engagement
The appointment or re-appointment of external auditors is recommended by RACCC and confirmed by the Board. The Society last tendered for external audit services in 2003 resulting in the appointment of the current auditor, Deloitte LLP (or its predecessor firms). RACCC conducts an annual assessment of auditor effectiveness and considers whether an audit tender is in the best interests of the Society. The Society is recommending to Members at the forthcoming AGM that Deloitte LLP be reappointed as Auditors. Under EU audit reform legislation, the Society will be required to change its external auditor for its 2023 year end.

CORPORATE GOVERNANCE REPORT

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 will stand down as the audit engagement partner after the conclusion of the 2017 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 during 2017 was updated to reflect updated 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 £21,000 (excluding VAT) have been provided by Deloitte in respect of assurance services.

Remuneration

The Directors' Remuneration Report on pages 24 to 25 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 2017 informal Member group meetings were hosted by the Executive Directors to meet with and gauge the views of Members on issues that affect them. Considerable work has been undertaken to extend communication with Members through customer surveys and the Members' panel. Non-Executive Directors spend time in the branches and the Contact Centre to help them understand the Member perspective.

Constructive use of the Annual General Meeting (AGM)
Details of the AGM are mailed to all Members who are encouraged to attend or to vote on resolutions. 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. As a further encouragement to vote the Society will be donating 20p to charity for every vote cast. Voting is made easier with an online voting option. 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.

COMMUNITY HIGHLIGHTS 2017

This year's Saffron Community fund grants, managed by Essex Community Foundation, were the highest awarded yet with a total of £8,748

£2,000
Accuro Care Services

£2,000
Home Start Royston

£2,000
Halstead Day Centre

£500
Colchester Furniture Project

£1,848
Newport Youth Centre

£400
Dunmow First Responders

DIRECTORS' REMUNERATION REPORT (UNAUDITED)

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.

This report is published with the aim of giving Members an insight into how the decisions around Directors' remuneration are taken. A resolution will be put forward at the Annual General Meeting inviting Members to vote on the report on Directors' remuneration. This vote is advisory and the Board will take into account Members' views on determining future policy.

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.

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. We meet the statutory National Minimum Wage and Voluntary 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
Median level
External benchmarking review in 2018

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

Society Average Pay Awards of 1.91%*
Society Average Bonus Awards of 8.31%**

National Minimum Wage
All staff are paid at least the minimum wage
We pay the voluntary living wage of £8.45 p.h.

Equality of Pay
Having carried out a review we are satisfied that there is equality of pay between men and women.

*Effective 1 April 2017
** Paid March 2017 relating to 2016 performance year

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	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	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 2016 performance year, 50% of bonus earned was deferred until March 2019. For the 2017 performance year, 40% of bonus earned will be deferred over 3 years, payable in 2019, 2020 and 2021.	Earned on an annual basis and is determined by a combination of organisational and individual performance For the 2017 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 2017

Pay awards, if made, apply from 1 March each year. In respect of the period commencing 1 March 2017, the annual pay review process itself saw basic salaries for all Executive Directors held at current levels for the second year running, as recommended by the Chief Executive Officer and agreed by the Board. However, following the departure of the Society's Operations Director and Society Secretary, the Chief Customer Officer and Chief Financial Officer took on additional responsibilities and, accordingly, each received a 5% uplift in basic salary.

Bonus payments awarded to the Executive Directors and paid in 2017 related to performance for the financial year ended 31 December 2016. These totalled £77,001 (averaging 16% of basic pay) and were awarded based on overall contribution to Society performance and individual merit. Of this, £19,063 is deferred for payment until 2019. Deferred bonuses from 2015, totalling £6,143, were also paid.

There were no other changes to the other benefits or pension contributions for Executive Directors in 2017.

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. There have been no increases in fees 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 76.

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 2017

The total remuneration of each Director is analysed and presented in Note 7 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 17.

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 (pages 8 to 17)
Business review and future developments	
Principal risks and uncertainties	
Financial risk management objectives and policies and risk exposures	Strategic report Note 28 to the Accounts
Disclosure requirements under CRD IV country by country reporting	Note 31 to the Accounts

Results

Group reported profit before tax for the year ended 31 December 2017 was £1.5million (2016: £1.2million). The Group profit after tax transferred to general reserves was £2.3million (2016: £1.3million).

Capital

Group gross capital at 31 December 2017 was £64.9million (2016: £62.4million) being 7.0% of total shares and borrowings (2016: 6.2%). Free capital at the same date was £47.7million (2016: £44.1million) and 5.2% of total shares and borrowings (2016: 4.4%). An explanation of these ratios can be found in the Annual Business Statement on page 75.

Mortgage arrears

At Group level at 31 December 2017 there were no properties (2016: none) where payments were 12 months or more in arrears. At 31 December 2017, the Group held 12 properties (2016: 17) 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 £13,175 (2016: £12,438) in support of charities and organisations. No contributions were made for political purposes (2016: 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 and viability

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 likely 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 28 to the Accounts, "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 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 above together with available market information and the Directors' 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.

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 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 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.

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 2021 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' REPORT

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

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

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, C H Field, S A Howe and T G Barr will stand for re-election.

Biographies of the Directors appear at pages 29 to 31. 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 significant effect on the position of the Group.

Geoffrey Dunn (Chairman)
On behalf of the Board
Date: 5 March 2018

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 plc 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 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 – the 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. He was also a Non-Executive Director of Citadele Banka, a Latvian bank that suffered a similar fate to Northern Rock.

He is 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, 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 has also served as a Governor at Bedfordshire University, is a Governor of the Lantern School Ely, is the Honorary Secretary at Cambridge Rugby Club and has sat on several industry advisory boards.

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

DIRECTORS' BIOGRAPHIES

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 had held a number of senior finance positions with Barclays, Caudwell Group and Willis Group having previously qualified with PriceWaterhouseCoopers. Colin is a Chartered Accountant (FCA) and lives in North Essex.

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 the Royal Surgical Aid Society, a UK charity supporting carers of people with dementia.

NEIL HOLDEN, Non-Executive Director

Neil Holden 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 several non-executive directorships together with advisory work for other clients. Neil is a Non-Executive Director of Bank of London and The Middle East plc (Chairman of Remuneration Committee), Non-Executive Director of IntegraFin Holdings plc (Chairman of Risk and Audit Committee), Non-Executive Director of Integrated Financial Arrangements Limited (Chairman of Audit Committee) and Chairman of IntegraLife UK Limited) and of Stanbic International Insurance Limited. He also advises financial services clients on risk and governance through Calmindon Limited.

As Chair of Saffron's RACCC, Neil's role is to utilise both his and Committee members' skills and experience, working with the executive team, to ensure that the robust assurance, risk management and control processes of the Society remain strong and relevant to Saffron's strategy, developing needs and regulatory obligations. Neil also chairs the Nominations Committee and 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.

SARAH HOWE, Chief Customer Officer

Sarah joined the Society as Chief Marketing Officer in March 2013. Sarah has almost 30 years' experience in a range of high profile marketing roles inside and outside financial services. Prior to joining the Society she was the Marketing Director for over 50s insurance intermediary brands RIAS and Castle Cover, both part of the Ageas Group. In this role she developed a multi-brand strategy and marketing integration plan following Ageas' purchase of Castle Cover Limited. Sarah also worked at Bupa for 11 years during which time she was appointed to the role of Chief Marketing Officer for the UK Insurance Division, leading the delivery of member focused product solutions, communication strategies and membership loyalty programmes. Sarah began her marketing career in the Home Shopping retail sector.

Sarah was appointed to the Board in May 2014 and Chairs the Product Management Committee. In January 2017, Sarah was appointed as Independent Chair of a Consumer Panel for Openwork Holdings Limited who are one of the largest financial advice networks in the UK. Sarah lives in Essex.

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 and 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

Opinion

In our opinion the financial statements:

- **Give a true and fair view of the state of the Group's and the Society's affairs as at 31 December 2017 and of the Group's and 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 Statement 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 Standard, 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 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 Key audit matters

Key audit matters	The key audit matters that we identified in the current year were: • Revenue recognition • Loan loss provisioning • Valuation of lifetime mortgages • Valuation of lifetime swap • Hedge accounting
Materiality	The materiality that we used in the current year for the Group was £282,000, which was determined on the basis of 0.5% of Group net assets at 31 December 2017
Scoping	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 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.

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 £777.2m (2016: £790.6m) presented in Note 11 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. Due to the migration of loan data between different systems, this has necessitated manual adjustments to the data in the current year in order for it to be used in the EIR models. The Risk, Audit, Conduct and Compliance Committee ("RACCC") report on page 19 refers to the risk around revenue recognition. Management's associated accounting policies are detailed on pages 42 to 44 with detail about judgements in applying accounting policies and critical accounting estimates on page 44.
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 engaged internal IT specialists to review the SQL scripts used to extract data from underlying lending systems. We challenged any amendments made to the redemption profiles used in calculating the run-off curves by assessing whether these were appropriate in light of recent redemptions activity. 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. This included testing of manual changes to inputs which Management were required to make during the year.
Key observations	We found the effective interest rate models to be working as intended. We are satisfied that the recognition of interest income is appropriate and in accordance with the requirements of IAS 39.

Loan loss provisioning	
Key audit matter description	Management account for the impairment of loans and advances to customers (excluding lifetime mortgages) using an incurred loss model. Under 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, determined by Management as being three months in arrears. Furthermore, 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 any rental receipts from buy-to-let properties under Receiver of Rent arrangements and disposal proceeds from repossessed properties. The key judgements in the impairment models are expectations of future House Price Index ("HPI") movements, the time horizon to sale, and projected occupancy rates for buy-to-let properties. The inappropriate application of these assumptions could have a material impact on the loan loss provision. We identified management bias in the assumptions as a potential area for fraud. As disclosed on page 51, the Group holds £3.9m of impairment provisions at year end (2016: £4.0m). This comprises a specific provision of £3.6m (2016: £3.7m) and an IBNR provision of £0.3m (2016: £0.3m). The RACCC report on page 19 refers to the risk around loan loss provisioning. Management's associated accounting policies are detailed on pages 42 to 44 with detail about judgements in applying accounting policies and critical accounting estimates on page 44.
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 challenged the appropriateness of the HPI growth rate assumptions used in the specific impairment model, and specifically whether these were appropriate in light of current and future uncertainty in the UK housing market as well as external market forecasts. Management has a process whereby a sales strategy for each property in possession or Receiver of Rent is formally determined and regularly reviewed by the Credit Committee. We reviewed documentation and minutes supporting the sales strategies for a sample of properties in possession and noted that the time horizons were consistent with those used in the specific impairment model. We tested the projected occupancy rates for a sample of Receiver of Rent cases by agreeing rates per the specific impairment model to tenancy agreements and historic data specific to our samples. Furthermore, we benchmarked against market averages as published by the Association of Residential Letting Agents. 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 found the impairment models to be working as intended and consider the recognised provision to be reasonably stated.

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 £65.9m (2016: £71.3m). 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 with a number of constituent components which involve the application of a significant amount of judgement. As a result we consider there to be a significant risk of material misstatement associated with the selection of an appropriate discount rate. There is significant potential for Management to bias the discount rate to achieve a similar level of movement in the fair value of the mortgage book as with the value of the associated swap. The overall portfolio valuation is highly sensitive to the discount rate assumption. We identified Management bias in the assumptions as a potential area for fraud. The discount rate comprises five individual components related to long term interest rates, cost of funding, cost of regulatory capital, a hedging premium and a liquidity premium. In addition to the discount rate, we have also identified a key audit matter surrounding the valuation of the No Negative Equity Guarantee ("NNEG") provision given this requires a significant degree of management judgement. Other key assumptions include mortality rates, voluntary prepayment rates, future long-term HPI expectations and forced sale discounts. The RACCC report on page 19 refers to the risk around the valuation of lifetime mortgages. Managements associated accounting policies are detailed on pages 42 to 44 with detail about judgements in applying accounting policies and critical accounting estimates on page 44.
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 the review of Management's lifetime mortgage model and the governance review of key judgements. We consulted with valuation specialists on the key assumptions above. We challenged the assumptions used to arrive at each of the components of the discount rate. The liquidity premium is the most judgmental component, with the basis for other components being derived from market observable data. We benchmarked the liquidity premium against an acceptable range based on external research. We consulted with valuation specialists on the key assumptions above. We inspected Management's calculation of the NNEG provision and benchmarked the level of provision against an acceptable range derived from a combination of peer analysis and external market research. We benchmarked mortality rates against recent actuarial tables and compared HPI assumptions with published external HPI data and forecasts. Voluntary prepayment rate and forced sale discount assumptions were corroborated against actual observable data on the portfolio. We tested the completeness and accuracy of key model data inputs by agreeing them back to underlying source data.
Key observations	We found the lifetime model to be working as intended. Overall we considered Management's valuation to be within an acceptable range.

Valuation of lifetime swap	
Key audit matter description	Management hold a swap with a notional value of £42.2m to hedge the economic risk (predominantly interest rate and prepayment risk) on the lifetime mortgage portfolio. This lifetime swap should be recognised at fair value through profit and loss in accordance with IAS 39 with any subsequent changes in fair value recognised through profit and loss. We identified a key audit matter associated with the valuation of the lifetime swap on the basis that this is a complex financial instrument with a variable notional which is flexible which is between an upper and lower limit. As is often the case with such instruments, Management use a swap counterparty valuation in order to determine the carrying value of the swap at the Statement of Financial Position date and any fair value movements to be recognised in the Income Statement. Management has no visibility over the valuation methodology or assumptions used to assess the appropriateness of the accounting entries based on these counterparty valuations resulting in a risk that such valuations are not performed appropriately resulting in a material misstatement in the financial statements. The RACCC report on page 19 refers to the risk around the valuation of the lifetime swap. Management's associated accounting policies are detailed on pages 42 to 44 with detail about judgements in applying accounting policies and critical accounting estimates on page 44.
How the scope of our audit responded to the key audit matter	We understood management's process for the valuation of the lifetime swap by undertaking a walk-through to identify the external sources used to arrive at the valuation. We assessed the design and implementation of key controls focused on the review of the swap counterparty valuation. We engaged internal financial instruments specialists to perform an independent valuation of the lifetime swap at the Statement of Financial Position date. We obtained a direct confirmation from the swap counterparty to verify the existence and valuation of the lifetime swap.
Key observations	The swap counterparty valuation was within an acceptable range as determined by our independent valuation. We recommended to Management that they formalise their assessment of the valuation obtained from the swap counterparty as part of their oversight over the valuation process.

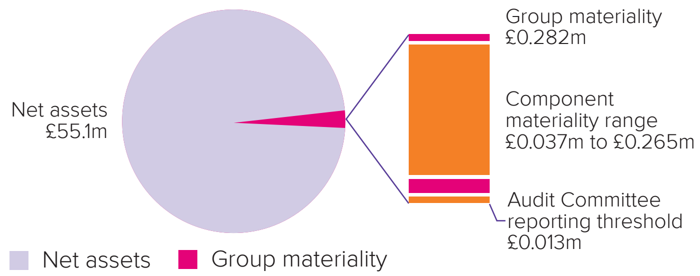
Hedge accounting	
Key audit matter description	Management hedge the interest rate risk exposure on fixed rate mortgage and savings products through a portfolio of interest rate swaps and apply hedge accounting in order to reduce the Income Statement volatility that arises from differences in accounting measurement between the hedging instruments (the swaps) measured at fair value and the hedged item (the mortgages or deposits) measured at amortised cost. Hedge accounting allows a fair value adjustment to be made in relation to the hedged risk (interest rate risk) which is offset against fair value movements in the swaps in the Income Statement. IAS 39 contains complex and prescriptive requirements relating to the documentation, designation and effectiveness of hedge relationships. Given the complexities involved in applying hedge accounting, we identified a key audit matter in respect of the incorrect posting of hedge accounting journals. Hedge accounting adjustments are included within net fair value movements of (£1,007,000) (2016: (£534,000)) in the Income Statement. Management's associated accounting policies are detailed on pages 42 to 44 with detail about judgements in applying accounting policies and critical accounting estimates on page 44.
How the scope of our audit responded to the key audit matter	We understood management's process for hedge accounting by undertaking a walk-through to identify the key controls and data flows. We assessed the design and implementation of key controls focused on the posting and review of hedge accounting journals. We reviewed the year-end hedge accounting journals to assess whether they had been posted correctly and in accordance with IAS 39. We engaged internal financial instrument specialists to review the underlying hedge documentation and Management's effectiveness testing in addition to independently reperforming Management's retrospective testing.
Key observations	We are satisfied that hedge accounting has been applied in accordance with the requirements of IAS 39 and that the hedge accounting journals were posted correctly. Overall we consider net fair value movements to be reasonably stated.

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	£282,000	£265,000
Basis for determining materiality	0.5% of Group net assets at 31 December 2017	0.5% of Society net assets at 31 December 2017
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 PRA, the Society's strategy is centred around maintaining a stable capital base, net assets has been a consistent base, and furthermore a number of peers in the Building Society sector are now using net assets as their basis for materiality.	



We agreed with the RACCC that we would report to the Committee all audit differences in excess of £12,690, 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 ranged from £36,800 to £265,000.

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.

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

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.

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.

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.

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.

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 74 for the financial year ended 31 December 2017 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 reappointed 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. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 14 years, covering the years ending 31 December 2004 to 31 December 2017.

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).

Peter Birch FCA (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
Leeds, United Kingdom
5 March 2018

THE ACCOUNTS

Income statement
for the year ended 31 December 2017

	Notes	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Interest receivable and similar income	2	28,119	27,533	32,623	32,029
Interest payable and similar charges	3	(8,524)	(8,524)	(12,706)	(12,706)
Net interest income		19,595	19,009	19,917	19,323
Fees and commissions receivable		654	659	549	575
Fees and commissions payable		(842)	(818)	(655)	(655)
Other operating income	15,27	285	285	449	449
Net fair value movements	4	(1,007)	(598)	(534)	58
Total net income		18,685	18,537	19,726	19,750
Administrative expenses	5	(13,932)	(13,932)	(14,022)	(14,022)
Depreciation and amortisation	14,16	(2,757)	(2,757)	(2,138)	(2,138)
Other operating charges	27	(63)	(63)	(51)	(51)
Operating profit before impairment losses and provisions		1,933	1,785	3,515	3,539
Income from investments		-	800	-	-
Impairment losses on loans and advances	12	(356)	(311)	(2,099)	(2,088)
Provisions for liabilities	26	(76)	(76)	(169)	(169)
Operating profit		1,501	2,198	1,247	1,282
Loss on disposal of property, plant and equipment		-	-	(16)	(16)
Profit before tax		1,501	2,198	1,231	1,266
Tax	8	765	672	35	28
Profit for the financial year		**2,266**	**2,870**	**1,266**	**1,294**

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 2017

	Notes	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Profit for the financial year		2,266	2,870	1,266	1,294
Available for sale reserve					
- Valuation (losses)/gains taken to reserves	23	(100)	(100)	1,014	1,014
- Amount transferred to income statement	2	(185)	(185)	(570)	(570)
Net actuarial gain/(loss) recognised in the defined benefit pension scheme	27	901	901	(1,263)	(1,263)
Unrealised gain on revaluation of property, plant and equipment		–	–	468	468
Tax relating to components of other comprehensive income	8	(167)	(167)	138	138
Total comprehensive income for the period		2,715	3,319	1,053	1,081

Statement of financial position
as at 31 December 2017

	Notes	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Assets					
Liquid assets					
- Cash in hand and balances with the Bank of England		765	765	630	630
- Loans and advances to credit institutions	9	87,154	86,578	120,809	120,595
- Debt securities	9	66,593	66,593	106,731	106,731
Derivative financial instruments	10	2,817	2,817	3,036	3,036
Loans and advances to customers	11	842,490	795,677	862,812	809,007
		999,819	952,430	1,094,018	1,039,999
Investments in subsidiary undertakings	13	-	45,657	-	51,563
Investment properties	15	2,785	2,785	2,680	2,680
Property, plant and equipment	14	4,743	4,743	5,254	5,254
Intangible assets	16	10,020	10,020	10,668	10,668
Other assets	17	2,331	2,199	1,917	1,908
Pension asset	27	207	207	-	-
Total assets		1,019,905	1,018,041	1,114,537	1,112,072
Liabilities					
Shares	18	802,289	802,289	903,475	903,475
Amounts owed to credit institutions	19	35,767	35,767	21,586	21,586
Amounts owed to other customers		85,833	85,833	91,486	91,486
Derivative financial instruments	10	27,312	27,312	31,596	31,596
Provision for liabilities	26	248	248	357	357
Other liabilities	20	3,074	3,086	2,753	2,768
Pension liability	27	-	-	615	615
Subordinated liabilities	21	10,268	10,268	10,270	10,270
Total liabilities		964,791	964,803	1,062,138	1,062,153
Reserves					
General reserves		54,699	52,823	51,678	49,198
Available for sale reserve	23	35	35	341	341
Revaluation reserve	24	380	380	380	380
Total reserves and liabilities		1,019,905	1,018,041	1,114,537	1,112,072

These accounts were approved by the Board of Directors on 5 March 2018 and were signed on its behalf by:

G R Dunn
(Chairman)

C H Field
(Chief Executive Officer)

D L Garner
(Chief Financial Officer)

Statement of changes in Members' interests

Group 2017	General reserve £000	Available for sale reserve £000	Revaluation reserve £000	Total £000
Balance as at 1 January 2017	51,678	341	380	52,399
Profit for the financial year	2,266	-	-	2,266
Other comprehensive income/(loss) for the year	755	(306)	-	449
Total comprehensive income/(loss) for the year	3,021	(306)	-	2,715
Balance as at 31 December 2017	54,699	35	380	55,114

Group 2016				
Balance as at 1 January 2016	50,752	(33)	627	51,346
Profit for the financial year	1,266	-	-	1,266
Other comprehensive income/(loss) for the year	(340)	374	(247)	(213)
Total comprehensive income/(loss) for the year	926	374	(247)	1,053
Balance as at 31 December 2016	51,678	341	380	52,399

Society 2017				
Balance as at 1 January 2017	49,198	341	380	49,919
Profit for the financial year	2,870	-	-	2,870
Other comprehensive income/(loss) for the year	755	(306)	-	449
Total comprehensive income/(loss) for the year	3,625	(306)	-	3,319
Balance as at 31 December 2017	52,823	35	380	53,238

Society 2016				
Balance as at 1 January 2016	48,244	(33)	627	48,838
Profit for the financial year	1,294	-	-	1,294
Other comprehensive income/(loss) for the year	(340)	374	(247)	(213)
Total comprehensive income/(loss) for the year	954	374	(247)	1,081
Balance as at 31 December 2016	49,198	341	380	49,919

Group cash flow statements

for the year ended 31 December 2017

	Group 2017 £000	Group 2016 £000
Cash flows from operating activities		
Profit before tax	1,501	1,231
Interest on subordinated liabilities	632	632
Gains on disposal of debt securities	(185)	(570)
Net fair value movements	1,007	534
Loss on disposal of property, plant and equipment	-	16
Depreciation and amortisation	2,757	2,138
Increase in impairment of loans and advances	356	2,099
Decrease/(increase) in loans and advances to credit institutions	1,585	(1,926)
Decrease in loans and advances to customers	14,399	9,008
Decrease in prepayments, accrued income and other assets	424	497
(Decrease)/increase in shares	(108,519)	6,015
Increase/(decrease) in amounts owed to credit institutions	14,687	(1,733)
Decrease in amounts owed to other customers	(5,622)	(29,071)
Decrease in accruals, deferred income and other liabilities	7,184	(1,720)
Pension contribution	-	(100)
Net tax received/(paid)	52	(436)
Net cash outflow from operating activities	(69,742)	(13,386)
Cash flows from investing activities		
Purchase of debt securities	(94,710)	(72,379)
Disposal of debt securities	134,748	126,910
Purchase of property, plant and equipment	(17)	(126)
Purchase of intangible fixed assets	(1,581)	(3,639)
Net cash generated from investing activities	38,440	50,766
Cash flows from financing activities		
Interest on subordinated liabilities	(632)	(632)
Net (decrease)/increase in cash and cash equivalents	(31,934)	36,748
Cash and cash equivalents at beginning of the year	93,054	56,306
Cash and cash equivalents at end of the year (2)	61,120	93,054

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 £765,000 (2016: £630,000) and loans and advances to credit institutions repayable on call and short notice of £60,355,000 (2016: £92,424,000).

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 26.

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 on the going concern basis as set out in the Statement of Directors' responsibilities on page 26. 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) 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.

d) 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.

e) 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.

f) 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.

g) 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 application 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 23). 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.

h) 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 28). 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.

i) 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.

j) 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 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

k) 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.

Notes to the accounts (continued)

l) 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 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.

m) 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.

n) 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.

o) 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.

p) 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:

i) Amortised cost accounting – expected mortgage life

Amortised cost accounting for mortgage assets requires judgements regarding the expected life of the underlying 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 alter the timing of recognition of interest receivable and amend the carrying value of loans and advances to customers as stated in the Statement of financial position.

ii) Impairment losses on loans and advances to customers

Impairment losses are calculated using credit risk characteristics, expected cash flows and historical experience. Estimates are made of house price inflation, default rates, time taken to sell properties in possession and the extent of any discounts that may apply and, for buy-to-let advances, the level of rental receipts.

iii) Fair value of derivatives and financial assets

The Society employs a number of techniques in determining the fair value of its derivatives and financial assets.

Derivative financial instruments

Calculated by discounted cash flow models using yield curves based on observable market data.

Financial assets at fair value through profit and loss

Estimated on the basis of the results of a discounted cash flow model that makes maximum use of market inputs. The fair value of the Group's portfolio of equity release mortgages are calculated in this way, making appropriate assumptions regarding mortality rates, voluntary early redemptions, future house price inflation and sale discount. Projected cash flows are discounted using a long-term interest rate, derived from quoted interest rates using generally observable market data in similar time bandings to match the expected timings of the cash flows of the mortgages, together with adjustments to reflect the cost of funding, capital, illiquidity and other risks. The fair value of the equity release mortgages and profit before tax would reduce by £1m with every 0.1% increase in the discount rate, or following a 0.5% reduction in the House Price Inflation index used (from 3.8% to 3.3%).

iv) 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 27 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.

2. Interest receivable and similar income	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
On assets held at amortised cost				
Loans fully secured on residential property	27,486	27,090	31,612	31,268
Loans to subsidiaries	-	1,419	-	1,498
Other loans	156	156	156	156
Other liquid assets / cash and short term funds	748	748	1,351	1,351
On available for sale securities				
Liquid assets	106	106	94	94
Gains on disposal	185	185	570	570
On financial instruments held at fair value through the income statement				
Loans fully secured on residential property	2,753	1,144	2,881	1,133
Derivatives	(3,315)	(3,315)	(4,041)	(4,041)
	28,119	27,533	32,623	32,029

Gains arising on the disposal of financial instruments comprise net profits from the sale of treasury instruments.

3. Interest payable and similar charges	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
On liabilities held at amortised cost				
Shares held by individuals	7,314	7,314	11,148	11,148
Subordinated liabilities	632	632	632	632
Deposits and other borrowings	527	527	829	829
On financial instruments held at fair value through the income statement				
Derivatives	51	51	97	97
	8,524	8,524	12,706	12,706

4. Net fair value movements	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Derivatives in designated fair value hedge relationships	1,388	1,388	685	685
Adjustments to hedged items in fair value hedge accounting relationships	(1,328)	(1,328)	(1,059)	(1,059)
Derivatives not in designated fair value hedge relationships	952	3,319	(6,541)	(2,439)
(Decrease)/increase in fair value of assets and liabilities	(2,019)	(3,977)	6,381	2,871
	(1,007)	(598)	(534)	58

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.

Notes to the accounts (continued)

5. Administrative expenses

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Staff costs (Note 6)	7,724	7,724	7,627	7,627
Remuneration of auditors:				
- audit of the Society's accounts	102	102	76	76
- audit of the Society's subsidiary pursuant to legislation	5	5	5	5
- all other services	21	21	11	11
Operating lease rentals	275	275	237	237
Other administrative expenses	5,805	5,805	6,066	6,066
	13,932	13,932	14,022	14,022

Note: all audit fees are borne by the Society.

6. Staff numbers and costs

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

	Group 2017	Society 2017	Group 2016	Society 2016
Principal office	113	113	122	122
Branch offices	55	55	56	56
	168	168	178	178

The aggregate costs of these persons were as follows:

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Wages and salaries	6,793	6,793	6,644	6,644
Social security costs	587	587	580	580
Other pension costs (Note 27)	344	344	403	403
	7,724	7,724	7,627	7,627

7. Remuneration of and transactions with Directors

Analysis of Directors' emoluments:	Salary/ fees £000	Bonus paid (1) £000	Other benefits £000	Pension /Pension allowance £000	2017 Total £000	2016 Total £000
Executive						
C H Field	170	20	18	23	**231**	267
S A Howe	156	17	16	21	**210**	209
D L Garner	156	27	16	20	**219**	203
	482	**64**	**50**	**64**	**660**	679
Non-Executive						
G R Dunn	48	-	-	-	**48**	48
J E Smith (to 20/04/16)	-	-	-	-	**-**	13
C R L Wilson (to 20/04/16)	-	-	-	-	**-**	10
T G Barr	30	-	-	-	**30**	30
N J Treble	38	-	-	-	**38**	35
N J Holden	38	-	-	-	**38**	38
J A Ashmore	30	-	-	-	**30**	30
E Kelly	30	-	-	-	**30**	30
	214	-	-	-	**214**	234
Total 2017	**696**	**64**	**50**	**64**	**874**	**-**
Total 2016	704	54	92	63	-	913

Notes:
1) Bonus paid in 2017 comprises £58k earned and accrued in 2016 plus £6k payment of bonus deferred from 2015. A further £19k of bonus earned remains deferred to be paid in 2019 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.

Notes to the accounts (continued)

8. Taxation on profit on ordinary activities

The tax charge comprises:

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Current tax on profit on ordinary activities				
UK corporation tax	50	32	255	255
Adjustments in respect of prior periods	(891)	(776)	(338)	(329)
Total current tax	(841)	(744)	(83)	(74)
Deferred tax				
Origination and reversal of timing differences	169	168	(28)	(30)
Adjustments in respect of prior periods	(93)	(96)	106	106
Effect of tax rate change on opening balance	-	-	(30)	(30)
Total deferred tax	76	72	48	46
Total tax credit on profit on ordinary activities	(765)	(672)	(35)	(28)
Tax charge/(credit) recognised in other comprehensive income	167	167	(138)	(138)
Total current and deferred tax credit	(598)	(505)	(173)	(166)

The standard rate of Corporation Tax was 20% with effect from 1 April 2015 and 19% from 1 April 2017, giving effective tax rates of 19.25% for the year ended 31 December 2017 and 20% for the year ended 31 December 2016. 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 2016 and 2017 relate to Research and Development tax credit claims in respect of the financial years ended 31 December 2014, 2015 and 2016.

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:

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Profit on ordinary activities before tax	1,501	2,198	1,231	1,266
Tax on profit on ordinary activities at standard UK corporation tax rate of 19.25% (2016:20%)	289	423	246	253
Effects of:				
Fixed asset differences	43	43	28	28
Non-taxable expense/(income)	(68)	(222)	(55)	(55)
Impact of rate change	(44)	(44)	(30)	(30)
Adjustments to tax charge in respect of previous years	(984)	(872)	(232)	(223)
Other	(1)	-	8	(1)
Total tax credit for the period recognised in the income statement	(765)	(672)	(35)	(28)

9. Liquid assets

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Loans and advances to credit institutions:				
Repayable on call and short notice	60,355	59,779	92,424	92,210
Placements with credit institutions	26,799	26,799	28,385	28,385
	87,154	86,578	120,809	120,595

As at 31 December 2017 £26,345k (2016: £28,380k) of cash has been deposited by the Group and Society as collateral against derivative contracts.

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Debt securities:				
Gilts	8,893	8,893	10,992	10,992
Money market funds	-	-	10,162	10,162
Treasury bills	3,994	3,994	15,998	15,998
Bonds	53,706	53,706	69,579	69,579
	66,593	66,593	106,731	106,731

The Society has pledged £21,070k of debt securities with the Bank of England for the Term Funding Scheme and Funding for Lending Scheme (2016: nil).

Movements during the year of debt securities are analysed as follows:

	Group & Society 2017 £000
At 1 January	106,731
Additions	94,710
Disposals	(134,748)
Net gains from changes in fair value recognised in Statement of comprehensive income	(100)
At 31 December	66,593

Notes to the accounts (continued)

10. Derivative financial instruments

	Group & Society		
	Contract/ notional amount £000	Fair values – Assets £000	Fair values – Liabilities £000
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)
As at 31 December 2016			
a) Unmatched derivatives – Interest rate swaps	128,534	2,287	(29,272)
b) Derivatives designated as fair value hedges – Interest rate swaps	149,500	749	(2,324)
Total recognised derivative assets / (liabilities)	278,034	3,036	(31,596)

Unmatched derivatives include an interest rate swap with a notional value of £42.2million (2016: £45.1million) 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 £12million, which the Society has elected to de-designate from their hedging relationship at 31 December 2017 (2016: £62million).

11. Loans and advances to customers

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Loans fully secured on residential property				
Held at amortised cost	777,220	766,125	790,643	777,667
Held at fair value through the income statement	65,905	30,109	71,289	30,392
Other loans - loans fully secured on land	2,748	2,748	2,926	2,926
	845,873	798,982	864,858	810,985
Provision for impairment losses on loans and advances (Note 12)	(3,936)	(3,858)	(3,977)	(3,909)
	841,937	795,124	860,881	807,076
Fair value adjustment for hedged risk	553	553	1,931	1,931
	842,490	795,677	862,812	809,007

The Society has pledged £87.4million of mortgage loan pools with the Bank of England for the Term Funding Scheme and Funding for Lending Scheme (2016: £137.3million Funding for Lending Scheme)

12. Impairment losses on loans and advances

	Individual £000	Collective £000	Total £000
Group			
At 1 January 2017	3,668	309	3,977
Charge for the year	291	65	356
Amounts utilised in the period	(397)	-	(397)
At 31 December 2017	3,562	374	3,936
Society			
At 1 January 2017	3,602	307	3,909
Charge for the year	245	66	311
Amounts utilised in the period	(362)	-	(362)
At 31 December 2017	3,485	373	3,858

13. Investments in subsidiary undertakings

	Society 2017 £000	Society 2016 £000
Shares in subsidiary undertakings	86	86
Loans to subsidiary undertakings	45,571	51,477
	45,657	51,563

Movement during the year of loans to subsidiary undertakings:

Cost	
At 1 January	51,477
Repayments received	(7,627)
Loans advanced	1,721
At 31 December	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)

14. Property, plant and equipment

	Group & Society			
	Land and buildings freehold £000	Land and buildings short leasehold £000	Equipment, fixtures, fittings and vehicles £000	Total £000
Cost or valuation				
At 1 January 2017	4,427	1,190	2,739	8,356
Additions	-	-	17	17
Disposals	-	-	-	-
Revaluation	-	-	-	-
At 31 December 2017	4,427	1,190	2,756	8,373
Depreciation				
At 1 January 2017	662	385	2,055	3,102
Charged in year	183	112	233	528
Disposals	-	-	-	-
Revaluation	-	-	-	-
At 31 December 2017	845	497	2,288	3,630
Net book value				
At 31 December 2017	3,582	693	468	4,743
At 31 December 2016	3,765	805	684	5,254

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 2017 would be £2,475,000 (2016: £2,607,000).

Land and buildings freehold includes non-depreciable land held by the Society for its own activities with a net book value of £735,000 (2016: £735,000).

15. Investment properties

	Group & Society £000
At 1 January 2017	2,680
Revaluation gain	105
At 31 December 2017	2,785

Investment properties are held at valuation and were professionally valued by Derrick Wade Waters, Chartered Surveyors, on an open market value basis as at 19 October 2017. The property rental income earned, all of which is leased out under operating leases, amounted to £196k (2016: £179k) and has been recognised within other operating income.

16. Intangible assets

	Group & Society £000
Cost	
At 1 January 2017	14,253
Additions	1,581
Disposals	-
At 31 December 2017	15,834
Amortisation	
At 1 January 2017	3,585
Charged in year	2,229
Disposals	-
At 31 December 2017	5,814
Net book value	
At 31 December 2017	10,020
At 31 December 2016	10,668

Intangible assets at 31 December 2017 comprise the costs of investment in new mortgages and savings platforms to meet the future needs of the Society and include nil (2016: £2,069,000) 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.

17. Other assets

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Other assets	34	14	302	302
Prepayments and accrued income	1,283	1,283	1,402	1,402
Corporation tax	1,014	902	213	204
	2,331	2,199	1,917	1,908

18. Shares

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Held by individuals	802,109	802,109	903,284	903,284
Fair value adjustment for hedged risk	180	180	191	191
	802,289	802,289	903,475	903,475

19. Amounts owed to credit institutions

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Amounts owed to credit institutions	34,000	34,000	19,340	19,340
Fair value adjustment	1,767	1,767	2,246	2,246
	35,767	35,767	21,586	21,586

Notes to the accounts (continued)

20. Other liabilities	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Corporation tax	-	-	-	-
Deferred tax (Note 22)	595	604	351	365
Other creditors	1,020	1,023	983	983
Other accruals	1,459	1,459	1,419	1,420
	3,074	3,086	2,753	2,768

21. Subordinated liabilities	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Fixed Rate 6.32% Subordinated Debt 2028	10,268	10,268	10,270	10,270

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.

22. Deferred taxation assets and liabilities	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Deferred tax assets				
Balance 1 January	14	-	17	-
Other	(5)	-	(3)	-
Balance 31 December	9	-	14	-
Deferred taxation liabilities				
Balance 1 January	365	365	458	458
Income statement charge	72	72	45	45
Charge/(Credit) recognised directly in equity	167	167	(138)	(138)
	604	604	365	365
Fixed asset timing differences	792	792	416	416
Other timing differences	(44)	(35)	(110)	(96)
Asset from losses carried forward	(198)	(198)	-	-
Capital gains	23	23	23	23
Other	22	22	22	22
Liability at 31 December	595	604	351	365

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.

23. Available for sale reserve	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Reserve at start of the year	341	341	(33)	(33)
Realised gains	(185)	(185)	(570)	(570)
Net changes in fair value	(100)	(100)	1,014	1,014
Tax relating to components of other comprehensive income	(21)	(21)	(70)	(70)
Reserve at end of the year	35	35	341	341

24. Revaluation reserve	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Revaluation reserve at start of the year	380	380	627	627
Unrealised valuation gains on property, plant and equipment	-	-	468	468
Transfer to general reserve	-	-	(715)	(715)
Revaluation reserve at end of the year	380	380	380	380

25. Financial commitments

a) Total future minimum lease payments under non-cancellable operating leases are as follows:

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Not later than one year	273	273	38	38
Later than one year and not later than five years	896	896	146	146
Later than five years	253	253	1,752	1,752

b) At 31 December 2017, the Group had capital commitments of nil (2016: nil) which were contracted but not provided for.

26. Provisions for liabilities	Group & Society		
	Financial Services Compensation Scheme Levy £000	Dilapidations £000	Total £000
2017			
At 1 January 2017	205	152	357
Charge for the year	76	-	76
Provision utilised	(185)	-	(185)
At 31 December 2017	96	152	248
2016			
At 1 January 2016	341	167	508
Charge for the year	169	-	169
Provision utilised	(305)	(15)	(320)
At 31 December 2016	205	152	357

Notes to the accounts (continued)

26. 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. 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. The initial three year term expired in September 2011, and under the renegotiated terms the interest rate was reset from 12 month Libor +30bps to 12m Libor +100bps. By virtue of it holding deposits protected under the FSCS scheme at 31 December 2016, the Society has an obligation to pay levies in respect of the interest cost for 2017/18.

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

27. 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 £344,000 (2016: £403,000).

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 2017 the scheme is shown in the Statement of financial position as a pension asset of £207,000 (2016: liability of £615,000) 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 2018.

27. Group pensions (continued)

Main assumptions

	Date of fund valuation	
	31 December 2017	31 December 2016
Rate of increase in salaries	2.1%	2.3%
Rate of increase in pensions in payment	3.0%	3.2%
Rate of increase in pensions in payment after 05.04.05	2.3%	2.3%
Discount rate	2.5%	2.6%
RPI inflation assumptions	3.1%	3.3%
CPI inflation assumptions	2.1%	2.3%

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.

Reconciliation of scheme's assets and defined benefit obligation:	Assets £000	Defined benefit obligation £000	Total £000
At 1 January 2017	13,899	(14,514)	(615)
Benefits paid	(257)	257	-
Administration expenses	(63)	-	(63)
Net interest cost	358	(374)	(16)
Re-measurement gains			
- Actuarial gain	-	587	587
- Return on assets excluding interest income	314	-	314
At 31 December 2017	14,251	(14,044)	207

The scheme liabilities were valued in accordance with the guidelines set out in Section 28 of FRS102 using a discount rate of 2.5% 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	2017 £000	2016 £000
Equities and other growth assets	9,888	10,556
Liability Driven Investments	3,430	2,418
Cash	16	14
Annuities	917	911
	14,251	13,899

Demographic assumptions	31 December 2017	31 December 2016
Mortality (Pre-retirement)	Nil deaths	Nil deaths
Mortality (Post-retirement)	S2PA CMI2016	S2PA CMI2013

Life expectancies (in years)	31 December 2017		31 December 2016	
	Males	Females	Males	Females
For an individual aged 65 in 2017	22.1	23.9	22.5	24.5
At age 65 for an individual aged 45 in 2017	23.5	25.4	24.4	26.5

Notes to the accounts (continued)

27. Group pensions (continued)

Analysis of other pension costs charged in arriving at operating profit:
Analysis of amounts included in other operating charges

	2017 £000	2016 £000
Administration expenses	63	51
	63	**51**

Analysis of amounts included in pension finance income

	2017 £000	2016 £000
Net interest (expense)/income	(16)	21
	(16)	**21**

Analysis of amount recognised in the Statement of comprehensive income

	2017 £000	2016 £000
Actual return on assets less interest	314	1,573
Actuarial gain/(loss) on defined benefit obligation	587	(2,836)
Total actuarial gain/(loss) recognised in the Statement of comprehensive income	**901**	**(1,263)**

28. 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.

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 2017 is shown in Note 10.

28. Financial instruments (continued)

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)

28. Financial instruments (continued)

Carrying values by category as at 31 December 2017

Group	Held at amortised cost		Held at fair value					
	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	Non-financial assets and liabilities	Total
Financial assets	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Cash in hand	-	765	-	-	-	-	-	765
Loans and advances to credit institutions	87,154	-	-	-	-	-	-	87,154
Debt securities	-	-	66,593	-	-	-	-	66,593
Derivative financial instruments	-	-	-	-	1,009	1,808	-	2,817
Loans and advances to customers	776,585	-	-	65,905	-	-	-	842,490
Other assets	-	-	-	-	-	-	20,086	20,086
	863,739	**765**	**66,593**	**65,905**	**1,009**	**1,808**	**20,086**	**1,019,905**
Financial liabilities								
Shares	-	802,289	-	-	-	-	-	802,289
Amounts owed to credit institutions	-	23,880	-	11,887	-	-	-	35,767
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	-	-	-	-	-	-	3,074	3,074
Subordinated liabilities	-	10,268	-	-	-	-	-	10,268
	-	**922,270**	**-**	**11,887**	**1,254**	**26,058**	**3,322**	**964,791**

Carrying values by category as at 31 December 2016

Financial assets								
Cash in hand	-	630	-	-	-	-	-	630
Loans and advances to credit institutions	120,809	-	-	-	-	-	-	120,809
Debt securities	-	-	106,731	-	-	-	-	106,731
Derivative financial instruments	-	-	-	-	749	2,287	-	3,036
Loans and advances to customers	791,523	-	-	71,289	-	-	-	862,812
Other assets	-	-	-	-	-	-	20,519	20,519
	912,332	**630**	**106,731**	**71,289**	**749**	**2,287**	**20,519**	**1,114,537**
Financial liabilities								
Shares	-	903,475	-	-	-	-	-	903,475
Amounts owed to credit institutions	-	3,924	-	17,662	-	-	-	21,586
Amounts owed to other customers	-	91,486	-	-	-	-	-	91,486
Derivative financial instruments	-	-	-	-	2,324	29,272	-	31,596
Provisions for liabilities	-	-	-	-	-	-	357	357
Other liabilities	-	-	-	-	-	-	3,368	3,368
Subordinated liabilities	-	10,270	-	-	-	-	-	10,270
	-	**1,009,155**	**-**	**17,662**	**2,324**	**29,272**	**3,725**	**1,062,138**

There have been no reclassifications during the year.

28. Financial instruments (continued)

Carrying values by category as at 31 December 2017

Society	Held at amortised cost		Held at fair value					
	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	Non-financial assets and liabilities	Total
Financial assets	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Cash in hand	-	765	-	-	-	-	-	765
Loans and advances to credit institutions	86,578	-	-	-	-	-	-	86,578
Debt securities	-	-	66,593	-	-	-	-	66,593
Derivative financial instruments	-	-	-	-	1,009	1,808	-	2,817
Loans and advances to customers	765,568	-	-	30,109	-	-	-	795,677
Investments in subsidiary undertakings	45,657	-	-	-	-	-	-	45,657
Other assets	-	-	-	-	-	-	19,954	19,954
	897,803	**765**	**66,593**	**30,109**	**1,009**	**1,808**	**19,954**	**1,018,041**
Financial liabilities								
Shares	-	802,289	-	-	-	-	-	802,289
Amounts owed to credit institutions	-	23,880	-	11,887	-	-	-	35,767
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	-	-	-	-	-	-	3,086	3,086
Subordinated liabilities	-	10,268	-	-	-	-	-	10,268
	-	**922,270**	**-**	**11,887**	**1,254**	**26,058**	**3,334**	**964,803**

Carrying values by category as at 31 December 2016

Financial assets								
Cash in hand	-	630	-	-	-	-	-	630
Loans and advances to credit institutions	120,595	-	-	-	-	-	-	120,595
Debt securities	-	-	106,731	-	-	-	-	106,731
Derivative financial instruments	-	-	-	-	749	2,287	-	3,036
Loans and advances to customers	778,615	-	-	30,392	-	-	-	809,007
Investments in subsidiary undertakings	51,563	-	-	-	-	-	-	51,563
Other assets	-	-	-	-	-	-	20,510	20,510
	950,773	**630**	**106,731**	**30,392**	**749**	**2,287**	**20,510**	**1,112,072**
Financial liabilities								
Shares	-	903,475	-	-	-	-	-	903,475
Amounts owed to credit institutions	-	3,924	-	17,662	-	-	-	21,586
Amounts owed to other customers	-	91,486	-	-	-	-	-	91,486
Derivative financial instruments	-	-	-	-	2,324	29,272	-	31,596
Provisions for liabilities	-	-	-	-	-	-	357	357
Other liabilities	-	-	-	-	-	-	3,383	3,383
Subordinated liabilities	-	10,270	-	-	-	-	-	10,270
	-	**1,009,155**	**-**	**17,662**	**2,324**	**29,272**	**3,740**	**1,062,153**

There have been no reclassifications during the year.

Notes to the accounts (continued)

28. Financial instruments (continued)

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 using the 'present value' method. Expected future principal (redemption) cash flows are derived by making appropriate assumptions regarding mortality rates and voluntary early redemptions together with assumptions on future house price inflation and sale discount.

The expected future cash flows are then discounted using a rate 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 timings of the cash flows of the mortgages, together with adjustments to reflect the cost of funding, capital, illiquidity and other risks.

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.

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 2017 Financial assets	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
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	-	11,887	-	11,887
Derivative financial instruments	-	1,254	26,058	27,312
	-	13,141	26,058	39,199

28. Financial instruments (continued)

As at 31 December 2016 Financial assets	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Debt securities	106,731	-	-	106,731
Loans fully secured on residential property	-	-	71,289	71,289
Derivative financial instruments	-	3,036	-	3,036
	106,731	3,036	71,289	181,056
Financial liabilities				
Amounts owed to credit institutions	-	17,662	-	17,662
Derivative financial instruments	-	2,324	29,272	31,596
	-	19,986	29,272	49,258

Amounts stated are for Group and Society except for loans fully secured on residential property which includes £35,795,243 (2016: £40,862,785) held within the Society's subsidiary Crocus Home Loans.

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:

	Group 2017 £000	Society 2017 £000	Group 2016 £000	Society 2016 £000
Cash in hand	765	765	630	630
Loans and advances to credit institutions	87,154	86,578	120,809	120,595
Debt securities	66,593	66,593	106,731	106,731
Derivative financial instruments	2,817	2,817	3,036	3,036
Loans and advances to customers	842,490	795,677	862,812	809,007
	999,819	952,430	1,094,018	1,039,999
Lending commitments (off balance sheet)	55,443	55,443	40,056	40,056
Maximum credit exposure	1,055,262	1,007,873	1,134,074	1,080,055

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.

Notes to the accounts (continued)

28. Financial instruments (continued)

The Group's treasury asset concentration is shown in the table below:	2017 £000	2016 £000
Central banks	28,429	36,348
Multinational development banks	38,776	12,207
Central Government	86,542	167,615
Other	-	11,370
	153,747	**227,540**

Concentration by credit grading	2017 £000	2016 £000
AAA	38,776	22,369
AA	86,542	200,803
A	28,429	3,160
Unrated	-	1,208
Total	**153,747**	**227,540**

Loans and advances to customers

The table below shows information on the Group's loans and advances to customers by geographical concentration:	2017 %	2016 %
Greater London	30	32
South East	31	31
South West	9	8
East Anglia	5	5
West Midlands	5	6
East Midlands	5	5
North West	6	5
Yorkshire & Humberside	5	4
Wales	2	2
North	2	2

The following table analyses the loan to value (LTV) of the mortgage portfolio	2017 %	2016 %
0% - 50%	39	39
50.01% - 75%	40	43
75.01% - 80%	8	6
80.01% - 85%	3	4
85.01% - 90%	4	2
90.01% -95%	4	3
>95%	2	3

The table below shows information on the Group's loans and advances to customers by payment due status:

Not impaired	2017 £000	2016 £000
Neither past due nor impaired	816,152	835,471
Up to three months overdue but not impaired	15,763	14,578
Over three months but not impaired	3,254	3,563
Possessions / receiver of rents	386	808
Impaired		
Up to three months overdue	-	-
Between three and six months overdue	-	-
Between six and twelve months overdue	-	96
Possessions / receiver of rents	6,935	8,296
	842,490	**862,812**

28. Financial instruments (continued)

Value of collateral held: Indexed	2017 £000	2016 £000
Neither past due nor impaired	1,887,771	1,969,256
Either past due or impaired	53,400	57,711
	1,941,171	**2,026,967**

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 2017.

	Interest only		Arrangements	
2017	Account balances £000	Number of accounts	Account balances £000	Number of accounts
Society	175	2	1,643	12
Crocus Home Loans	-	-	489	4
Group total	**175**	**2**	**2,132**	**16**
2016				
Society	-	-	1,026	11
Crocus Home Loans	-	-	920	9
Group total	**-**	**-**	**1,946**	**20**

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:

	Number of accounts 2017	Number of accounts 2016
Capitalisations	-	1
Payment holidays	-	-
Mortgage term extensions	-	2
Interest rate concessions	1	1
	1	**4**

Notes to the accounts (continued)

28. Financial instruments (continued)

During the year ended 31 December 2017, no new properties were taken into possession by the Society (2016: nil) or by Crocus Home Loans (2016: nil).

At the end of 2017 the Society had 12 properties in possession representing capital balances of £1.6m which is 0.2% of the total Society book (2016: 0.30%).

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 2017 the Group was a Receiver of Rents on 17 properties (2016: 29) representing capital balances of £7.2m (2016: £9.0m), which is 0.9% of the total Group book (2016: 1.1%). Of these properties 11 were also in possession (2016: 16), included in the values for possession cases specified above, representing capital balances of £1.6m (2016: £2.1m). 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 2017 provisions of £3.6m were maintained (2016: £3.7m).

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 on the opposite page 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.

28. Financial instruments (continued)

Group residual maturity as at 31 December 2017	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
Financial assets	£000	£000	£000	£000	£000	£000
Cash in hand	765	-	-	-	-	765
Loans and advances to credit institutions	86,701	453	-	-	-	87,154
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	676,802	842,490
Other assets	-	1,122	783	4,066	14,115	20,086
	87,466	**18,308**	**62,014**	**152,159**	**699,958**	**1,019,905**
Financial liabilities and reserves						
Shares	593,907	30,672	151,235	26,475	-	802,289
Amounts owed to credit institutions	2,260	9,067	8,145	16,295	-	35,767
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	-	2,300	165	-	609	3,074
Subordinated liabilities	-	268	-	-	10,000	10,268
Reserves	-	-	-	-	55,114	55,114
	681,714	**42,385**	**159,976**	**43,999**	**91,831**	**1,019,905**
Net liquidity gap	**(594,248)**	**(24,077)**	**(97,962)**	**108,160**	**608,127**	**-**

Notes to the accounts (continued)

28. Financial instruments (continued)

Group residual maturity as at 31 December 2016

Financial assets	On demand £000	Not more than three months £000	More than three months but not more than one year £000	More than one year but not more than five years £000	More than five years £000	Total £000
Cash in hand	630	-	-	-	-	630
Loans and advances to credit institutions	120,218	591	-	-	-	120,809
Debt securities	10,162	19,054	64,548	2,786	10,181	106,731
	131,010	19,645	64,548	2,786	10,181	228,170
Derivative financial instruments	-	-	1,020	2,016	-	3,036
Loans and advances to customers	-	9,581	25,742	131,178	696,311	862,812
Other assets	-	1,920	46	4,362	14,191	20,519
	131,010	**31,146**	**91,356**	**140,342**	**720,683**	**1,114,537**

Financial liabilities and reserves

	On demand £000	Not more than three months £000	More than three months but not more than one year £000	More than one year but not more than five years £000	More than five years £000	Total £000
Shares	610,091	60,159	185,878	47,347	-	903,475
Amounts owed to credit institutions	2,427	1,513	8,037	9,609	-	21,586
Amounts owed to other customers	84,858	1,702	4,926	-	-	91,486
Derivative financial instruments	-	175	-	2,371	29,050	31,596
Provisions for liabilities	-	-	205	71	81	357
Other liabilities	-	3,368	-	-	-	3,368
Subordinated liabilities	-	270	-	-	10,000	10,270
Reserves	-	-	-	-	52,399	52,399
	697,376	**67,187**	**199,046**	**59,398**	**91,530**	**1,114,537**
Net liquidity gap	**(566,366)**	**(36,041)**	**(107,690)**	**80,944**	**629,153**	**-**

28. Financial instruments (continued)

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

Group & Society As at 31 December 2017

	On demand £000	Not more than three months £000	More than three months but not more than one year £000	More than one year but not more than five years £000	More than five years £000	Total £000
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**

Group & Society As at 31 December 2016

	On demand £000	Not more than three months £000	More than three months but not more than one year £000	More than one year but not more than five years £000	More than five years £000	Total £000
Shares	607,313	61,837	189,580	51,576	-	910,306
Amounts owed to credit institutions	2,410	1,515	7,728	8,819	-	20,472
Amounts owed to other customers	85,357	1,715	4,963	-	-	92,035
Derivative financial instruments	-	1,034	2,170	8,969	24,402	36,575
Subordinated liabilities	-	319	313	2,528	14,111	17,271
Total liabilities	**695,080**	**66,420**	**204,754**	**71,892**	**38,513**	**1,076,659**

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)

28. 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 2017	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
Financial assets	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Cash in hand	765	-	-	-	-	765
Loans and advances to credit institutions	86,701	453	-	-	-	87,154
Debt securities	5,076	35,769	16,926	8,822	-	66,593
Derivative financial instruments	-	-	-	-	2,817	2,817
Loans and advances to customers	517,901	22,978	211,054	63,223	27,334	842,490
Other assets	-	-	-	-	20,086	20,086
Total Financial assets	**610,443**	**59,200**	**227,980**	**72,045**	**50,237**	**1,019,905**
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	-	1,766	35,767
Amounts owed to other customers	85,833	-	-	-	-	85,833
Derivative financial instruments	-	-	-	-	27,312	27,312
Provisions for liabilities	-	-	-	-	248	248
Other liabilities	-	-	-	-	3,074	3,074
Subordinated liabilities	-	-	-	10,000	268	10,268
Reserves	-	-	-	-	55,114	55,114
Total Financial liabilities and reserves	**720,864**	**164,569**	**36,510**	**10,000**	**87,962**	**1,019,905**
Impact of derivative instruments	218,910	(557)	(152,700)	(65,653)	-	-
Interest rate sensitivity gap	108,489	(105,926)	38,770	(3,608)	(37,725)	-
Sensitivity to profit and reserves:						
Parallel shift of + 1%	(218)	565	(799)	226	-	(226)
Parallel shift of + 2%	(436)	1,130	(1,598)	453	-	(451)

28. Financial instruments (continued)

As at 31 December 2016	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
Financial assets	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Cash in hand	630	-	-	-	-	630
Loans and advances to credit institutions	120,218	591	-	-	-	120,809
Debt securities	29,209	64,425	2,771	10,035	291	106,731
Derivative financial instruments	-	-	-	-	3,036	3,036
Loans and advances to customers	629,596	4,199	154,389	44,363	30,265	862,812
Other assets	-	-	-	-	20,519	20,519
Total Financial assets	**779,653**	**69,215**	**157,160**	**54,398**	**54,111**	**1,114,537**
Financial liabilities and reserves						
Shares	670,059	185,878	47,347	-	191	903,475
Amounts owed to credit institutions	3,925	7,170	8,246	-	2,245	21,586
Amounts owed to other customers	91,486	-	-	-	-	91,486
Derivative financial instruments	-	-	-	-	31,596	31,596
Provisions for liabilities	-	-	-	-	357	357
Other liabilities	-	-	-	-	3,368	3,368
Subordinated liabilities	-	-	-	10,000	270	10,270
Reserves	-	-	-	-	52,399	52,399
Total Financial liabilities and reserves	**765,470**	**193,048**	**55,593**	**10,000**	**90,426**	**1,114,537**
Impact of derivative instruments	116,234	36,154	(107,254)	(45,134)	-	-
Interest rate sensitivity gap	130,417	(87,679)	(5,687)	(736)	(36,315)	-
Sensitivity to profit and reserves:						
Parallel shift of + 1%	(141)	418	(208)	20	-	89
Parallel shift of + 2%	(283)	836	(416)	39	-	176

At 31 December 2017, the Group had an interest rate swap with a notional value of £42.2m (2016: £45.1m) 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)

28. Financial instruments (continued)

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

	Gross amounts* £000	Financial collateral** £000	Net amounts £000
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	(26,345)	967
Total Financial liabilities	**27,312**	**(26,345)**	**967**
2016 Financial assets			
- Derivative financial instruments	3,036	(2,350)	686
Total Financial assets	**3,036**	**(2,350)**	**686**
Financial liabilities			
- Derivative financial instruments	31,596	(28,380)	3,216
Total Financial liabilities	**31,596**	**(28,380)**	**3,216**

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

29. 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	2017 £000	2016 £000
General reserves		54,699	51,678
Available for sale reserve	23	35	341
Revaluation reserve	24	380	380
Pension fund adjustments[1]		(207)	-
Deductions for intangible assets[2]	16	(10,020)	(10,668)
Total Common Equity Tier 1 Capital		44,887	41,731
Collective impairment losses	12	374	309
Subordinated liabilities	21	10,000	10,000
Total Tier 2 Capital		10,374	10,309
Total regulatory capital		55,261	52,040
Risk weighted assets		373,100	394,486
Capital ratios			
Common equity tier 1 ratio		12.0%	10.6%
Total capital ratio		14.8%	13.2%
Leverage ratio		4.4%	3.7%

Notes:

(1) 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.

(2) 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.

30. 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 13 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 2017 was £874,000 (2016: £913,000). Further information on compensation for key management personnel can be found in Note 7 and in the Directors' Remuneration Report.

Notes to the accounts (continued)

30. Related party transactions (continued)

c) Transactions between key management personnel and their connected persons

Shares and deposits	2017 Number of key management personnel	Amounts £000	2016 Number of key management personnel	Amounts £000
Balance at 1 January	11	155	11	267
Net movements in the year	(2)	(59)	n/a	(112)
Balance at 31 December	9	96	11	155

	2017 Number of connected persons	Amounts £000	2016 Number of connected persons	Amounts £000
Balance at 1 January	2	11	2	33
Net movements in the year	(1)	(11)	-	(22)
Balance at 31 December	1	-	2	11

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 2017, there were no outstanding mortgage loans granted in the ordinary course of business to Directors and their connected persons.

31. 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 2017:

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

Average number of employees: As disclosed in note 6 to the accounts

Annual turnover: Equivalent to total net income and, along with profit before tax, is as disclosed in the income statement on page 38

Corporation tax paid: As disclosed in the cash flow statement on page 41

Public subsidies: There were none received in the year

ANNUAL BUSINESS STATEMENT

for the year ended 31 December 2017

1. Statutory percentages

	Ratio at 31 December 2017	Statutory limit
	%	%
Lending limit	1.4	25
Funding limit	13.2	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 2017	Ratio at 31 December 2016
	%	%
As a percentage of shares and borrowings:		
Gross capital	7.0	6.2
Free capital	5.2	4.4
Liquid assets	16.7	22.4
As a percentage of mean total assets:		
Profit after taxation	0.21	0.11
Management expenses	1.56	1.44

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 the 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 2017

3. Information relating to the Directors and other officers as at 31 December 2017

Name of Director	Date of Birth	Date of Appointment	Occupation	Other Directorships
J Ashmore	16.1.1971	19.5.2015	Director	Crocus Home Loans Ltd The Challenge Network Commonwealth Games England AHI Group Jazz-works Ltd Fitness Over Fifty Ltd
T G Barr	22.11.1962	10.04.2014	Director	Crocus Home Loans Ltd IT Range Ltd Cambridge Rugby Union Football Club Ltd (Honorary Secretary)
G R Dunn	10.07.1949	26.05.2011	Director	Crocus Home Loans Ltd
C H Field	24.11.1973	1.05.2014	Chief Executive Officer	Crocus Home Loans Ltd
D L Garner	29.9.1971	14.9.2015	Chief Financial Officer	Crocus Home Loans Ltd
N J Holden	7.12.1959	27.03.2014	Director	Crocus Home Loans Ltd BLME Holdings plc Bank of London & The Middle East plc IntegraFin Holdings plc Integrated Financial Arrangements Ltd IntegraLife UK Ltd Stanbic International Insurance Ltd
S A Howe	28.05.1965	1.05.2014	Chief Customer Officer	Crocus Home Loans Ltd
E Kelly	14.8.1965	19.5.2015	Director	Crocus Home Loans Ltd MHS (Holdings) Ltd St James's Place Corporate Secretary Ltd Cirenco Ltd SJPC Corporate Investments Ltd St James's Place International Assurance Ltd Willsher Consulting Ltd
N J Treble	24.08.1959	27.03.2014	Director	Crocus Home Loans Ltd Batesons Consulting Ltd Eskmuir Group: Eskmuir Properties Ltd Eskmuir Investments Ltd Eskmuir Securities Ltd Eskmuir (Thayer Street 1) Ltd Eskmuir (Thayer Street 2) Ltd 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:
Deloitte LLP, One City Square, Leeds, LS1 2AL

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

4. Directors' service contracts

As at 31 December 2017, C H Field, D L Garner and S A Howe had service contracts with the Society which could be terminated by either party giving six months' notice.

OUR VALUES

GENUINE

Our business is built on two things – trust and serving our Members, not shareholders.

APPROACHABLE

We are friendly and proud of our place in Members' communities.

STRAIGHTFORWARD

We always communicate clearly and offer uncomplicated products and services.

CONSISTENT

Our Members depend on us for competitive, good quality products and services that meet their needs and reward their loyalty.

PROACTIVE

By anticipating future developments and Member needs, we not only future-proof our business, but can take action to minimise negative consequences, seize opportunities and improve our Members' experience.

Saffron Building Society

0800 072 1100
saffronbs.co.uk

Saffron House,
1A Market Street
Saffron Walden
Essex
CB10 1HX