REPORT & ACCOUNTS 2011

Yorkshire
BUILDING SOCIETY

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CHAIRMAN'S REPORT
Ed Anderson

ANOTHER LANDMARK YEAR

In my sixth annual review as Chairman of Yorkshire Building Society I am pleased to report that the Society has achieved an excellent overall performance, improving profits and increasing mortgage assets in very difficult market conditions and strengthening our position as the UK's second-largest independent mutual building society.

Demanding market conditions and regulatory change presented the Society with significant challenges as well as fresh opportunities over the course of the year. In 2011 the resilience of the Yorkshire's balance sheet enabled us to pursue and successfully conclude two major transactions: a merger with Norwich & Peterborough Building Society (N&P) and the acquisition of the mortgage and savings business of Egg Banking plc, both of which serve to strengthen the Yorkshire's position. It is a pleasure to welcome all our new members who have joined us either as a result of the merger with N&P or by virtue of being customers of Egg. Regrettably, after careful consideration we took the decision to wind-down the Society's offshore subsidiary Yorkshire Guernsey Ltd after regulatory changes meant that it was unable to serve its original role.

The Board's view of the external environment is that the level of uncertainty in the economy has increased over the past year with the stabilisation evident in some areas earlier in 2011, such as the wholesale markets, reversing by the end of the year. As a consequence we believe that our prudent approach remains right for the Society and is in the best interests of our current and future members.

The Board, particularly the non-executive directors, is responsible for the corporate governance of the Society and for ensuring that best practice is adopted in this area. Our approach to corporate governance and details of the formal committee structures in place to deliver it are set out in detail in the Corporate Governance Report on pages 43 to 51.

The Board's focus

The Board maintained its focus on the following critical areas in 2011 as well as addressing important discrete issues such as the appointment of the Society's next Chief Executive:

- **Core business performance**
  The Board continued to give close attention to overseeing the Society's delivery of a consistent level of profitability, which is essential to maintaining its capital strength and its ability to deliver benefits to our members. In particular, new mortgage lending continued to be undertaken in a controlled and sustainable way. As a result of our focussed approach, the lending undertaken in recent years is proving to be of consistently high quality. A comprehensive review of the Society's performance is set out in the Chief Executive's Report and in the Business Review on pages 6 to 31.
- **Merger, acquisition and integration**
  In addition to overseeing the successful completion of the programme to integrate the operations of Chelsea Building Society into the business, the Board supervised the programmes responsible for the Yorkshire's merger with N&P and the acquisition of Egg's mortgage and savings business. Planning for the full integration of these two additions to the Society is well underway and, as with the Chelsea, the Board will strive to ensure that the expected benefits are obtained and thereby additional value is generated for our members.
- **Corporate governance and regulation**
  As noted above we continue to ensure that the Board adopts the highest standards of corporate governance and that the Society operates in accordance with both the spirit and letter of all relevant regulation.

Regulatory reform at both domestic and international levels continues apace requiring every part of our business to respond to the changes. One important development is the Financial Services Authority (FSA) restarting the funding review of the Financial Services Compensation Scheme (FSCS). The review originally started in 2009 but was put on hold due to the development of EU directives and UK regulatory reform. The review will look at a range of issues including how the annual levy is calculated. We continue to be actively engaged in lobbying to ensure that as a result of their prudent, primarily retail-funded business models, building societies, and in turn their members, are protected from further inequitable payments to the FSCS.

Looking ahead, our regulator the FSA will cease to exist in its present form and will be replaced by two new regulatory bodies. The Prudential Regulation Authority (PRA) will be a subsidiary of the Bank of England responsible for day-to-day supervision of financial institutions, whilst the Financial Conduct Authority (FCA) will regulate how financial services firms conduct their business. The new regulators are expected to be in place by the end of 2012 and the Board will ensure that the Society continues to comply with the relevant regulatory frameworks.

- **Succession of Chief Executive**
  The non-executive directors exercised utmost diligence in undertaking the process of finding and appointing a suitable successor to Iain Cornish following his decision to step down. The process was overseen personally by me and I am confident that Chris Pilling, who succeeded Iain on 31 December 2011, will continue to drive the Yorkshire forward towards the achievement of our vision, 'to be the best organisation that our customers do business with'. We seek to achieve this by providing our members and other customers with products and services that offer long-term value and financial security, backed up by excellent service.

Board and General Management changes

Iain Cornish, who served as the Society's Chief Executive for the past eight years, stood down from his role at the end of the year. As I explained in my report last year, this was entirely a personal decision on Iain's part, as he felt that the time was right to allow a new leader to take the Society forward.

Under Iain's outstanding leadership the Society has not only survived the global financial crisis so far, but has emerged stronger, having undergone transformational development. I would especially like to thank Iain for his tremendous contribution to the Society's success over his long career with the Yorkshire and, on behalf of myself and my colleagues, wish him well for the future.

Iain is succeeded as Chief Executive by Chris Pilling who brings with him a wealth of skills and experience in delivering exceptional customer service in the retail financial services sector, which will prove invaluable in equipping him to lead the Society forward, building on the strong position we have established. Teamwork is central to our culture and Chris joins an extremely strong leadership team which has done an impressive job in leading the Society through an exceptionally demanding period.

Richard Davey, Non-executive Director, has announced his intention to stand down at the forthcoming AGM after six years on the Board and having served as our Vice Chairman for the past five years. Richard has made an excellent contribution to the Board and I am particularly grateful for his commitment and support in the role of Vice Chairman during the period of global economic crisis. It is anticipated that his successor as Vice Chairman will be announced at the AGM.

There were no other changes to the Board or General Management team during 2011.

A complete list of the Board of Directors can be found on page 51 and profiles of each of the Society's directors and General Managers can be found on pages 36 to 39.

Our people

It has been impressive to see how the capability and confidence of the Society's people have developed over the past two years as they have worked together to successfully drive the business forward in challenging and volatile times.

The strong year for the Society in 2011 in terms of financial performance, as well as the successful completion of two major mergers and acquisitions, is testament to the hard work and commitment of our staff. As a Board we believe the remuneration awarded to our staff for 2011 is a fair and proportionate reward for the results that have been delivered, reflecting the Society's all-round excellent performance as well as individual contributions. Further details of our remuneration policy can be found in the Directors' Remuneration Report on pages 64 to 70.

2012 will see continued focus by the Board on our people strategy, ensuring on-going support and development for our staff.

I wish to thank everyone who works for the Society for the way in which they have continued to focus on providing excellent service to our members and other customers across all of our brands, as well as taking the organisation forward so successfully.

The future

We recognise that the outlook for the economy and the impact of regulatory changes on our business is more uncertain than at any time since the emergence of the global financial crisis, hence we will continue to manage the business in a prudent manner within our clearly defined risk appetite.

We are mindful that the ongoing economic uncertainties are likely to result in continued margin pressures. We also intend to continue to invest materially in the business. However, we look forward to the future with confidence. We anticipate extending a wider range of products and services to a growing membership as we take advantage of the opportunities that our recent merger and acquisition activities offer the Yorkshire.

As we pursue our vision, our strategy will continue to be to strengthen the Society's reputation by providing excellent customer service, to deliver sound financial results and to ensure the long-term resilience of the business. Challenging though it may be, the Society's Board and people are committed to continue to deliver these benefits for our current and future members.

Ed Anderson
Chairman

CHIEF EXECUTIVE'S REPORT
Chris Pilling

GREAT LEGACY - BRIGHT FUTURE

I have inherited a fantastic legacy including an excellent performance for 2011. I am very optimistic about the future for the Yorkshire, which I am committed to ensuring will see us continue to pursue our vision – 'to be the best organisation that our customers do business with'.

I am delighted to have joined Yorkshire Building Society at such an exciting time. The Society has a long-held reputation for delivering outstanding value and excellent service to its members. It is clear to me that at a time when 'trust' in banks is at an all-time low, the Yorkshire's success is based on its committed people, mutual status and operating principles that are the foundations of its financial strength.

I am pleased to report that the Yorkshire achieved an excellent performance for 2011 with significant growth in mortgage and savings balances, an increased level of operating profit, stable net interest margin and robust capital and liquidity positions.

Vision and strategy

The Yorkshire is an independent mutual building society and is committed to remaining one. It is a business which has been built around its members for 147 years. Our vision is simple; 'to be the best organisation that our customers do business with' and the Yorkshire aims to achieve this by providing its members and other customers with a comprehensive range of mortgage, savings, investment and insurance products that provide them with financial security and long-term value, backed up by excellent personal service.

During 2011 this approach to running the business resulted in a significant amount of positive external recognition, including over 2,800 'Best Buy' mentions†, averaging 54 per week, and a wide range of industry awards.

Mortgage Finance Gazette Awards: WINNER

Best National Building Society
Best Overall Lender
Best Online Lender
Best Intermediary Lender (Accord)

Moneyfacts Awards: WINNER

Best Building Society Mortgage Provider
Best Short Term Fixed Rate Mortgage Provider
Best First Time Buyer Mortgage Provider

Moneywise Mortgage Awards: WINNER

Best Lender for Fixed Rate Mortgages
Best Lender for Current Account/Offset Mortgages

Moneynet Awards: WINNER

Best Overall Mortgage Provider

Credit Today Awards: WINNER

Best Mortgage Lender of the Year

Moneywise Children's Savings Awards: WINNER

Best Youth Account
Best Children's Savings Account

ifsProShare Annual Awards:

Share Plan Administrator to the winners of 45% of the awards, including:

Best Employee Share Plan Following a Major Corporate Change

† Source: PressWatch Financial from Kantar Media.

The Society made significant progress during 2011 against the strategic priorities set out by Iain Cornish in his Chief Executive's report for 2010:

- **Delivering an exceptional customer experience**
  - Once again our members confirmed that the Yorkshire delivered a great customer experience; 9 out of 10 respondents to our regular customer surveys said that they would recommend the Yorkshire to their family or friends. Another key indicator of how effectively the Group is delivering an exceptional customer experience is the net promoter score, which in 2011 continued to rank the Yorkshire well above the average for the financial services industry. Our net promoter score refers to the net percentage of customers who, when responding to the question "how likely is it that you would recommend us to a friend or colleague?" would either recommend or detract from the organisation.
  - During 2011 the Society piloted a branch revitalisation programme which focussed on enhancing the position of branches at the heart of the communities in which they operate. Following the success of the pilot a number of initiatives are being rolled out across our branch network, with further pilots taking place across all of our brands in 2012. In addition to investing in existing branches, we will continue to look for opportunities to open additional branches and agencies in new locations. We currently intend to open twelve new branches over the next two years.
  - A number of new products were launched in 2011 including the Yorkshire's 'Triple Access Saver' account. This product was designed using feedback from the Society's Member Panel and provides savers with the flexibility to access their money three times a year whilst earning an attractive rate of interest. It has successfully attracted over 8,000 new customers and has been a best-selling account in the year.
  - The Yorkshire strives to ensure that customers are treated fairly; this ethos is illustrated by the fact that the Financial Ombudsman Service overturned only 1 in 9 complaint decisions in favour of the customer which compares very favourably with the average for the financial services sector, in which the Ombudsman overturned nearly 1 in every 2 cases*.

- **Maintaining a high level of financial strength and stability**
  The Group achieved a very strong financial performance in 2011 in very challenging economic and market conditions. Some of the highlights of the Group's performance, which include the merger and acquisition activity undertaken during the year, include:
  - **Increased profit;** statutory profit before tax increased to £130m (2010: £115m) and core operating profit of £163m (2010: £128m), representing a continuation of the trend reported at 31 December 2010. Core operating profit is defined in the Business Review on pages 20 and 21.
  - **Maintained capital strength;** core tier 1 capital ratio of 12.6% (31 December 2010: 12.4%).
  - **Higher total assets;** 9% increase to £32.6bn (31 December 2010: £30.1bn).
  - **Increased members' savings balances;** 21% increase to £26.0bn (31 December 2010: £21.4bn).
  - **Increased mortgage balances;** 14% increase to £26.7bn (31 December 2010: £23.3bn).
  - **Lending volumes increased;** gross mortgage lending of £4.1bn (2010: £2.8bn).

  The Group's business performance and position are explained in detail in the Business Review on pages 12 to 31.

- **Ensuring our people are well trained, rewarded fairly and committed to delivering for our members**
  The results of regular feedback surveys support the belief that our people are committed to and engaged in delivering the Society's strategy. The results of the last survey in May 2011 showed that the Yorkshire's performance on more than 9 out of 10 key indicators was better than, or in line with, comparable UK financial services organisations; in some instances it was better by more than 20 percentage points†. The General Management team are not complacent about these results. As noted in the Chairman's Report, 2012 will see continued focus by the Board on our people strategy which will ensure that our people continue to work in a friendly and inclusive culture, are equipped to deliver a customer experience that differentiates us from others and are rewarded fairly for doing so.

*Source: Financial Ombudsman Service, latest published complaints data for the first six months of 2011.

†Source: ORC International Benchmark Report 2011.

- **Continually improving our administrative processes and systems**
  During 2011 the Group completed the successful integration of Chelsea Building Society into the Yorkshire following our merger in 2010, which included transferring many of the Chelsea systems onto a common Society-wide platform. A new paperless online mortgage application process was rolled out to Chelsea customers during the year, enhancing the service provided to them. This is just one example of our approach to invest continually in all of the Group's brands.

  The Yorkshire continued to invest in its arrears management processes. This is critical in times of challenging economic conditions when some borrowers will face difficulties. The Group has developed a range of measures, commonly known as 'forbearance', which can be used to help manage these circumstances. At all times the Society aims to try to help the borrower through short-term difficulties and avoid creating future problems for them, whilst also protecting the interests of our members.

  Significant investment in many of our systems and processes is planned for 2012 and beyond, including improving the efficiency and effectiveness of the core business systems. This will enable our people to continue to provide the best possible levels of customer service across each brand and distribution channel.

- **Looking ahead and seizing opportunities**
  The year presented the Yorkshire with two important opportunities in the shape of a merger and an acquisition. Last year my predecessor said that in the right circumstances we would take the opportunity to grow by merging with smaller societies. The merger with Norwich & Peterborough Building Society (N&P) was one such opportunity. The merger completed on 1 November 2011 and work on integrating the business is well underway. The Society also completed the acquisition of the mortgage and savings business of Egg Banking plc on 31 October 2011. The Yorkshire has already announced that it intends to take the opportunity to develop new products and services as a result of these transactions. More information on these developments is set out below under 'Corporate development'.

  In 2011 the Group made a cautious re-entry into the buy-to-let market and we intend to develop a presence in this growing area of the mortgage market over the course of this year.

Our strategic priorities are the areas in which the Group is investing significant resources in order to deliver our strategy and vision. The focus of our strategic priorities is reviewed regularly by the Board to ensure they remain targeted at the areas that will ultimately deliver the greatest benefits to members.

Community role

The Society's branch and agency network operates at the heart of communities across the UK. At a time when many institutions have been closing their high street branches in order to cut costs, the Yorkshire has continued to invest and has increased the size and reach of its network, providing more members with face-to-face access to products and services, which they have told us they value. At the end of the year our growing network of branches and agencies was the 9th largest of all banks and building societies in the UK and comprised:

- **135 Yorkshire branches.**
- **46 N&P branches.**
- **35 Chelsea branches.**
- **8 Barnsley branches.**
- **94 Yorkshire agencies.**

As at 31 December 2011 the Society operated 224 branches and 94 agencies, demonstrating the huge investment that has been made over the past five years (2006: 131 branches and 71 agencies).

The Society recognises that branches play an important role in their local communities and for this reason the branch revitalisation programme is working to enhance the already differentiated customer experience that they offer, as well as embedding further the position of each branch in its local community.

Irrespective of the challenging economic conditions, the Society remains committed to providing support to good causes and charities through its corporate responsibility programme 'Societies Together'. Some of the highlights in 2011 include:

- Charity of the Year - staff raised over £85,000 and, with a donation from the Yorkshire Building Society Charitable Foundation, the Alzheimer's Society received £175,000.
- Yorkshire Building Society Charitable Foundation donated over £462,000 to more than 2,000 charities, of which 90% were member nominated.
- Make a Difference Week received over 1,600 nominations for donations to local causes that are important to our members.
- Successful launch of Small Change, Big Difference™ scheme to members who joined the Group as a result of our merger with Chelsea - 11% of these members have already signed up.
- Over 177,000 accounts joined Small Change, Big Difference™ scheme in 2011; resulting in just under 800,000 members now participating in the scheme.
- Over 3,500 volunteer hours were completed by staff working on around 60 projects in our local communities.

Details of the Group's Societies Together programme are set out in the Corporate Responsibility Report on pages 32 to 35.

Corporate development

The core strength and stability of the Society has enabled it to undergo a transformational level of corporate development over recent years, in particular completing two large mergers and a material business acquisition, all of which serve to grow the business and strengthen its long-term position. The Group's development over the past two years has seen our membership grow by over 57% (2011: 3.3m, 2009: 2.1m). It is at this point appropriate to review the key aspects of those recent developments and to comment on the position looking ahead:

- **Chelsea**
  Integration of the Chelsea, including migration of core systems, is now complete. The integration programme was successfully delivered by internal teams in line with our plans, achieving annualised synergies of £33.5m as at 31 December 2011; these are expected to exceed £36m per annum by the end of 2012. The experience of merging with and subsequently integrating a large building society has strengthened the skills and confidence of many of our people and this experience proved invaluable when undertaking further transactions in 2011.

- **N&P**
  The Yorkshire completed the merger with N&P on 1 November 2011 and work on integrating the business is well underway. N&P's members voted overwhelmingly in favour of the merger and I welcome them to the Society. The merger brought together two organisations sharing similar values, including a strong commitment to mutuality. The Group has gained the opportunity to consider developing our own products in areas where N&P has complementary capabilities and expertise, such as the current account market.

- **Egg**
  The Yorkshire acquired the mortgage and savings business of Egg Banking plc on 31 October 2011. The acquisition brought savings balances of £2.1bn and a £0.4bn mortgage book to the Society. The additional retail funds acquired are supporting our appetite to increase mortgage lending in 2012. I would like to welcome Egg savers and borrowers who became members of the Society on completion of the transaction. The Group will seek to extend the functionality of Egg Money Manager across all of its brands; Money Manager enables customers to view all of their online accounts together in one place irrespective of which institution they are held with.

- **Our position on merger activity and integration**
'Looking ahead and seizing opportunities' is one of the Yorkshire's strategic priorities. To date the focus of this priority has been on undertaking strategic mergers and acquisition activities. Our focus for 2012 will shift from further potential mergers to ensuring that we take full advantage of the opportunities that a larger business presents us with, which includes effectively integrating N&P and the business acquired from Egg Banking plc, delivering planned synergies and leveraging newly acquired knowledge and skills to improve the range of products and services offered to members.

  Further consolidation is anticipated in the building society sector and the Yorkshire remains of the view that mergers between building societies are preferable to combinations with institutions from outside the sector. We will consider further mergers provided we are satisfied that they are clearly in the interests of current and future members and that the resources demanded by the subsequent integration work remain inside the Society's operational capacity and risk appetite.

Our people

As explained above, our people are a key focus of our strategic priorities and the General Management team know that it is the attitude, skills and commitment of these individuals above all else that makes the business successful. The Yorkshire benefits from people who are genuinely committed to providing excellent service to customers. On a daily basis my colleagues bring the vision and values to life across all of the Society's brands and locations.

The Society's growth has resulted in many new colleagues joining the business. This is illustrated by the growth in employee numbers over the last five years; the average total number of people employed at the end of the year was 3,266 (2006: 2,337). During this period of merger-led growth, the Society's values of fun, fairness, passion and people working together have been preserved and our people strategy will, in 2012, set the future direction for all our people in our larger and more complex business.

I welcome the colleagues who joined the Society during the year following the merger with N&P and thank them for their resilience during what has been a period of inevitable uncertainty for them. I know they share our commitment to providing our members and other customers with the highest possible standards of service and have no doubt that they will play an important role in extending the Society's customer experience to a growing membership.

Looking ahead

I have inherited a great legacy and am excited about working with my colleagues to address the challenges that will take the Yorkshire forward. We will continue to develop and invest in the attributes of the business that differentiate us from competitors, as well as making changes where needed to enable our people to deliver the strategy and achieve our vision 'to be the best organisation that our customers do business with'.

The Yorkshire has a tremendous opportunity to build on its position and I am very much looking forward to being a part of that. I am committed to maintaining the Group's status as an independent mutual building society, focussed on the interests of current and future members and providing a real and trusted alternative to the banks.

Chris Pilling
Chief Executive

FINANCIAL SECURITY AND LONG-TERM VALUE

The following section provides a detailed review of the Group's performance in 2011, including both income statement and balance sheet analyses and looks at some of the key performance indicators ('KPIs') that the Board and management use to monitor and direct the Group.

Vision and strategy

The Group's vision remains 'To be the best organisation that our customers do business with'. We aim to achieve this by:

- Providing members with financial security and long-term value.
- Delivering a strong customer service through engaged and motivated staff.

Fundamental to achieving our vision, and hence at the core of our strategy, is our commitment to remaining a mutual organisation, and specifically a leading independent building society providing competitive products and excellent service across multiple products, brands and distribution channels. This is not an end in itself but we believe it is the best way to meet the needs of our members and other customers.

Our financial strategy is driven by our mutual ethos and looks to achieve a balance between delivering value for members whilst maintaining acceptable levels of profitability, growth and financial strength. Within this is our target to optimise rather than maximise profits. This means that we look to price our products so that they deliver value to our members and, by being attractive to them, achieve growth for the Group whilst at the same time generating sufficient profits to maintain a strong capital position (since retained profits are our main source of capital), and so provide financial security for our members. This is not always an easy balance to achieve, especially in a market that is, as now, subject to stressed conditions brought on by economic conditions in the UK and abroad.

This means that we look, as far as is prudent in a competitive marketplace, to provide savings and mortgage products that give long-term value to our members.

At the same time we look to minimise our costs without impairing the service we provide to our members. For example, we could reduce costs materially by reducing the size of our branch network but believe that maintaining a broad network is at the heart of the service we provide to our members. Indeed we remain committed to expanding our branch and agency network. Within the context of minimising costs over the long term we have recognised that we must incur additional costs in order to deliver strategic deliverables (such as mergers and acquisitions and systems renewals), which will ultimately improve our cost efficiency over the long term. This approach means that our costs are currently higher than we would normally accept but we remain of the view that this short-term expenditure is the right approach for the long-term delivery of value.

The Risk Management Report, on pages 55 to 63, sets out the main risks that the Group faces and how we look to manage them. Strategically, we continue to operate in an economy and core markets characterised by a range of short and long-term uncertainties. For example:

- The economy remains vulnerable, with a risk of falling back into recession. This would have a further impact on unemployment, and therefore on arrears and loan losses. As a mortgage lender this is clearly a material area of risk for the Yorkshire. As would be expected, managing it whilst doing all that we sensibly can (bearing in mind our responsibilities to the wider, as well as individual, membership) for borrowers who find themselves in arrears is an area of focus for us.
- The wholesale markets continue to be extremely volatile, not least because of the continued uncertainties over the future of the eurozone and individual countries. This gives us uncertainty over both the market value of some assets and the ability to access wholesale funding going forwards.

- The outlook for interest rates (which directly impact both our mortgage and savings customers) remains unclear although a prolonged period of low rates, resulting in pressure on our saving members, does seem increasingly likely. We continue to try and protect our savers, as far as is commercially sustainable, from the worst impacts of this.
- As highlighted last year, the economic conditions, and general socio-economic trends, continue to promote an increasing level of financial crime that the whole industry is experiencing, meaning there is a need for constant vigilance and evolution to keep pace with the perpetrators.
- Current trends in housing and mortgage volumes remain subdued, and these combine with the wider economic conditions to create a possibility of material future falls in house prices. Opinions seem to vary between expecting broadly flat house prices and moderate falls over the next few years.
- The issues within the wholesale funding markets continue to put pressure on the retail savings market. In the face of this pressure we are seeing some of our competitors continuing to pay what we believe are unsustainable rates (i.e. the price paid for savings cannot be fully recouped from mortgage loans).
- The fast pace of regulatory change continues, with a raft of new regulation which came into effect in 2011 and even more to follow, along with further regulatory reviews to be completed that will deliver even more change. A fundamental change in UK regulatory structures is also imminent. There is also a review by the authorities of how the Financial Services Compensation Scheme (FSCS) liabilities are funded. Under the current FSCS terms the Group continues to pay a material contribution to the FSCS following the failure of institutions such as Bradford & Bingley and the Icelandic banks. This levy, unfairly, places greater financial onus on those institutions with proportionately higher retail funds, thereby punishing the structurally safer organisations.

These uncertainties form the most prominent part of the backdrop against which our strategic and tactical decisions are currently made. The Group's focus is on steering a course through these uncertainties to ensure that it remains a strong and independent building society capable of providing value and service to its members.

It is in this context that the Board assesses the Group's 2011 performance.

Impact of mergers and acquisitions on ratios

A number of our KPIs (such as net interest margin and management expenses) are calculated as a percentage of mean assets to provide a ready measure of how effective we are in managing our business. During 2010 and 2011 these ratios have been distorted by our merger and acquisition activity, due to the point in the year at which the assets involved were brought into the business.

For example, in 2010 the completion of the Chelsea merger, in April, resulted in nine months of income and expenditure being included in the ratio, but the use of mean assets effectively resulted in the inclusion of six months worth of corresponding assets. The calculation is therefore distorted by the assumption of too low an asset figure, and results in a higher simple ratio than one calculated by taking an average based on, for example, the asset figure at each month end.

Conversely, as the N&P and Egg transactions completed towards the end of 2011, the mean asset figure is overstated against the associated income and expenditure figures, and the resulting ratio is understated.

Despite this, it is important to monitor and report the figures based on the simple average asset figure as this provides comparability against other institutions. We are, however, keen that readers of this report understand the impact of this anomaly, and hence the underlying trends. Therefore, in this report we have used the simple average figures unless stated otherwise, and explicitly refer to the Adjusted ratio (based on monthly mean assets) where this provides a different perspective on our actual performance.

Income statement overview

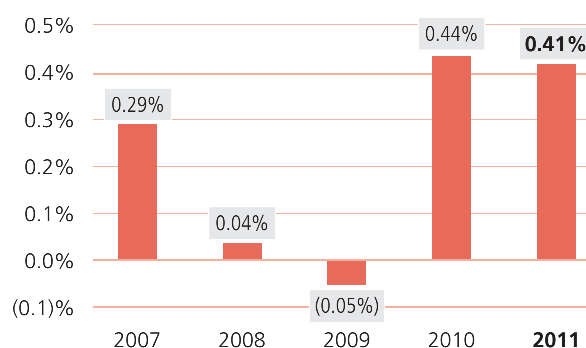
This section looks at our profit before tax on both a statutory and a core operating basis, with commentary that explores the underlying drivers of the Group's performance. Both measures indicate a strong financial performance in 2011, building on 2010's performance.

Key Performance Indicator explanation:
The Board monitors the Group's performance on both a statutory and a core operating basis because it believes that both add value to its oversight of the Group. Statutory profit before tax is the most commonly used comparative definition of profit and is a key component of our capital. However, it includes a number of items that the Board believes do not reflect the longer-term, sustainable business performance either because they are pure accounting measures (e.g. negative goodwill), are one-off in nature (e.g. integration costs) or are timing differences that reverse over time (e.g. some fair value adjustments). The Board therefore uses core operating profit, which excludes these items, to look through to the underlying Group performance. Core operating profit is considered further on page 20.

STATUTORY PROFIT BEFORE TAX

	2007 £m	2008 £m	2009 £m	2010 £m	**2011 £m**
Net interest income	188	165	148	273	**329**
Fair value movements	(43)	(29)	(10)	(10)	**(10)**
Profit from sale of assets	(2)	(1)	11	15	**3**
Other income	41	31	31	43	**47**
	184	166	180	321	**369**
Negative goodwill	-	3	-	17	**6**
	184	169	180	338	**375**
Management expenses	(120)	(122)	(131)	(173)	**(209)**
	64	47	49	165	**166**
Provisions	(9)	(39)	(61)	(50)	**(36)**
Profit before tax	55	8	(12)	115	**130**

STATUTORY PROFIT BEFORE TAX AS % OF MEAN ASSETS



2011 has seen the Group broadly sustain 2010's return to more normal levels of profit.

In 2011, statutory profit before tax increased by 12% to £130m. On a simple mean assets ratio it has decreased from 0.44% to 0.41% but has improved from 0.40% to 0.42% on an Adjusted ratio basis.

The fall in the simple ratio is mainly driven by non-core items as follows:

- £12m decrease in profits from asset sales, i.e. higher profits made in 2010 than in 2011.
- £7m increase in merger and other exceptional costs relating to integrating the Chelsea and successfully completing the N&P and Egg deals.
- £11m lower negative goodwill from the N&P merger than arose on Chelsea.

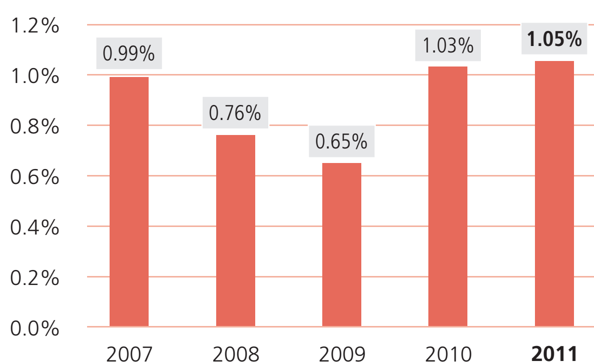
Against this, core operating items that improved in absolute terms were:

- A full year's trading of the Chelsea (against nine months in 2010).
- The achievement of cost synergies associated with the Chelsea merger.
- A further reduction in mortgage loss provisions.

Net interest income

Key Performance Indicator explanation: The Board monitors the Group's net interest margin, a measure that calculates net interest income as a percentage of mean assets. This measure tracks how effective an institution is in earning income on its assets, and in managing the interest paid for its funding. The cheaper they can raise funding, and the more effectively they invest assets, the higher this ratio will be. Because the majority of our assets and liabilities are in the form of mortgage loans to, or savings deposited by, our members, our policy is to optimise rather than maximise this ratio since the product rates that underlie this ratio are our key mechanism for delivering value to our members. As such we have a lower margin than many of our non-mutual peers. The challenge is to achieve the appropriate balance, within a competitive marketplace, between providing value to members, achieving adequate levels of asset growth, taking only sensible levels of risk and making sufficient profits to maintain a strong capital position.

NET INTEREST MARGIN BEING NET INTEREST INCOME AS % OF MEAN ASSETS



2011 saw the continuation of more normal net interest margins following the dip in 2008 and 2009.

The Group's net interest margin rose to 1.05% in 2011, up from 1.03% in 2010. On an Adjusted ratio basis the increase was more marked from 0.94% to 1.07%.

This improvement is driven by a wide range of interacting factors that are discussed below.

The focus on further enhancing our funding and liquidity management has continued throughout 2011, with resulting margin benefits:

- Despite the issues in wholesale markets, we have developed a securitisation capability which enabled us to enhance and diversify our wholesale funding through an issue to a different pool of investors and at a better interest rate than we could achieve on retail funding. This reflects our desire to raise a sensible proportion of our funding from wholesale sources which provide cost-efficient funding.
- We do not, however, wish to be over-reliant on this type of funding as many institutions were before the credit crunch. Overall, 2011 saw us further reduce the proportion of funding from wholesale sources i.e. a shift further towards retail funding.
- During the year we also reduced the average cost of wholesale funding we have in place, repaying relatively expensive funding early in the year and replacing it with less expensive wholesale funding.
- Furthermore, whilst the covered bond which matured in November was comparatively cheap funding we effectively replaced it with retail balances, acquired with N&P and Egg, with an average rate substantially lower than the current marginal cost of either retail or wholesale funds; this should help to protect our future margins.

The focus within retail funding has been to continue to offer fair rates to our members and to avoid some of the more unsustainable pricing seen, from time-to-time, in the market. For example, we continued, as in 2010, to manage down the more unsustainable fixed-rate retail balances acquired with the Chelsea. Overall, the competition for retail funding during 2011 and our commitment to continually deliver value to our savings members has meant that the margin on our retail books (excluding N&P and Egg) has remained broadly the same as in 2010.

Liquidity management has continued to focus on the balance between the need to maintain a prudent level of high-quality assets and the desire to optimise our interest margin given that the assets in which we can now (under the current regulatory regime) invest our liquidity provide only minimal levels of return. Members should be assured

that if a conflict ever arose between these two aims we would always err towards the former i.e. towards maintaining the financial robustness of our balance sheet against seeking to increase profits at the risk of that robustness. Early in 2011 we continued to manage down these low-interest-earning assets whilst always maintaining well in excess of our regulatory requirement. Compared to 2010 this meant a much lower cost of carrying excess liquidity (i.e. amounts over and above what we and our regulator, the FSA, consider sensible). During the early autumn it was necessary to maintain a higher level of surplus liquidity to carry us safely through the N&P and Egg transactions and a number of material wholesale maturities. Following the successful completion of these transactions we have restored more efficient levels of liquidity which will protect margins going forward.

Non-organic growth (i.e. the N&P and Egg transactions) means that we have not had to 'chase' mortgage lending at unsustainable rates. With this in mind we initially projected a modest decrease in our mortgage book during 2011 (excluding these two deals). In reality, we have grown the book by £0.7bn over and above these strategic acquisitions and our total loan assets now stand at around £27bn. This, better than expected, net lending performance was also achieved at better margins than anticipated.

Finally, 2011 has seen the continuation of a larger than usual standard variable rate position which developed in our mortgage books last year i.e. whilst we have seen more borrowers moving away from standard variable rate mortgages the overall proportion on these products is still higher than was usual before the financial crisis commenced. We remain of the view that this is a temporary situation that will unwind when the economy and markets recover. It has nevertheless continued to provide us with a net interest benefit.

Fair value movements

Key Performance Indicator explanation: The Board monitors the Group's fair value movements in absolute terms. These movements represent adjustments to the value of a number of assets and liabilities to reflect their current market value. Since the Group generally retains these assets and liabilities to their normal maturity dates (when the full face value is generally expected to be realised) these mark to market adjustments are in effect timing differences, which will in time usually reverse out.

In 2011, £4m (2010: £6m) of the adverse movements relate to hedge accounting and these continue to be viewed as a timing difference which will reverse in time. Because of this, the Group's aim is to minimise their year-on-year impact on our results. The 2011 movement is considered to be within acceptable tolerances.

The remaining £6m movement (2010: £5m) relates to our historic and inactive portfolio of structured asset investments. The total current value of all such investments is £57m, compared to £71m in 2010. The remainder of the fall in value is due to scheduled maturities, all of which were received in full.

As described in the Risk Management Report on page 61, these positions are monitored constantly for any evidence that these losses may not reverse as the underlying instruments approach maturity (i.e. that the underlying investments are losing money). In such circumstances the adjustments would be re-classified as impairments, through the Income Statement.

The current market uncertainty, particularly around developments in the eurozone, means that there is a risk that (irrespective of the performance of individual assets) some fair value movements may not reverse and consequently represent a potential future loss. At present there is no evidence that this risk has crystallised and permanently impaired the value of any of the investments.

Profit from sale of assets

We are required to continually prove the liquidity of our liquid assets by maintaining a constant level of transactions in the market (i.e. to prove that we can sell them and realise their cash value if needed). This means that the decisions to sell such assets are not decided with a view to realising a profit but only to prove their liquidity. The prevailing market conditions delivered a profit of £3m in 2011, compared to a profit of £15m in 2010. This income is highly variable, as it is driven primarily by the requirement to demonstrate liquidity and the unpredictable timing of when actual sales are completed, rather than a desire to deliver a predictable income stream and so be more selective about the timing of sales.

Other income

Key Performance Indicator explanation: The Board monitors the Group's other income in absolute terms. This figure principally represents the income we earn from selling non-mortgage and savings products (such as home and contents insurance, investment products and other insurances), combined with that we earned from a number of smaller business divisions (being our YBS Share Plans and Yorkshire Key Services operations). This measure indicates how successful we have been in:

- Providing appropriate and competitively-priced products to our members through our partnerships with other financial institutions.
- Running our smaller business divisions.

In 2011, our non-interest income (net of charges) increased from £43m to £47m, a 9% increase year-on-year. Measured as a simple mean assets ratio it decreased from 0.16% to 0.15%, but on an Adjusted ratio basis it remained steady at 0.15%.

Overall, given the economic conditions, we are comfortable that this steady rise in the absolute level of our net other income reflects our ability to provide our members and other customers with the insurance and investment products they need. Nevertheless, we feel that our performance in this area can improve, particularly around income generation on the migrated Chelsea business (and on the N&P business once migrated).

One positive contribution in this area was the reduction in fees paid in respect of the Government's Special Liquidity Scheme due to our early withdrawal from the scheme in early summer; a reflection on our financial strength and the success of our asset and liquidity management.

Negative goodwill

This item arose from the merger with the N&P; the 2010 equivalent related to the merger with the Chelsea. Goodwill reflects the difference between the deemed purchase price for the merged entity and the net value of its assets after fair value adjustments.

Although there is no purchase consideration in the case of a merger, accounting rules require one to be attributed to the business, based on a theoretical net present value calculation. A negative goodwill amount reflects the fact that the deemed purchase price was lower (i.e. cheaper) than the value of the assets acquired and implies that less was paid for the business than it is worth. However, given that the deemed purchase price is based on a theoretical net present value calculation rather than an actual purchase price we believe that the figure has no bearing on actual underlying performance. The figure also does not affect reserves or capital since an initial reduction in reserves is immediately reversed through the Income Statement.

The Board does not consider that this figure reflects any aspect of the real performance of the business or the real value of the mergers to the Group.

Management expenses

The Group continues to focus on its efficiency and effectiveness in how it delivers services to members – a key measure of this is its management expenses ratio.

Key Performance Indicator explanation:
The Board monitors the Group's cost efficiency using two measures:

- Management expenses ratio – (management expenses as a percentage of mean assets) looks at how much it costs us to manage every £100 of assets. This provides a broad measurement of how well the Group manages its costs to remain efficient whilst still delivering effective service, and how growth, inflation and efficiency are being balanced. Put simply, the lower the ratio the more efficiently an organisation is being managed.
- Cost:Income ratio – (management expenses as a percentage of total income) looks at the relationship between our income generation and our costs. In some cases an institution may well have higher costs than its peers, but if these costs are generating additional income and hence profits then such a structure makes sense. The lower the ratio the less an institution is spending to generate every £1 of income.

Looking at the first of these, the simple mean asset ratio increased, from 0.66% to 0.67%, despite the realisation of savings from the Chelsea merger amounting to £33m per annum and the benefit generated by the timing of the N&P and Egg transactions. In absolute terms, whilst net interest and other income rose by £56m in 2011 our expenses rose by £36m, absorbing nearly two thirds of this additional income.

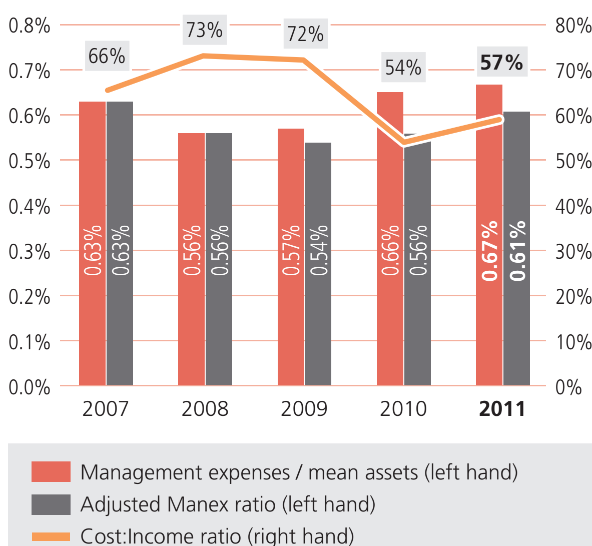
The factors behind the continuation of the increase in cost ratios seen last year include:

- Rising inflation and an increase in VAT (most of which cannot be reclaimed by the Group) have, as highlighted last year, put continued pressure on costs.
- Merger and acquisition activity generated transaction and integration costs for Chelsea, N&P and Egg.
- The running costs of both the Egg and N&P businesses are high and will remain so until the completion of the relevant integration projects in late 2012 and 2013 respectively.
- The Board has taken the decision to invest significantly in both our business processing capacity and our ability to deliver major projects (such as mergers or systems development), as well as in our branch revitalisation project so that these can be delivered without jeopardising our service to customers.

A number of these costs are considered to be exceptional in nature (e.g. one-off costs for mergers, acquisitions and closures). Excluding these items (and their equivalents in 2010), the simple ratio fell marginally from 0.62% to 0.61%. The Adjusted ratio (also excluding these costs) rose from 0.56% to 0.61%. This increase in the Adjusted ratio reflects the other factors noted above, in particular the impact of inflation and VAT, of the high running costs of N&P and investment in our underlying systems, processes and branches.

The Group's Cost:Income ratio (the line on the chart) also increased during 2011 driven by many of the same factors as outlined above.

MANAGEMENT EXPENSES AND COST:INCOME RATIOS



Management expenses / mean assets (left hand)
Adjusted Manex ratio (left hand)
Cost:Income ratio (right hand)

The factors discussed above will continue to put pressure on our cost ratios over the next few years before the full benefits of the new businesses and our other investments are realised. We continue to focus on achieving value for money in these investments whilst ensuring that we do indeed continue to invest to enable us to effectively deliver value to our members. Our aim is to reduce these cost ratios to more sustainable levels once the investment needed is complete.

Provisions

Key Performance Indicator explanation: The Board monitors the Group's provisions charge in absolute terms. This measures how far our assets have failed to perform from a credit risk perspective. It includes both actual losses incurred as a result of defaulting borrowers, and our estimate of potential losses on mortgages and other assets that, based on our portfolio's current behaviour, we believe are already impaired (whether or not they are actually in arrears). Whilst clearly heavily influenced by factors such as the wider economy (in particular unemployment levels) and the housing market (in particular house prices) this measure gives the Board a clear view on whether the risks taken on our lending and investments are in line with expectations.

The breakdown of the provisions charge in recent years is as follows:

	2007 £m	2008 £m	2009 £m	2010 £m	**2011 £m**
Provisions against loan portfolios	5.0	25.0	59.0	40.8	**30.1**
Provisions against impaired investments	6.9	-	0.9	5.1	**-**
Provisions for other items	(3.0)	(1.0)	(1.4)	-	**-**
Internally generated provisions	8.9	24.0	58.5	45.9	**30.1**
FSCS charges	-	14.7	2.7	3.6	**5.6**
Total provisions	8.9	38.7	61.2	49.5	**35.7**

The main provisions charge against our, principally residential, loan portfolios fell again in 2011, by 26% against 2010 despite a loan book which is 16% larger. This initially seems to run counter to our general concerns over the persistent threats to the economy and specifically to unemployment and house prices, which are major drivers of arrears and mortgage losses respectively. A number of factors continue to give the Board confidence that our overall provisions remain at a prudent level, including:

- The continued increase in the quality of our residential mortgage book, which was further enhanced with the addition of N&P and Egg.
- The fact that our arrears levels (over three months excluding possessions) continue to improve such that they fell from 2.26% to 1.90% during the year, and increased the degree by which they are below the industry average.
- The fair value adjustments relating to the Chelsea and N&P mergers enabled us to provide additional protection from future losses over and above what can be provided through standard 'incurred loss' provisioning. When calculating the fair value of the mortgages we effectively provided for expected lifetime losses on these loans when they were brought onto our balance sheet. Any losses incurred on these books that are in line with our original expectations are set against the fair value adjustments rather than being charged through the Income Statement. Losses in 2011 were in line with our expectations, and even after charging these against the 'provisions' originally made we continue to carry significant protection against future losses on these books.
- The Group has recovered an amount of £5.0m in relation to losses suffered by Chelsea prior to the merger. This amount nets off against our provisions charge. As this recovery was far from certain at the time of the merger, no value was ascribed to it in the fair value adjustments made at the time, and so these amounts have been credited to the Income Statement in 2011.

The following table shows the overall 'protection' provided against the Chelsea and N&P loan books. The figures are the combined effect of the impairment provisions previously carried by the merged entities and the credit risk elements of the fair value adjustments made on merger.

PROVISIONS AND FAIR VALUE ADJUSTMENTS FOR CREDIT RISK

	2010 £m	**2011 £m**
Brought forward	-	**213**
Previously carried by Chelsea / N&P	53	**13**
Fair value on merger Chelsea / N&P	176	**39**
Utilised losses	(16)	**(21)**
	213	**244**

Whilst not in any way a return to pre-recession levels, the movement in charges is clearly a step in the right direction, and reflects our management of arrears during 2011. The economy and housing markets clearly remain stressed and many commentators are forecasting increased unemployment and falling house prices in 2012, both of which could lead this figure to rise again even with continued firm management of arrears.

As referred to in the Chief Executive's report, the Group exercises a certain amount of 'forbearance' to borrowers who may face difficulties in making their mortgage payments:

- In the first instance the objective is to engage the customer in constructive dialogue with the aim of clearing accrued arrears and re-establishing sustainable, regular payments. To achieve this, the Group uses a variety of tools ranging from the use of forbearance facilities through to ending the customer's relationship with the Group. This includes taking possession and selling mortgaged properties, as in some cases this will be a better option for both the borrower and the Group than allowing the position to deteriorate further.
- Forbearance tools are only applied where deemed appropriate for an individual customer's circumstances, and are used in line with industry guidance. These may include capitalisation of arrears (adding them to the underlying loan), temporary interest-only concessions, payment arrangements (to make regular but reduced payments for a limited period), payment holidays and term extensions. The use of account management tools are either fully recognised within provisioning or are low in materiality. Further details can be found in Note 39.
- In using these tools we need to balance the desire to help customers in the short-term with our responsibility to ensure that whatever measures we agree to are realistic (e.g. are affordable by the customer) and are not delaying and exacerbating the underlying issue. We also have to balance our responsibility to individual customers with our duty to all our members and manage our risks responsibly and maintain our financial strength and stability.

Other elements of the provisions charge are related to non-core items:

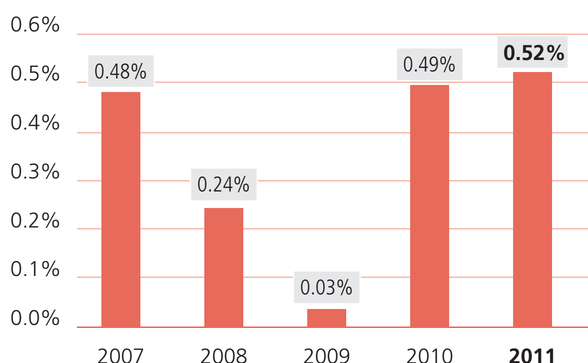
- Impaired investments – despite the reduction in the value of our structured investments discussed earlier, there is no evidence of any further impairment of individual assets and so, unlike in the previous two years, no provisions charge has been made this year.
- Other items – the credits in 2009 and prior years related to the release of over-provisions against potential compensation claims relating to long-discontinued business activities such as endowment policy sales.
- Financial Services Compensation Scheme – as previously noted, the Group continues to pay a material contribution to the FSCS following the failure of institutions such as Bradford & Bingley and the Icelandic banks. This levy, unfairly, places greater financial onus on those institutions with proportionately higher retail funds, thereby punishing the structurally safer organisations.

Core operating profit

A number of Income Statement components do not reflect our underlying performance and are reversed when calculating core operating profit. This measure gives the Board a clear view of our ongoing performance without shorter-term distortions, both positive and negative:

	2007 £m	2008 £m	2009 £m	2010 £m	**2011 £m**
Statutory profit before tax	55	8	(12)	115	**130**
Reverse out the following items:					
Fair value movements	43	29	10	10	**10**
Sale of assets/ other income	(11)	(2)	1	1	**(1)**
Non core provisions:					
• Structured credit	7	7	1	5	**-**
• FSCS	-	15	3	4	**6**
• Other liabilities	(3)	(1)	(2)	-	**-**
Negative goodwill	-	(3)	-	(17)	**(6)**
Mergers, acquisitions and closures	-	-	7	10	**24**
Core operating profit	91	53	8	128	**163**

CORE OPERATING PROFIT AS % OF MEAN ASSETS



In 2010, we restored higher levels of profitability. In 2011 we have built on that, adding £35m to core operating profit although this includes the full year impact of Chelsea (nine months included in 2010) and two months of Egg and N&P. The simple ratio to mean assets rose to 0.52% (against 0.49%) whilst on the Adjusted basis the ratio has increased to 0.53% from 0.44%.

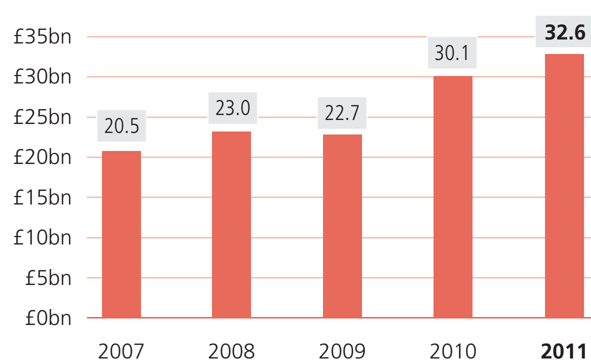
Balance Sheet overview

The growth in the Group's business seen in recent years has continued in 2011, with the merger with N&P and the Egg acquisition. Gross assets now stand at just under £33bn, and have doubled in the past six years (from £16bn in 2005).

GROUP BALANCE SHEET

	2007 £bn	2008 £bn	2009 £bn	2010 £bn	**2011 £bn**
Liquid assets	4.7	5.3	6.7	5.9	**4.9**
Mortgage and other loans	15.4	16.3	15.0	23.4	**27.0**
Other assets	0.4	1.4	1.0	0.8	**0.7**
Total assets	20.5	23.0	22.7	30.1	**32.6**
Retail savings	12.4	13.7	13.8	21.4	**26.0**
Wholesale funding	6.6	7.3	7.2	6.3	**3.9**
Other liabilities	0.2	0.8	0.5	0.7	**0.7**
	19.2	21.8	21.5	28.4	**30.6**
Remunerated capital	0.3	0.3	0.3	0.4	**0.4**
Reserves	1.0	0.9	0.9	1.3	**1.6**
Total liabilities	20.5	23.0	22.7	30.1	**32.6**

TOTAL ASSETS (£bn)



Several years of strong organic growth came to an end when the balance sheet was allowed to shrink, in 2009, to manage funding at the onset of the economic downturn. Subsequent growth has been achieved primarily through the addition of Chelsea, N&P and Egg.

As explained last year, the balance sheet growth in 2010 was considerably less than the full £12bn of Chelsea's balance sheet primarily because of the careful management out of unwanted assets and liabilities. In a similar way, whilst the N&P merger and Egg acquisition initially added £5bn of assets, the overall growth in the year was less than £3bn. This was because we used the funds from Egg to repay wholesale funding and to help with the run-off of our offshore deposit taker. In doing so we have further shifted our funding balance from wholesale to retail; our retail savings balances grew by £4.6bn during the year. Against this, we also grew our mortgage book by £3.6bn i.e. by more than the net growth in our balance sheet. We now have a higher, and better, proportion of earning mortgage assets as opposed to liquidity, which earns minimal interest income under the current regulatory regime.

Unfortunately, new requirements placed upon us and other institutions by the Guernsey authorities, mean that our deposit taker, Yorkshire Guernsey Limited (YGL), was no longer viable because the new rules meant that nearly all YGL's funds would have to be kept as liquidity, earning minimal amounts, rather than lent to homeowners. The excess liquidity generated by the Egg deal enabled us to repay this funding although this did sadly mean the closure of our Guernsey operation. It meant we let £820m of funding leave the Group, with a matching reduction in our liquidity.

The assets and liabilities acquired with N&P were subject to a number of 'fair value' adjustments to reflect a more commercial, market value as distinct from the amounts at which they were recorded in N&P's own records. At the same time a number of other adjustments were needed to bring their values in line with the Yorkshire's accounting policies. The overall impact of these adjustments was to reduce the opening reserves of N&P by approximately £55m. The principal adjustments are as follows (all are pre-tax):

- A net increase of £46m representing the differences between the actual interest rates being charged or earned on N&P's products and financial instruments, and the market rates achievable as at 1 November 2011 e.g. if a particular set of N&P mortgages charge a higher rate than we could have obtained if lending the money at 1 November 2011, then we have to reflect this as an increase in that asset's value as at the time of the merger. These adjustments will reverse over time, through the Income Statement, as the underlying balances mature. Thus, the accounting conventions for these types of transactions have the effect of 'front-ending' the rate impact (in this case a net benefit) and then reverse it back out over time through profit.
- A net reduction of £53m relating to items (principally swaps) recorded at historic cost by N&P (who had not adopted IFRS) but which must be shown at fair value (under IFRS) by the Yorkshire. As with the rate-related adjustments these adjustments will reverse (in this case as positive movements) through the Income Statement as the associated instruments approach maturity.
- An adjustment of £39m to reflect the amount that we could lose through borrower defaults over the remaining life of the N&P loan portfolios. The rules dictating acquisition accounting mean that in determining the fair value of the assets at acquisition, the expected losses for the whole life of the loan portfolios are provided for at this point in time, in addition to the existing loss provisions already made in N&P's books that only covered loans already impaired. This accounts for the uplift, the effect of which (provided our estimates of future losses are accurate), is that any future losses on these assets will not be reflected in our Income Statement. It is equivalent to bringing forward to 1 November 2011 all future loan loss charges on these loans.
- A provision of £32m against potential third-party claims which reflects the risk of further such claims being received and proven to be valid e.g. potential mis-selling claims relating to financial advice provided in previous years by N&P, and the cost of managing those claims. This is in addition to provisions already made by N&P prior to the merger.

The acquired Egg portfolios constituted a good quality mortgage portfolio valued at £0.4bn and a retail savings book of £2.1bn. These portfolios were acquired at a modest net discount of £8m.

Looking in more detail at the principal balance sheet items:

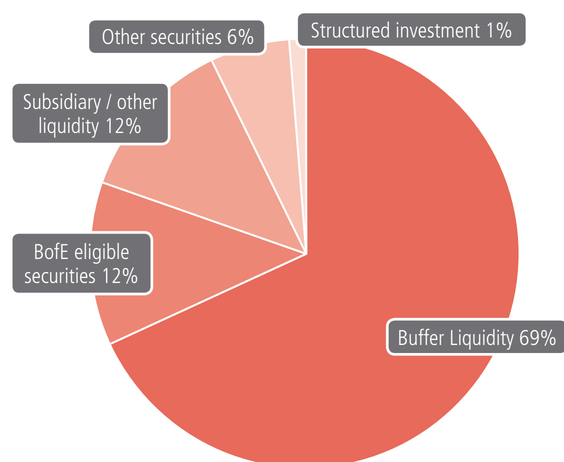
Liquid assets

Key Performance Indicator explanation: The Board monitors the Group's liquidity position in a number of ways, including by continually running potential stress scenarios to test that adequate liquidity is in place, and by monitoring the make-up of our funding and liquidity portfolios. The key measure, however, is to monitor the total level of 'buffer liquidity' against our regulatory requirement (set by the FSA). Buffer liquidity constitutes cash and investments with the UK government (deposits with the Bank of England or holdings of UK Gilts and similar investments) and with supranational institutions. As such it represents the most liquid and safest form of holding.

The FSA's liquidity regime requires us to hold certain levels of the highest quality, or 'buffer', liquid assets (i.e those that are most easily converted into cash). The level is driven by the nature and maturity profile of our funding. Over the last couple of years we have re-structured our funding profile with, in particular, far lower levels of short-dated funding that requires higher liquidity to be held against it. 'Buffer' assets are low risk which means they are also lower earning. This all means that whilst a high proportion of our liquid assets are held in these very low earning assets, we can also hold a lower overall level of liquidity, as shown in the table opposite.

Over two-thirds of our total liquidity is now in 'buffer' liquidity. The majority of the remaining liquidity is either being realised or converted to 'buffer' as the underlying investments mature, and this is expected to continue in 2012. We continue to hold levels of liquidity that are significantly above our regulatory requirement.

BREAKDOWN OF LIQUID ASSETS AS AT 31 DECEMBER 2011



	2009 £bn	2010 £bn	**2011 £bn**
Buffer liquidity	3.2	4.4	**3.3**
Bank of England eligible securities	1.1	0.4	**0.6**
Other securities	1.9	0.7	**0.3**
Total core liquidity	6.2	5.5	**4.2**
Subsidiary / other liquidity	0.4	0.3	**0.6**
Structured investment	0.1	0.1	**0.1**
Total liquid assets	6.7	5.9	**4.9**

The Group's portfolio of structured investments, to which there have been no additions for several years, now stands at just £57m. The portfolio is being monitored very closely and managed down as quickly as is commercially sensible. Nevertheless, the nature of the investments means that their values remain susceptible to the kind of market upheaval we continue to see. During 2011 the total value of the portfolio reduced by £14m, as a result of maturities (which were received in full) and further falls in the value of the remaining book. Even with these falls in value there is still no evidence that further impairment provisions are required.

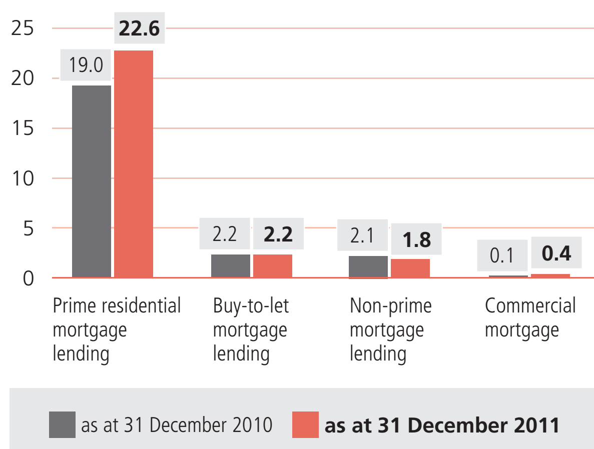
2011 has seen the continuation and deepening of the difficulties affecting a number of eurozone countries, and concerns persist about institutions based in these countries, whether or not they are guaranteed by their own governments. The only one of these countries where the Group has a direct exposure to government owned or guaranteed institutions is Ireland, and at the end of 2011 our exposure was £164m. During 2011 a total of £69m was received in full repayment, when due, of individual debts; a further £51m was received in February 2012. The Group continues to monitor closely the remaining exposures, all of which are senior debt maturing in 2012, and continues to believe that no impairment provision is required against these loans.

Mortgage assets and new mortgage lending

The completion of the N&P merger and Egg acquisition meant the continuation, to a lesser degree, of the shift in the make-up of our mortgage assets introduced by the earlier Chelsea merger. The 2011 deals added primarily residential mortgage assets (£2.7bn in total). They also, for example, brought in a book from the N&P of £0.3bn of commercial lending to local businesses across the UK, as well as our first (relatively small) current account (i.e. overdraft) and personal loan books. The Group remains comfortable with its overall portfolio mix, which remains primarily prime residential lending.

	31 December 2010		**31 December 2011**	
	£bn	%	**£bn**	**%**
Prime mortgage lending	19.0	81%	**22.6**	**84%**
Buy-to-let lending	2.2	9%	**2.2**	**8%**
Non prime lending	2.1	9%	**1.8**	**7%**
Total residential	23.3	99%	**26.6**	**99%**
Other lending	0.0	<0.1%	**0.0**	**<0.1%**
Retail lending	23.3	99%	**26.6**	**99%**
Commercial lending	0.1	<0.5%	**0.4**	**1%**
Total loans	23.4	100%	**27.0**	**100%**

MORTGAGE BALANCES BY LOAN TYPE 2010 AND 2011 (£bn)



Looking in more detail at the acquired portfolios:

- The merger with N&P added some £2.6bn of loans which were 73% prime residential.
- N&P's loans included £0.3bn of buy-to-let residential lending and £0.3bn of commercial loans. Both of these subsidiary portfolios are of good quality and do not add disproportionately to the Group's risk profile.
- The remaining 1% of the N&P loan book was unsecured, being personal loans and overdrafts; these represent less than 0.1% of the Group's loans.
- The Egg transaction added some £0.4bn of very good quality prime residential mortgages.

As with the Chelsea merger in 2010, we have inherited certain mortgage assets with N&P which we do not consider to be core to our business model. Consequently we do not intend to do any more lending in these areas and will be looking to manage down these 'legacy' positions. Conversely, there are some aspects of the N&P loan book that we will be considering for future development. These decisions will be taken carefully and slowly with a clear eye on the Group's residential lending and low-risk focus.

The make-up of our mortgage portfolio, and the potential risks that are contained within it, are monitored closely by the Group across a wide range of characteristics and analyses. These include, for example, considering the geographic make-up of the portfolio, its indexed loan-to-value position and its ongoing arrears position.

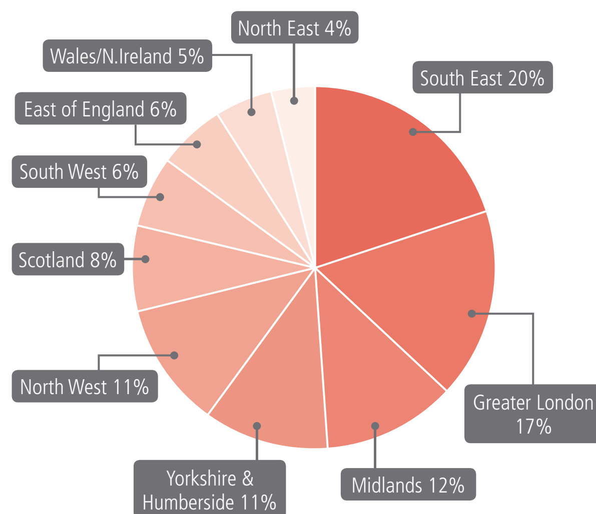
Taking these in turn:

- The UK economy and housing market faces potentially very different future conditions in its various regions. The addition of N&P and Egg's mortgage loans has not had as marked an impact on the geographical split as the Chelsea merger in 2010. This was both because of the relatively small size of the books and because the new assets have a similar split to that of the existing group. The Group's biggest geographic exposures are now in London and the South East which is more in line with, although still lower than, the overall market.

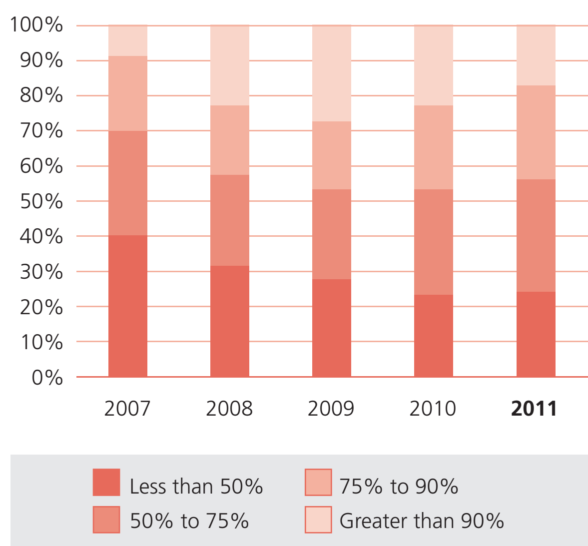
GEOGRAPHIC DISTRIBUTION

	2007	2008	2009	2010	**2011**
Yorkshire & Humberside	17%	17%	17%	13%	**11%**
South East	15%	15%	15%	18%	**20%**
North West	14%	14%	14%	9%	**11%**
Midlands	11%	11%	12%	13%	**12%**
Greater London	11%	11%	11%	16%	**17%**
Scotland	12%	12%	11%	8%	**8%**
North East	6%	6%	6%	7%	**4%**
Wales/N Ireland	6%	6%	6%	5%	**5%**
South West	5%	5%	5%	7%	**6%**
East of England	3%	3%	3%	4%	**6%**
	100%	100%	100%	100%	**100%**

MORTGAGE ASSETS BY REGION (%) AS AT 31 DECEMBER 2011



INDEXED LOAN-TO-VALUE PROFILE



- The indexed loan-to-value for a mortgage portfolio provides a broad estimate of the equity which borrowers retain in their properties, and therefore how much risk we are exposed to in the event that borrowers default. The Group has a higher than average proportion of loans in the higher loan-to-value bands, reflecting its historic (and continued) focus on the first time buyer market and our commitment to help borrowers at all stages of their home ownership journey. The Board remains focussed on this characteristic of the mortgage portfolio through uncertain times. A combination of positive house price movements and the new portfolios from Egg and N&P have marginally improved the ratios in 2011.

INDEXED LOAN-TO-VALUE

	2007	2008	2009	2010	**2011**
Greater then 90%	9%	23%	27%	22%	**18%**
75% to 90%	21%	19%	19%	24%	**25%**
50% to 75%	30%	27%	26%	30%	**33%**
Less than 50%	40%	31%	28%	24%	**24%**
	100%	100%	100%	100%	**100%**

Key Performance Indicator explanation: The Board monitors the Group's arrears performance using a range of different measures and analyses. It does this because the current arrears performance and its trend give a direct indication of how well borrowers are, or are not, coping with current economic conditions and therefore how exposed the Group may be to borrower defaults and hence loan losses. A range of arrears measures are used because they may each provide a slightly different perspective on current and prospective conditions. However the key measure used by the Board is the number of borrowers whose loans are in arrears by three monthly payments or more.

LOANS WITH PAYMENTS MORE THAN THREE MONTHS IN ARREARS AS % OF TOTAL LOANS

	2007	2008	2009	2010	**2011**
Number of accounts	0.95%	1.59%	1.84%	1.84%	**1.58%**
Balances outstanding on accounts	1.04%	1.99%	2.46%	2.26%	**1.90%**

During the year we have maintained our focus on managing arrears, and combined with the impact of the N&P and Egg deals, this has seen our ratio fall once again. The Group's approach to forbearance in cases where borrowers face difficulties in making their contractual repayments is explained in Note 39 to the accounts.

Key Performance Indicator explanation: The Board monitors the Group's new lending performance across a range of measures, and between different channels and portfolios, with the over-arching metric being net new lending in absolute terms. This figure is used because it provides a measure that includes all portfolios and channels, and measures our effectiveness in gross mortgage lending, the rate at which existing borrowers are redeeming their mortgages and how effective we are being in retaining borrowers whose original loan deals are maturing. As such it gives a good guide to how well we are performing both in terms of offering the type of competitive mortgage products that our customers want, and of meeting our growth aspirations.

The Group increased its gross new mortgage lending, to £4.1bn against £2.8bn last year, achieving a market share of 2.9% which is significantly ahead of our 1.9% historic market share of mortgage balances. New loans exceeded net repayments for the first time since 2008, with £0.7bn added organically to our mortgage books. This reflects our commitment to being an active mortgage lender provided this can be achieved within our relatively low risk appetite and following our approach of funding first and lending second. Overall, with the addition of £3.0bn of balances from N&P and Egg, our balances grew by £3.8bn in total, and our share of balances to 2.1% (from the 1.9% historic share noted above). Going forward we will continue to lend as much as we can do within the constraints of available funding, our relatively low risk appetite and market conditions.

Retail and wholesale funding

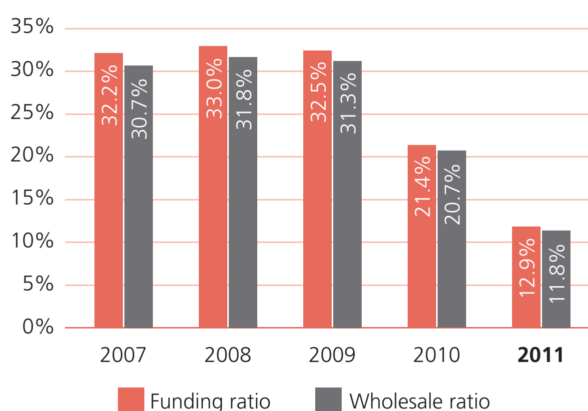
Key Performance Indicator explanation: The Board monitors the Group's relative reliance on wholesale versus retail funding through two measures:

- Funding ratio – which calculates the proportion of total shares and borrowings that are not in the form of shares. This is a statutory ratio and by law the Group must maintain it below 50%.
- Wholesale ratio – which calculates the proportion of our total funding that is from wholesale sources, in effect from banks and other financial or commercial institutions.

Wholesale funding provides valuable diversity in the Group's funding profile. However, the Group's aim is to maintain a sustainable level without establishing too great a reliance on wholesale markets.

2011 saw the continuation of our trend towards retail savings and away from money raised on wholesale markets. This was achieved primarily through the merger with N&P and the Egg acquisition.

WHOLESALE FUNDING RATIOS



	2007	2008	2009	2010	**2011**
Funding ratio	32.2%	33.0%	32.5%	21.4%	**12.9%**
Wholesale ratio	30.7%	31.8%	31.3%	20.7%	**11.8%**

Retail savings now account for 88% (2010: 79%) of our total funding meaning that they fund 97% of our mortgages (2010: 94%).

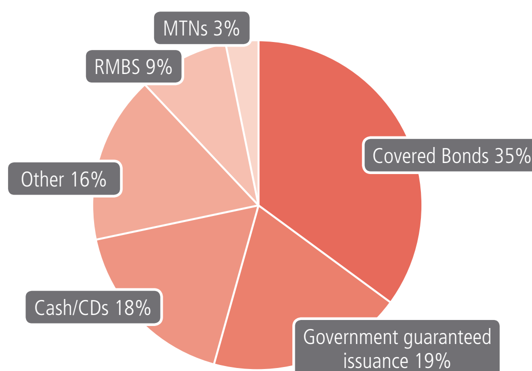
Key Performance Indicator explanation:
The Board monitors the Group's retail savings performance by tracking its net retail inflow in absolute terms, being the net amount by which its retail savings balances grow in any period. Any portfolio of retail savings products will, at any point in time, have some products where balances are growing and others where the balances are reducing, reflecting the relative attractiveness of those products against the market. It is, in our view, not a sustainable strategy to offer market-leading rates on all savings products at all times, but neither do we look to offer eye-catching introductory rates and then quietly and, in our view unfairly, reduce product rates to de minimis levels once the introductory period is past. Instead we look to compete fairly, offering competitive rates on new products whilst maintaining fair rates on existing balances. This means that, at times when the savings market is overheated, we will inevitably see some outflows on some of our products.

Competition for retail savings has been fierce throughout 2011 for a number of reasons - HM Treasury, through National Savings and Investments, has been raising funds through tax-free investments that financial institutions have been unable to match, whilst the disruption in the wholesale markets has also meant that some institutions have had to turn to retail funding and have been prepared to 'pay up' to close their funding gaps.

Whilst keen to offer our saving members good value, the Group has consistently refused to offer unsustainable rates which would damage the long-term interests of our members as a whole. The savings balances and liquidity added with the N&P and Egg deals helped us to maintain our prudent stance of not having to overpay for the most expensive and most volatile (i.e. least loyal) retail funding.

The Group's wholesale funding portfolio was as follows at the end of the year:

WHOLESALE FUNDING PORTFOLIO



	2010 £m	**2011 £m**
Cash/CDs	194	**688**
Covered Bonds	1,808	**1,350**
Government guaranteed issuance	2,221	**747**
Medium Term Notes	227	**116**
Residential Mortgage Backed Securities	0	**347**
Other	844	**619**
	5,294	**3,867**

In terms of maturing funding, in 2011:

- We repaid a maturing €1.5bn, five-year covered bond.
- We repaid a maturing £750m bond issued under the government sponsored Credit Guarantee Scheme (CGS). It should be remembered that we originally chose to access this scheme (only available to institutions that satisfied the scheme's strict conditions) because we felt it represented an opportunity to secure longer term funding at reasonable rates - not because we viewed it as a 'lifeline'.
- Our strong funding and liquidity position, augmented by the completion of the Egg and N&P transactions, also meant we could take advantage of a rule change which allows the early repayment of bonds issued under the CGS. An exercise was conducted in December that brought forward the redemption of £724m of the remaining CGS bonds by allowing bondholders to bid to sell back the bonds. This materially reduced the cost of the scheme to the Group, delivering financial benefits to the Group and enhancing our external reputation.

- We also had sufficient funding to be in a position to exit the Bank of England's Special Liquidity Scheme well ahead of the scheduled redemption date of January 2012.

Turning to new issuance:

- The Group responded to the developing sterling covered bond market with an issue which raised £750m of long-term (seven year) funding.
- We launched our first securitisation (of prime residential mortgages), and further diversified our funding sources and extended our maturity profile (see Note 35).

Irrespective of the short-term adjustments facilitated by the N&P and Egg deals, the Group intends to continue to be active in the wholesale markets to ensure an appropriate balance of price, diversity and duration. This is why 2011 saw a mix of early repayments and new issuance, including the opening up to the Group of new funding sources.

Key Performance Indicator explanation: A key measure for the Group in monitoring its wholesale funding position is the weighted average maturity of its outstanding funding. This metric provides a measure of how long the Group has funding in place for, since it reflects the average remaining term (weighted by balances) of outstanding wholesale funding. It is important to achieve a balance here – since too long an average maturity suggests a preponderance of more expensive long-term funding, whilst too short an average maturity suggests that the Group will have to constantly issue and re-issue funding.

The Group's weighted average maturity at 31 December 2011 was 22.9 months compared to 15.6 months at 31 December 2010. This reflects the aspiration and intention expressed last year to extend the maturity of our book through new issues and the inevitable impact of the repayment of significant maturing issues which were, by definition, shortening the average at last year end. The 2010 position was at the lower end of our acceptable range, and so the lengthening of this average maturity is welcomed.

Capital

The Group's capital ratios continue to reflect our core strength, with all ratios reflecting our very strong standalone and comparative position.

Key Performance Indicator explanation: The Board looks at two key measures to monitor the Group's capital strength, which is important since it represents the money held to protect investors against ever losing any of their money with the Group. The higher these ratios the more capital an institution has in place, relative to the riskiness of its assets, and therefore the stronger its position:

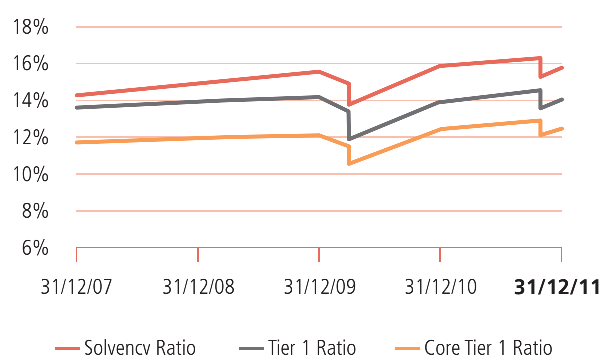
- Core Tier 1 ratio – core tier 1 capital represents the very strongest form of capital for any financial institution, and for the Group is essentially its accumulated profits built up over time. The ratio compares this to its assets weighted according to how much risk they carry - all financial institutions, by their very nature, take some degree of risk in investing their assets, but differing assets carry differing degrees of risk.
- Capital Excess – as a part of the Internal Capital Adequacy Assessment Process the FSA sets minimum capital requirements for the Group, based on its view of the Group's own assessment of the risk profile of its assets and wider business activities. The Board monitors closely the degree to which the Group carries capital above this requirement.

The Group's capital resources and ratios are set out in detail in Note 31 to the accounts, but are summarised in the table and graph below. Data is included for the positions immediately before and after the Egg and N&P deals in 2011 to show the impact that they had on our capital ratios.

£m	31/12 2007*	31/12 2008	31/12 2009	31/12 2010	30/10 2011	01/11 2011	**31/12 2011**
Total Capital Resources	1,120	1,161	1,238	1,778	1,784	1,863	**1,892**
Tier 1 Capital Resources	1,062	1,104	1,123	1,562	1,586	1,654	**1,679**
Core Tier 1 Capital Resources	916	937	964	1,394	1,410	1,480	**1,502**
Risk Weighted Assets	7,805	7,832	7,927	11,205	10,915	12,205	**11,965**
Tier 1 Ratio	13.6%	14.0%	14.2%	13.9%	14.5%	13.6%	**14.1%**
Core Tier 1 Ratio	11.7%	12.0%	12.2%	12.4%	12.9%	12.1%	**12.6%**

*restated to reflect the impact of the move to Basel II calculation from 1 January 2008.

CAPITAL RATIOS



The impact of the Egg and N&P transactions was to create a temporary dip in our capital ratios, as shown by the graph above. However, the ratios had improved by the year end, primarily due to the addition of second half profits to our capital. This pattern was similar to that experienced as a result of the larger Chelsea merger, where pre-merger ratios were re-established by the end of the year. These dips effectively represent the 'price' we paid for these three major transactions over the past two years.

By the end of 2011 our Core Tier 1 ratio, at 12.6%, was in fact marginally above the 2010 figure, and it remains a healthy position. This stability was achieved through balance sheet management (see the sections on liquidity and wholesale funding above) and strong profitability, including the realisation of cost synergies from the Chelsea merger.

The Group remains committed to maintaining strong capital ratios as these are the most fundamental measure of the security we offer our members. Once again our Capital Excess has grown year-on-year and we continue to hold what we believe to be a sensible but not excessive amount over and above what the FSA requires us to hold.

Customer satisfaction measures

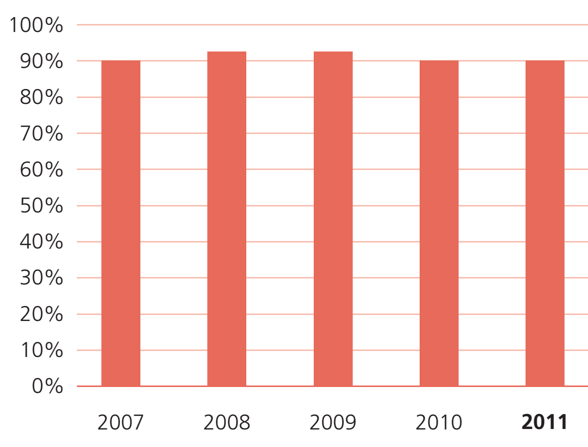
In addition to financial indicators, the Board monitors a range of measures designed to reflect how well the Group is meeting our members' and other customers' needs for high-quality products and services.

Key Performance Indicator explanation:
The Group looks at a range of customer metrics, with the key ones being:

- Customer satisfaction – which shows the proportion of our customers who say that they are satisfied or more than satisfied with the service they received.
- Net promoter score – which shows the percentage of customers prepared to actively promote our products and services to others, less those who would actively detract from them, and excluding those who are neutral towards us i.e. it is the net proportion of our customers with an actively positive perspective of us, and not just the gross number.
- Complaints – a range of data (including the number and type received, the speed with which complaints are resolved, the proportion that are accepted or rejected, how many are referred to the Financial Ombudsman Service and how many of those are found in our, or the customer's, favour).

Our customer satisfaction measure which is a representative sample of our customer base has continued to score around the 90% mark, which is in line with the benchmarks we set ourselves.

CUSTOMER SATISFACTION



As explained above, the net promoter score is the difference between the number of 'promoters' and 'detractors' among our customers, ignoring those who are neutral. In other words it is those who are willing to actively promote the Group minus those who would actively advocate against us. As such it is a very sensitive measure. 47% is regarded as an excellent score for a financial institution since the average for the banking sector is 0%*, meaning many financial institutions register negative scores.

NET PROMOTER SCORE

Yorkshire brand	47%
Chelsea brand	16%
Other brands	n/a
Combined	41%

Whilst the Yorkshire brand receives extremely good net promoter scores we are clearly faced with a number of legacy issues with the Chelsea brand, in part due to the managing out of unsustainable savings products. We continue to monitor the position closely and to work actively to improve it.

The Board also reviews a number of measures in relation to customer complaints. One key indicator is the Financial Ombudsman Service (FOS) 'complaint overturn' rates. This shows the percentage of instances where the FOS has overturned, in the customer's favour, decisions where individual firms originally found against the customer. Thus, a lower figure is good as it means that the FOS is more satisfied than not with the decisions made by the individual firm in response to customer complaints i.e. in more cases they agree that we have made the right decision.

The latest table, published in Q3 2011 and representing the period 1 January 2011 to 30 June 2011, quoted the performance of approximately 150 of the largest qualifying firms. Yorkshire (including Chelsea) once again had one of the lowest published rates with an FOS overturn rate of only 11%. This is an improvement from the 14% for the equivalent period last year, and is the lowest published figure for any high-street bank or building society. The Board considers this to be an excellent performance.

Results for N&P and Egg are shown separately in the table as the latest data relates to the first six months of 2011. Their performance is poor compared to the Yorkshire's although, particularly for N&P, it is felt the results are driven by specific, isolated problems (such as the well publicised KeyData mis-selling issues) rather than the core business. Nevertheless one of the focuses for the Board and management is to ensure that we adequately address the service and complaints issues inherited with these institutions.

FOS complaints overturn rates for a selection of providers (% of complaints referred to FOS then resolved in favour of consumers 1/1/2011 to 30/6/2011†)

National Savings & Investment (i.e. HM Treasury)	10%
Yorkshire Building Society	**11%**
Nationwide Building Society	14%
HSBC	20%
Northern Rock	20%
Northern Rock (UKAR)	33%
Egg Banking plc	**42%**
Barclays Bank	43%
Santander UK plc	44%
Bank of Scotland plc	44%
The Co-operative Bank Plc	44%
Direct Line Insurance	45%
Royal Bank of Scotland	45%
Lloyds TSB Bank plc	63%
Tesco Personal Finance	61%
Sainsbury's Bank	62%
Norwich & Peterborough Building Society	**92%**

Staff metrics

The Board monitors a number of areas to ensure that staff numbers remain stable and our people motivated.

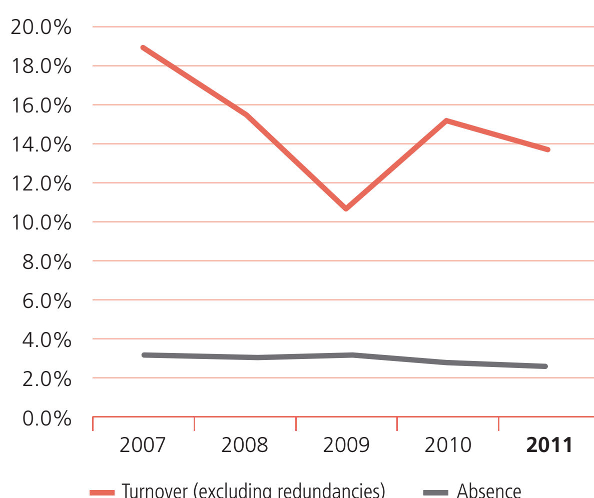
Key Performance Indicator explanation: The Group looks at two staff metrics on a monthly basis, as well as undertaking periodic detailed staff surveys:

- Turnover – this measures how many of our staff are leaving the organisation. Whilst this inevitably includes a number of retirements and similar leavers, movements in the ratio will give a broad indication of our staff's satisfaction with the Group as an employer. It excludes redundancies as these represent specifically merger-related short-term anomalies.
- Absenteeism – this measures the percentage of working days lost through sickness and other forms of absenteeism. Generally a lower ratio will suggest a more committed, healthy and satisfied workforce.

*Source: Satmetrix 2011 Net Promoter® Benchmark Study of Consumers in France, Germany, and the UK.

†Source: Financial Ombudsman Service.

	2007	2008	2009	2010	**2011**
Staff turnover	18.9%	15.6%	10.7%	15.1%	**13.6%**
Staff absenteeism	3.1%	3.1%	3.2%	2.8%	**2.6%**



The results for both these measures continue to be better than target despite the additional workload and significant disruption created by the Chelsea, N&P and Egg transactions. Both also improved year-on-year in 2011.

Major projects

Our project agenda has, for a couple of years now, clearly been heavily focused on mergers and acquisitions, and as would be expected our formal project management and monitoring processes have been applied to the Chelsea, N&P and Egg integrations with the establishment of a separate programme for each.

During 2011 we substantially completed the integration of the Chelsea, meaning that the business, processes and systems have now been incorporated successfully into the Yorkshire. We have retained the Chelsea brand and their branches and maintained a presence in Cheltenham in the form of a customer service centre. Nearly all of the planned financial benefits have been realised although programme costs have been slightly higher than anticipated; nevertheless these costs represent less than two thirds of one year's worth of the annual cost savings achieved. The remaining savings are on track to be realised in 2012.

On 31 October 2011 we acquired the savings and mortgage balances of Egg Banking plc. Given the other pressures on our planning and integration teams, the Board took the decision to enter into an agreement with Citibank for them to continue to administer these balances on our behalf (and under our direction) until late 2012. In the Board's view this is the most appropriate way to maintain customer service and to control the risks associated with managing a number of major projects simultaneously. Work on integrating these portfolios onto our systems and processes, and on identifying where we can learn from the Egg approach, is well underway and on track for delivery in late 2012.

One day later, on 1 November 2011, the merger with the N&P came into effect. The focus in the preceding months was to ensure that we completed all the necessary tasks to ensure a smooth legal and operational transition and to establish a stable combined business. We have now entered the second phase of the programme which is to develop a detailed integration plan.

At the same time the Group is undertaking a number of major projects to enhance and strengthen our core systems and processes. These are designed to ensure that we can continue to deliver a safe, compliant and member-focussed service. To help ensure the delivery of this as well as the projects themselves, we are investing in a significant project delivery infrastructure. Whilst these investments will increase our cost-base in the short term, the Board is confident that they will ensure the safe delivery of a wide range of benefits, including a reinforcement of our financial stability, whilst ensuring there is no deviation from our core offering.

Other business review issues

In common with previous years a number of other areas that might be considered within a Business Review are included within other sections of this document, and therefore are not covered separately here. These consist of:

- Corporate Responsibility – pages 32 to 35
- Corporate Governance Report – pages 43 to 51
- Audit Committee Report – pages 52 to 54
- Risk Management Report – pages 55 to 63

Robin Churchouse
Finance Director

STRENGTHENING RELATIONSHIPS WITH ALL OUR LOCAL COMMUNITIES

Rooted in the ethos of a mutual building society is a deep commitment to its local communities and here at the Yorkshire we take that commitment very seriously, whilst embracing our values of fun, fairness, passion and people working together. Our programme covers all the community, charity and volunteering activities for the Society's brands; Yorkshire, Barnsley, Chelsea and Norwich & Peterborough building societies, and Egg – hence 'Societies Together'.

Our Societies Together vision

Our vision is to have a community programme that inspires, motivates and engages our members, staff and local communities to get involved in our community activities.

2011 activities

As we know that time can be just as valuable as money to charities and community groups, we are as committed to our volunteering activities as we are to our grant-giving schemes.

So much has happened in 2011, here are just some of our highlights – bringing to life the enthusiasm and commitment of our staff and the wonderful support we receive from our members.

In 2011 over £462,000 was donated to over 2,000 causes – 90% of which were nominated by our members. Our unique Small Change, Big Difference™ scheme provides a large proportion of the Charitable Foundation's funding – over £2m since 2000. Through the scheme members donate their pennies of interest every year to the Charitable Foundation – an average of less than 50p per account, per year - demonstrating that the small change really can make a big difference to the lives of others in our local communities.

Small Change, Big Difference and the Chelsea

Since July 2011 new and existing Chelsea members have been able to join the Small Change, Big Difference™ scheme. To celebrate this launch, the Charitable Foundation donated £1,000 to a charity nominated by every Chelsea branch. The charities included; Streatham Youth and Community Trust, The Chelsea Pensioners Appeal and Harrow Carers. This resulted in a total of £35,000 being donated to 35 good causes in areas where our Chelsea members and staff live and work.

Charity of the Year: Alzheimer's Society – Who Cares? We Do!

2011 saw the launch of the Yorkshire's first ever Charity of the Year campaign. The Alzheimer's Society was chosen after consultation with members, staff and the Charitable Foundation Trustees. Over 750,000 people in the UK have dementia and there are around 400,000 primary carers of someone with this condition.

Iain Cornish launched the campaign by cycling over 170 miles between our sites in Bradford and Cheltenham over three days in July. In addition, staff really got involved with over 100 fundraising activities taking place from trekking the Jordan Desert, climbing the Three Peaks and skydiving to summer parties, recipe book sales, raffles and tombolas.

A fantastic £175,000 was donated to the charity – £85,000 was raised by staff and members, which was then significantly boosted by the Charitable Foundation. The money raised is funding the development and implementation of a programme to provide carers with quality, one-to-one support and information.

Make a Difference Week

This was held during November, when members, staff and the general public were invited to recommend a local good cause or charity to be considered to receive a donation of £100 from the Charitable Foundation at Christmas. The response was overwhelming with £116,000 being shared between those causes nominated – demonstrating that together we can Make a Difference.

Individual donations

The Charitable Foundation's focus, in addition to its annual campaigns, is on providing grants to charities nominated by our members and causes that staff have a personal interest in. As the funds donated are to buy specific items it is very clear how the money is helping local communities.

National Star College

The National Star College provides specialist further education, training and personal development for young people aged 16-25 with complex physical disabilities, brain injuries and associated sensory, learning, medical, emotional and behavioural difficulties. Laura Brookes from the National Star College said:

"The money that the staff at the Chelsea have raised, which was matched by the Charitable Foundation, will go towards two new iPads for students at the college. For students with limited movement or limited ways of communicating the iPads really do open up a new world and a way for them to communicate. A huge thank you and well done to everyone at the Chelsea."

Percy Hedley Foundation

The Percy Hedley Foundation is a school for children with cerebral palsy which provides a wide range of services to over 1,000 families each year. The charity was nominated by Nicola Williams of the Yorkshire's Newcastle branch, to receive a donation from the Charitable Foundation to purchase toys for the children. Nicola said:

"This is a charity very close to my heart. They have done a lot to support my niece who has special needs and I know many children will benefit from the use of the new toys. They will make a real difference to the children as they develop their sensory skills".

We asked...you said...we're doing!

Each year we ask our Member Panel (a group of over 8,500 members), and all Society staff, what they think about our Societies Together programme and for any suggestions they may have to improve it.

The members told us in 2011 who their favourite charities were and to support these, the Charitable Foundation donated £38,500, shared between those causes nominated.

Around 75% of members and staff told us that they prefer to find out about our activities via a website. Work will begin on a dedicated Societies Together website in the future.

Over 120 community projects requiring volunteer support were identified by the Member Panel. These volunteering opportunities are being promoted to staff across the country to encourage them to take up the challenge and support causes that are important to our members.

58% of staff and over 50% of members stated we should be supporting more homeless charities. This led to the Charitable Foundation supporting a winter shelter for the homeless in Bradford. The Inn Churches charity provides accommodation, hot meals and support to those that find themselves on the streets over the winter months. The accommodation is provided by churches in the Bradford area that open their doors to those of any or no religion. The shelter is open between November and February, although the work of the charity continues all year round to find more permanent accommodation for their guests. In addition the Charitable Foundation has supported their 'home starter' packs – including bedding, pots and pans, crockery and basic kitchen equipment for those who do secure a new home.

The Environment

We all have a responsibility to our environment and we are continually looking at ways to reduce our impact as a business and within our local communities. Continuing our extensive recycling programme we now recycle around 90% of Head Office waste and over 80% of branch waste. This covers items such as paper, cardboard, aluminium cans, glass, plastic and even food waste from our Bradford Head Office. Through branch refurbishments and upgrades, opportunities are taken to improve the energy efficiency of buildings wherever practical, including efficient boilers, insulation and low-energy lighting. Green travel initiatives have been introduced including supporting National Bike to Work week, Lift Share week and the Metrocard Scheme which provides staff in the West Yorkshire area with discounted public transport costs.

As part of our actionteering programme every member of staff is encouraged to use two days' paid leave each year to work on voluntary or charitable activities in their local communities.

Over 3,500 volunteer hours were completed by staff in 2011 on around 60 different projects. These included:

Swain House Primary School

Alan Redmonds from Group Services, based in Bradford, rallied his teams and over a six-month period they have built a strong relationship with the school. Over 50 volunteers have worked with the children and teachers to improve the outdoor learning areas – creating a pond, story circle and wild flower meadow including bird hides, feeders and mini beast hotels. In 2012 the volunteers will continue to work with the school to design and build a sensory garden for the hearing-impaired children who attend the school.

Grimethorpe Sports Ground

Barnsley Building Society staff wanted to get involved by supporting a community project recommended to them by a member. 16 staff stepped in to help Grimethorpe Sports Ground, in the old mining town, which had been given grants towards the re-generation of the ground. Although they had the funds to start making a difference they did not have the manpower to help them achieve it. The staff picked up their paint brushes and over two days completed a spruce up of the ground.

Societies Together

The Society collected over £21,000 for Y Care International Emergency Appeals for Pakistan Flood and East Africa Drought disasters

Since 1999 the Charitable Foundation has donated £4m to over 12,500 causes

Since 2007, staff have completed over 1,200 volunteer days

In 2011 staff dress down days raised over £35,000 supporting Comic Relief, Prostate Cancer, Breast Cancer and Children In Need

Everything we do within our Societies Together programme has our members, staff and local community at its heart and 2011 has been a very exciting year.

We start 2012 by welcoming our Norwich & Peterborough members and colleagues and Egg members and will be keen to hear their thoughts on our activities and how, together, we can strengthen our relationships with all our local communities.

NON-EXECUTIVE DIRECTORS

Ed Anderson, BSc, CPFA (age 61) Chairman

Ed Anderson joined the Board in 2003 and was appointed Chairman on 1 January 2007. He is a member of the Group Risk and Nominations Committees.

Ed is an accountant by training and divided his executive career between airport management and local councils. He is Chairman of the Airport Operators Association and was the Managing Director of Leeds Bradford International Airport for 10 years until his retirement in 2007. Prior to that, he was an executive director at Leeds City Council. Ed is a member of the Council of the University of Leeds and is involved in various other local organisations.

Kate Barker, CBE (age 54) Non-executive Director

Kate Barker joined the Board in November 2010 and is a member of the Group Risk Committee and a trustee of the N&P Building Society Pension Scheme.

Kate was previously on the Board of the Society and stepped down when she became a member of the Bank of England's Monetary Policy Committee (MPC) in 2001. Prior to her appointment to the MPC, she was Chief Economic Adviser to the CBI.

Kate also has a background in housing and is the author of major policy reviews on housing supply and planning for the previous government. In 2006 she was awarded a CBE for services to social housing. She is a non-executive director of Electra Partners and Taylor Wimpey plc and a senior advisor to Credit Suisse.

Roger Burden, PhD (hon), FCIB, MBCS, FRSA (age 65) Non-executive Director

Roger Burden joined the Board in April 2010, following the completion of the merger with Chelsea Building Society, and is a member of the Remuneration Committee. He joined the Chelsea's Board as a non-executive director on 1 November 2009 when merger discussions between the two societies were well advanced.

Roger has extensive experience at a senior level within the financial services sector. He is a former Chief Executive and Chairman of Cheltenham & Gloucester Plc as well as a former Chairman of the Council of Mortgage Lenders. Roger is also a director and a former Chairman of the Football Association.

Lynne Charlesworth, BA, MBA (age 55) Non-executive Director

Lynne Charlesworth joined the Board in 2006 and is the Chair of the Group Risk Committee and a trustee of the Society's Pension Scheme. She also oversees the Group's policies and practices on 'Treating Customers Fairly' on behalf of the Board.

Lynne has a background in risk management, particularly within the financial services and property sectors. She has worked within the building society industry and became Group Risk Manager of Abbey National Plc when it took over the former National & Provincial Building Society. In the 1990s, Lynne founded a successful property and asset management business and is now joint Managing Director of a private investment company, St. James Investments Limited.

Richard Davey, BA (age 63) Vice Chairman

Richard Davey joined the Board in 2005 and is a member of the Audit, Nominations and Group Risk Committees.

Richard has an investment banking background and was formerly Head of Investment Banking at NM Rothschild and Sons. He has extensive experience of the financial services sector having run Rothschild's Financial Services Group, working with a number of high street banks and insurers. Richard is Chairman of London Capital Group Holdings Plc and is also a non-executive director of Severn Trent Plc and Amlin Plc.

Richard has decided to retire from the Board immediately following the Annual General Meeting to be held on 18 April 2012.

Philip Johnson, FCA (age 65) Non-executive Director

Philip Johnson joined the Board in 2007 and is Chair of the Audit Committee.

Philip retired as a partner at Deloitte LLP in 2007 where he was Head of Audit Quality and Risk Management for the UK, a member of the Deloitte Board of Partners and Chairman of the Deloitte Audit Committee.

During his 30 years as a partner with Deloitte, Philip specialised in providing advisory and assurance services to large corporate clients. He has considerable experience of financial services through leading some major investigations in the sector. Philip is President of the Federation of European Accountants and a member of the Audit Committee of the Wellcome Trust.

David Paige, BSc, FCA (age 60) Non-executive Director

David Paige joined the Board in 2006 and is a member of the Audit, Group Risk and Remuneration Committees. He is also a trustee of the Society's Pension Scheme.

David, a chartered accountant, has extensive experience within the financial services industry on the risk, financial and audit sides. He was a partner at Coopers & Lybrand in their financial services division before moving into senior executive positions with NatWest Bank Plc, Zurich Financial Services, Aviva Plc and Royal & Sun Alliance Insurance Group Plc where he was Executive Director (Risk).

David is a non-executive director of several of Aegon's UK businesses and Willis Ltd.

Simon Turner, BSc (age 60) Non-executive Director

Simon Turner joined the Board in 2005 and is Chair of the Remuneration Committee and a member of the Audit Committee.

Simon has extensive experience in marketing, sales and general management in a variety of roles in the electrical and publishing markets. He was Managing Director of Philips in the UK and Ireland until 1999 when he joined DSG International Plc where he was Group Managing Director of PC World, and all PC City operations in Europe, as well as being responsible for the service business of the Group; he also chaired their pan-european internet business. Prior to retirement at the end of 2008, Simon was the Group Purchasing Director of DSG International Plc. He is now self employed and works in a variety of roles in the electronics industry worldwide.

EXECUTIVE DIRECTORS

Chris Pilling, BSc (age 46) Chief Executive

Chris Pilling joined the Society on 31 December 2011. He has a wealth of experience in delivering exceptional customer service both within the financial services sector and elsewhere. Prior to joining the Society, Chris was with HSBC Bank Plc for six years, most recently as Head of Branch Network. His previous roles with HSBC also included Chief Executive of First Direct, which is its telephone and internet-based retail bank. Prior to HSBC, Chris held a number of senior marketing positions in various sectors including Marketing and Customer Services Director at ASDA.

Chris is also a non-executive director of The Department of Health.

Ian Bullock, BSc, FIA (age 51) Sales and Marketing Director

Ian Bullock is a qualified actuary and joined the Society in 2003 as Head of Insurance and Financial Services, soon acquiring responsibility for other functions. He was promoted to the General Management team in 2004 and became Sales & Marketing Director in April 2007.

Ian has the responsibility for Product Development, Marketing and the Society's distribution network, including our branches, agencies and online business. He is also Chairman of Accord Mortgages Ltd, the Society's intermediary lending subsidiary.

Andy Caton, BA (age 48) Corporate Development Director

Andy Caton joined the Society in 1991 as an economist and was appointed to the General Management team in 1998. In 2004 he was appointed Corporate Development Director and is responsible for the Treasury, Corporate Affairs, Legal & Secretarial and Corporate Development functions.

Andy is also a trustee of Yorkshire Building Society Charitable Foundation, which is the focus for the Society's grant-giving activities, and a trustee of the N&P Building Society Pension Scheme.

Robin Churchouse, MA, ACA (age 46) Finance Director

Robin Churchouse joined the Society in 2004 as Head of Finance. He was promoted to the General Management team in June 2006 and was appointed Finance Director in June 2010. He now has responsibility for the Corporate Planning, Finance and Group Internal Audit functions. Before joining the Yorkshire, Robin gained a wide range of experience across a number of financial services organisations, including roles in finance, planning and strategy, management consultancy, corporate finance, risk management and prudential regulation.

GENERAL MANAGERS

Rachel Court, BA (age 45)
General Manager Human Resources & Customer Service

Rachel Court was appointed to the General Management team in 2006 and is responsible for the Human Resources and Customer Services functions. Having joined the Society in 1991, Rachel has gained a broad experience across the Group starting in the customer service functions of Mortgage Arrears, Mortgage Administration and Investment Services. She then spent a period as Sales Director of Accord Mortgages Ltd before becoming the Society's Head of Mortgages prior to her appointment as a General Manager.

David Henderson, BSc (age 51)
General Manager Group Services and Chief Information Officer

David Henderson joined the Society in 2007 as Chief Information Officer and has responsibility for the Group's IT, Premises, Programme Delivery and Corporate Share Plan functions. He is also Chairman of the subsidiary Yorkshire Key Services Ltd which offers IT solutions and account administration services to other financial institutions. David heads the integration work following the recent building society mergers and the acquisition of the Egg savings and mortgage accounts.

David started his career in the building society sector. Prior to joining the Yorkshire, he held a range of senior IT positions within a major UK banking group.

Mark Jenkins, BA, FCA, DipL (age 49)
General Manager Commercial Development

Mark Jenkins joined the Chelsea Building Society in September 2009 and was a member of the Chelsea Board from October 2009. Following the merger of the Chelsea with the Yorkshire in April 2010, Mark became the General Manager for the Yorkshire's Commercial Development function and is responsible for three key areas: buy-to-let, commercial and social housing lending.

Before joining the Society he spent 10 years with Price Waterhouse and a further 15 years with the Nationwide Building Society. A chartered accountant by profession, he has a wealth of corporate finance and commercial lending experience.

Richard Wells, FCIB (age 48)
General Manager Risk

Richard Wells joined the Society in 2010 as General Manager Risk. He is responsible for managing all of the risks planned or encountered by the Group. Richard has extensive experience of risk management within the financial services industry including senior risk management roles at a number of the UK's major banks and building societies.

DIRECTORS' REPORT

The directors have pleasure in presenting their annual report, together with the Group Accounts and Annual Business Statement, for the year ended 31 December 2011.

Business objectives and activities

The Group's vision is 'to be the best organisation that our customers do business with', which we aim to achieve by:

- Providing members with financial security and long-term value.
- Delivering a strong customer service through engaged and motivated staff.

Further information on the Group's vision and strategy is given in the Business Review on pages 12 to 13.

Principal risks, uncertainties and going concern

The principal risks and uncertainties faced by the Group and our approach to managing them are set out in the Risk Management Report on pages 55 to 63.

As set out on page 71 the directors are required to prepare these financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Society will continue in business.

In accordance with best practice, the Board undertakes regular rigorous assessments of whether the Group is a going concern in the light of current economic and market conditions and all available information about future risks and uncertainties.

The future risks considered in the latest review, performed in February 2012, included:

- The impacts on the continuing financial crisis, principally around the eurozone, on the availability and price of both wholesale and retail funding.
- The impact on the Group's profitability of potential changes to the funding of the Financial Services Compensation Scheme.
- The Group's exposure to retail credit losses in the light of the outlook for the UK economy.
- The perception of financial institutions as a result of rating agency action.
- Further changes to the regulatory framework.
- The outlook for interest rates.
- The impact on current economic conditions on the level of fraud in the UK retail financial services markets.

Factors addressed when considering the Group's ability to manage future risks and uncertainties included liquidity, funding, capital resources, future profitability and risk management processes. Stress-testing was used to assess the Group's ability to withstand a variety of extreme circumstances and conditions.

The Board has satisfied itself that the going concern assessment adequately addresses mergers and acquisitions (see below) both in terms of the risks and uncertainties faced by the enlarged Group and those presented by the associated integration exercises.

As a result of the detailed assessment performed in February 2012 the Board concluded that the Group has sufficient resources to continue in operational existence for the foreseeable future and as a result that it is appropriate to prepare these financial statements on the going concern basis.

One key tool for mitigating risk is the requirement for all institutions to hold minimum levels of capital. In this regard, the Group uses the standardised approach under the Capital Requirements Directive (Basel II), and holds well in excess of its regulatory requirement. The disclosures required under Basel II Pillar 3 will be published on the Society's website.

Another key tool is the requirement to hold a sufficient level of high-quality liquid assets to meet potential stress scenarios. The Group holds such liquidity in line with our risk appetite which ensures we are consistently well above the regulatory requirement.

Mergers and acquisitions

During the year, the Society acquired the retail books of Egg Banking plc (Egg) and merged with Norwich & Peterborough Building Society (N&P). Further details relating to the impact of these transactions are given in the Business Review on pages 12 to 31.

Business review and future developments

Key developments and the future outlook are reviewed by the Chairman and Chief Executive on pages 3 to 11 and in the Business Review on pages 12 to 31. The Business Review identifies and explains the Group's Key Performance Indicators and sets out how it has performed against each during 2011.

Profit and capital

Profit before tax for the year was £129.7m (2010 – £115.4m) and after tax the amount transferred to Group general reserves was £106.2m (2010 – £91.8m).

Total Group reserves at 31 December 2011 were £1,557.6m (2010 – £1,337.5m). Details of reserves movements are given in the Statements of Changes in Members' Interest on page 76.

Gross capital at 31 December 2011 was £1,965.5m (2010 – £1,719.7m) including £230.9m (2010 – £214.9m) of subordinated debt and £177.0m (2010 – £167.3m) of subscribed capital. Expressed as a ratio to shares and deposits gross capital was 6.59% (2010 – 6.20%) and free capital was 6.06% (2010 – 5.69%). These ratios are explained on page 134.

One of the Group's principal measures, to monitor the level of capital within the business, is the solvency ratio, the calculation of which is in Note 31 on page 108. The Group's solvency ratio has decreased to 15.8% (2010 – 15.9%).

Further information about the Group's capital strength is outlined in the Business Review on pages 28 to 29.

Mortgage arrears

Details of the Group's mortgage accounts which were 12 months or more in arrears at 31 December 2011 were as follows:

	2011	2010	**2011** % of mortgage accounts/balances	2010 % of mortgage accounts/balances
Number of accounts	**814**	668	**0.30**	0.28
Balances outstanding on accounts	**£113.1m**	£94.1m	**0.42**	0.40
Amount of arrears included in balances	**£11.8m**	£8.8m	**0.04**	0.04

The increase in the absolute level of arrears results mainly from the merger with N&P and the acquisition of Egg's mortgage book.

Further details of the Group's arrears position and the various provisions made against potential losses are set out in the Business Review on pages 12 to 31. Note 39 on page 126 describes the various forbearance measures offered by the Group to borrowers experiencing difficulties in meeting their repayments.

Staff

Our staff are key to our operations.

The Group's management meet staff representatives regularly to discuss a wide range of topics. Communication with and between all staff is subject to regular review and includes regular 'Pulse' staff opinion surveys, team briefings, an intranet site, in-house magazines and bulletins.

An equal opportunities policy is followed and the Group gives full consideration to applicants and staff with disabilities. In 2010 the Group had its Investor in People (IIP) accreditation reaffirmed and has been recognised as going beyond the required IIP standard to meet the higher 'bronze' rating.

The Group supports the continued learning and development of its staff through regular analysis of training needs and by the provision of a broad range of training opportunities.

Directors

The names of the directors of the Society who served during the year, their roles and membership of Board committees are described in the Corporate Governance Report on pages 43 to 51.

Iain Cornish stepped down as Chief Executive on 30 December 2011 and was succeeded by Chris Pilling on 31 December 2011.

The Board wishes to acknowledge Iain's outstanding contribution to the continuing success of the Group.

At the 2012 Annual General Meeting (AGM), Chris Pilling will be put forward for election by the members. At the same meeting, Ed Anderson, Lynne Charlesworth and Simon Turner will retire as directors in accordance with the Society's rules and the Building Societies Act 1986 and, being eligible, offer themselves for re-election. Biographical details of all directors are outlined on pages 36 to 38.

None of the directors had an interest in, or share of, any associated body of the Society at any time during the financial year.

The directors in office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Group's auditor is unaware.

Charitable donations

In 2011 Yorkshire Building Society's Charitable Foundation donated over £460,000 to some 2,000 causes, of which 90% were suggested by members, maintaining the Foundation Trustees' desire to support causes across the UK with the assistance of member nominations. The funds were primarily raised through the 'Small Change, Big Difference™' scheme. Further details can be found in the Corporate Responsibility Report on pages 32 to 35.

Supplier payment policy

The Group pays supplier invoices in accordance with the terms agreed at the start of trading.

The creditor days were six days at 31 December 2011 (2010 – seven days).

Auditor

The re-appointment of Deloitte LLP as auditor is to be proposed at the AGM.

On behalf of the Board

Ed Anderson
Chairman

22 February 2012

CORPORATE GOVERNANCE REPORT

Introduction

This report provides members with information on the Society's corporate governance framework. It is based on the principles and provisions of the UK Corporate Governance Code (the Code) published by the Financial Reporting Council (the FRC) in June 2010, which applies to listed companies, to the extent that they are relevant to a building society. A copy of the Code is available at www.frc.org.uk.

In the interest of transparency, the Financial Services Authority (FSA) also encourages each building society to explain in its Annual Report and Accounts whether, and to what extent, it adheres to the Code.

The Board's approach to corporate governance is influenced by the following:

- That the Board is accountable to the Society's members for the conduct and performance of the business.
- That the interests of members are at the heart of the Board's decision-making.
- That the interests of other parties, such as employees and the communities in which we operate, are also taken into account.
- That the Society should be managed in a prudent and effective manner with effective decision making and robust management of the risks that the Society may face.
- That the effectiveness of the Board is vital to the financial strength and future success of the Society.

The Board is committed to complying with best practice in corporate governance but it does not consider that this should be a 'box ticking' exercise and where it believes that there is a justifiable reason for a departure from the Code then it will do so, particularly if it is believed that such departure is in the best interests of members and that the governance of the Society is not compromised.

The Board considers that the Society has complied in 2011 with the guidance issued by the Building Societies Association on the Code unless the contrary is stated within this report.

One change in the Code which the Board wishes to highlight is the requirement for the annual re-election of all directors at the Annual General Meeting (AGM) of FTSE 350 companies. Although the Society is not a FTSE 350 company, this is a provision that would apply to the Society on the basis set out above. The Board considered this provision in respect of the 2011 AGM and agreed that this should not be brought in at that time. The Board was concerned that in extreme circumstances this provision could have implications for the financial stability of the Society which would not be in the best interests of members. The Board has reviewed the position and has concluded that the same policy should be adopted for 2012, i.e. that not all the directors should be put forward for re-election at the AGM to be held in April 2012.

The Society's Rules, which sets out the constitution of the Society, states that only those directors who are due for election or have not been re-elected within the previous three years should be put forward for election/re-election by members. However, the Rules do enable re-elections to be brought forward. In normal circumstances there would be one election at the 2012 AGM, that of Chris Pilling, Chief Executive and one re-election, Simon Turner, non-executive Director. However, to allow members a greater say, the re-election of two directors have been brought forward to the 2012 AGM, namely Ed Anderson, Chairman, and Lynne Charlesworth, non-executive Director. As mentioned on page 4, Richard Davey, Vice Chairman, is to retire immediately following the AGM. This will mean that out of 11 directors on the Board after the AGM, members will have had the opportunity to vote on four of them.

The Code

The following sections of this report describe how the Society has applied the main and supporting principles of the Code during 2011 using the section headings and main principles as set out in the Code. As the Code applies to listed companies, the main principles set out below refer to 'companies' but for the purpose of this report, this should be taken to refer to building societies.

Section A: Leadership

A.1 The role of the Board

Main principle: "Every company should be headed by an effective board which is collectively responsible for the long-term success of the company."

The Board applies the principles of good governance by adopting the following procedures:

- The Board held 13 meetings in 2011. The attendance record of each director at those meetings and at relevant Board committee meetings is set out on page 51.
- The Board's principal role is to focus on the Group's strategy, to ensure that the necessary resources are in place for the Group to meet its objectives, and to ensure that financial and internal controls and systems of risk management are robust. In particular, its role is to provide general direction to the organisation and to safeguard the interests of members.
- The Board maintains a schedule of reserved matters (which is reviewed at least annually) in order to ensure that it exercises control over the Group's affairs. These include the approval of the annual results and strategic aims of the Group, including mergers and other acquisitions and disposals, as well as approval of policies and matters which must be approved by the Board under legislation and the Society's Rules. The Board is also responsible for the recruitment and terms of employment of the executive directors and other General Managers (collectively known as the General Management team). Other matters are delegated to the General Management team or to other specified members of staff or committees, including the Board committees referred to below. Details of all the directors and other members of the General Management team are set out on pages 36 to 39.

Board committees

The Board committees referred to above are:

- The Audit Committee – details are contained in the Audit Committee Report on pages 52 to 54.
- The Group Risk Committee – details are contained in the Risk Management Report on pages 55 to 63.
- The Nominations Committee – details are set out on page 45.
- The Remuneration Committee – details are contained in the Directors' Remuneration Report on pages 64 to 70.

The terms of reference of each of the above mentioned Board committees are available on request from the Group Secretary or on the Society's website at www.ybs.co.uk/committees. The chair of each committee reports to the subsequent Board meeting on the matters discussed at each committee meeting. The minutes of each committee meeting are circulated to all directors.

In addition to the above committees, there is a Chairman's Committee which is made up of the Chairman, Vice Chairman and Chief Executive. Other directors may be co-opted onto the committee, as agreed by the Board, to consider specific matters. The committee's main function is to decide on any matter that requires attention before the next Board meeting (except for specific issues that have to be determined by the full Board) or to consider any matter which the Board has delegated to it.

A.2 Division of responsibilities

Main principle: "There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision."

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose.

The Chairman is responsible for leadership of the Board and for ensuring that the Board acts effectively, promoting high standards of corporate governance. The Chief Executive has overall responsibility for managing the Society and its subsidiaries and for implementing the strategies and policies agreed by the Board, supported by the General Management team and through a suite of management and risk committees.

A.3 The Chairman

Main principle: "The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role."

The Chairman's main responsibility is set out in section A.2 above. The Chairman is key in setting the tone of the Board meetings to ensure, amongst other things, that there is a culture of openness. This is tested through the annual review process.

A.4 Non-executive directors

Main principle: "As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy."

The Board's principal role is set out in section A.1 above and includes the responsibilities set out in this main principle of the Code. In addition to playing their part on the Board as a whole, the non-executive directors are responsible for bringing independent judgement to Board debate and decisions using their own experience and skills, and for constructively challenging the General Management team.

To provide focus on the development of strategy, twice a year (in June and September) the Board has specific strategy sessions outside of the usual Board meetings.

The non-executive directors meet without the executive directors present at least twice a year to discuss relevant matters including succession planning and the overall performance of the General Management team.

The Vice Chairman, who is also the Society's Senior Independent Director, deputises for the Chairman when appropriate and provides support and guidance to the Chairman and would act if required as an intermediary for the other directors. As Senior Independent Director, he is also the main point of contact for members should the normal channels of communication with the Chairman, Chief Executive or other executive directors fail or be inappropriate. The Vice Chairman also leads the review of the Chairman's performance.

Section B: Effectiveness

B.1 The composition of the Board

Main principle: "The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively."

The size and composition of the Board and the Board committees are kept under constant review by the Chairman and are reviewed formally by the Nominations Committee at least annually. This is to ensure that there is adequate succession planning for executive and non-executive directors and that there is the optimum mix of skills and experience on the Board for the direction of the Group's activities and to populate and chair the Board committees.

As at the date of this report, the total number of directors on the Board is twelve, consisting of four executive directors and eight non-executive directors. However, the Board accepts that there needs to be flexibility in this number (particularly in the number of non-executive directors), to take into account any future skills or experience gap either due to changes in the Society's business activities or as part of succession planning and recruitment.

B.2 Appointments to the Board

Main principle: "There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board."

The appointment of new directors is considered by the Nominations Committee which is made up of the Chairman, the Vice Chairman and the Chief Executive. The committee is responsible for considering matters relating to the composition of the Board, including nominating candidates for the position of non-executive director, taking into account the balance of skills, knowledge and experience of directors and making recommendations to the Board as appropriate. It also reviews the succession planning for directors and other senior executives.

Under the Society's rules all directors are subject to election by members at the AGM following their appointment (or at the AGM in the following year if the director is appointed by the Board in the period between the beginning of the year and the AGM). In addition, all directors must receive approval from the FSA as Approved Persons in order to fulfill their controlled function as a director.

In normal circumstances, an external agency is engaged to assist in the recruitment of non-executive directors once a vacancy and the required skills and experience have been identified. Any such vacancy is advertised in national and the main local press to enable members to apply. In addition, the advertisement is made known to those members who have shown an interest in becoming a non-executive director. In 2011 no vacancies for non-executive directors were identified and accordingly no recruitment was undertaken.

As referred to in section B.1 above, the composition of the Board is under constant review by the Chairman. A review of the succession planning for non-executive directors is currently being undertaken by the Nominations Committee and will be shared with the FSA following Board approval which is expected to be by the end of April 2012. This plan will take into account the guidance issued by the FRC in March 2011 on Board Effectiveness.

Following the announcement in February 2011 of Iain Cornish's decision to step down as Chief Executive, the Chairman, working closely with the other non-executive directors, through a specially constituted Nominations Committee (which included additional non-executive directors and not the Chief Executive), undertook a comprehensive search process for Iain's successor using an independent executive search firm, Egon Zehnder International Ltd. A short list was drawn up by the Nominations Committee who interviewed the short-listed candidates prior to the non-executive directors reaching a decision on the successful candidate, Chris Pilling. His appointment was subsequently approved by the FSA following an interview under the FSA's Significant Influence Function process. Chris took up his appointment on 31 December 2011.

The Board gives consideration to geographical representation and diversity on the Board although it has adopted the principle that appointments should be made on merit. For this reason, the Board has not set any measurable objectives as recommended by the Davies Report on 'Women on Boards' published in February 2011 for FTSE 350 companies.

The percentage of females on the Society's Board at the date of this report is 17%. In addition, 25% of the General Management team (excluding executive directors) is female and for the next level of senior managers (i.e. those managers who report directly to a member of the General Management team) it is 26%. The Society takes into account diversity at all levels of recruitment and encourages staff through various initiatives, including taking on voluntary roles such as trusteeship and non-executive roles in local, albeit small, voluntary organisations, to enable staff to gain experience of Board roles.

B.3 Commitment

Main principle: "All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively."

One of the criteria which the Board takes into consideration when recruiting a non-executive director is his/her ability to have sufficient time to take on the position. In addition, during the term of their directorship with the Society, any other positions that such directors take-up have to first be referred to the Board so that the time commitment and any potential conflict of interest can be considered. The letters of appointment of non-executive directors give an indication of the time commitment required although this will change depending on whether he/she is chair and/or member of any Board committee(s). The commitment will also increase, inevitably, when a potential merger or other major development is being considered. In 2011 the involvement in terms of time of the Chairman and other directors was considerably more than would normally have been the case due to consideration of the merger with the Norwich & Peterborough Building Society (N&P) and the acquisition of the Egg Banking plc (Egg) mortgage and savings accounts. No additional fees were paid to the non-executive directors for this additional time commitment.

Copies of the letters of appointment of each of the non-executive directors are available for inspection on request from the Group Secretary.

The Board is satisfied that the independence of non-executive directors who have directorships or senior positions in other organisations is not compromised.

B.4 Development

Main principle: "All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge."

The Chairman ensures that, on appointment, non-executive directors receive a comprehensive tailored induction programme on the Group's business and regulatory environment. All non-executive directors update their skills, knowledge and familiarity with the Group through internal presentations by senior managers, relevant external and internal courses and through branch visits and attendance at member events referred to on page 50. In November 2011, for the second year, Deloitte presented an update on regulatory issues to the Board which was forward looking. Individual training requirements for non-executive directors are discussed as part of the performance evaluation process (see below) and a training record for each non-executive director is maintained by the Group Secretary.

Non-executive directors are encouraged to contact individual members of the senior management team to discuss any queries that they may have. In addition, to enable the non-executive directors to discuss matters with the business managers, four informal dinners were held in 2011.

The non-executive directors are also encouraged to undertake branch and department visits on an ad hoc basis. This complements any Board presentations that are given by specific business areas. For example, in 2011 the Board visited a Chelsea branch where they received presentations by a number of branch and area managers on the branch experience of the integration of Chelsea Building Society with the Yorkshire and on the branch revitalisation programme.

The non-executive directors are also encouraged to attend a member meeting, as referred to on page 50, during the year.

B.5 Information and support

Main principle: "The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties."

The Chairman ensures that the directors receive accurate, timely and clear information to enable the Board to carry out its responsibilities effectively. In February 2011, the Group Internal Audit (GIA) function, together with external consultants, completed a review of the information provided to the Board. It concluded that the above criteria were met and supported the direction of an existing initiative to enhance the content and presentation of management information.

As a result of these reviews, a revised Board management information pack was introduced in August 2011. This has enhanced the reporting to the Board on both financial and non-financial information, to make it more focused and comprehensive with more use of 'dashboards' to highlight performance against targets (including Key Performance Indicators). The revised format also ensures that risk is an integral part of each reporting item.

The Board agenda contains standing items, for example:

- The management information pack referred to above. The executive directors and other General Managers (who attend the Board meetings) highlight key issues contained in the pack in relation to their business areas.
- Minutes of Board committee meetings held since the previous Board meeting and oral updates from the chairs of Board committees on the main issues discussed and matters agreed. This ensures that all Board members are aware of the key discussions and decisions made by the committees.
- Minutes of the meetings of the General Management team, UK subsidiary Board meetings and those of the Customer Value Committee and Financial Management Committee which are both management committees.

The agenda also includes items for decision and key matters which need to be debated. If a major item will require more detailed consideration then the Board may delegate this to be considered by the Chairman's Committee (see page 44) or a specific committee made up of named directors. During 2011 the Chairman's Committee (which also included the chair of the Group Risk Committee) was used to review in detail the transaction documents for the merger with N&P and the acquisition of the Egg mortgage and savings accounts.

All directors have access to independent professional advice if required and have the benefit of appropriate liability insurance cover at the Society's expense. In addition, they have access to the advice and services of the Group Secretary who is responsible for ensuring that Board procedures are complied with and for advising the Board, through the Chairman, on governance matters.

B.6 Evaluation

Main principle: "The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors."

The Board undertakes an annual evaluation of the performance and effectiveness of the Board together with an annual review of the performance of individual directors. Between November 2010 and January 2011 an external Board effectiveness review and individual director reviews were conducted by Praesta Partners LLP. The results were reported in the 2010 Corporate Governance Report. Due to this recent comprehensive external review, an internal Board evaluation was undertaken at the end of 2011 through the means of an internal questionnaire. The results of the questionnaire were reviewed by the Board at its meeting in December 2011. Overall, the results were very positive but a number of issues were agreed. This included having more time scheduled in the Board annual calendar for meetings of the non-executive directors only and continuing to ensure that robust succession plans are put in place for executive directors (and for other General Managers) and for the non-executive directors, work on which was already underway.

In 2011, internal performance evaluations of the Audit Committee and the Group Risk Committee were carried out through the means of a questionnaire completed by all relevant committee members. The results were reviewed by the relevant committees and any appropriate improvements were identified for action. An evaluation of the Remuneration Committee will take place in the first quarter of 2012.

Due to the comprehensive individual evaluation of all directors (which, as referred to above was facilitated externally and was concluded in January 2011) together with the fact that the recently appointed Chief Executive, Chris Pilling, will want input into the reviews of the executive directors, the Board agreed to defer the next individual assessments (both executive and non-executive directors) to later in 2012. These reviews will be undertaken internally. However, the Board did review the performance and effectiveness of the three non-executive directors who are subject to re-election at the 2012 AGM at its December Board meeting. This took the form of discussions at the meeting following prior consideration by the Nominations Committee. The relevant director was not present at these meetings when his/her performance was reviewed and discussions in relation to the Chairman were led by the Vice Chairman. In addition, the performance of the executive directors is subject to continuous assessment by their manager in accordance with the performance review process for all staff. This is carried out by the Chief Executive whose own ongoing performance reviews are undertaken by the Chairman.

B.7 Re-election of directors

Main principle: "All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance."

Under the Society's Rules, directors have to submit themselves for re-election at least once every three years. Non-executive directors are usually expected to serve for two full three-year terms following their first election to the Board (subject to the Board reviewing their performance prior to any proposal for re-election), and may be asked to serve for further terms of up to three years each, as appropriate.

At the 2012 AGM, members will be asked to elect Chris Pilling, Chief Executive, as a director following his appointment by the Board which took effect on 31 December 2011. Members will also be asked to vote on the re-election of Ed Anderson, Chairman and non-executive directors Lynne Charlesworth and Simon Turner as referred to on page 42 of this report. The Board has confirmed that the performance of these directors due for re-election continues to be effective and that they continue to demonstrate the necessary commitment to their respective roles. The process to review the performance of the directors is set out above.

Details of the above mentioned directors, together with those of all the other directors, are set out on pages 36 to 38.

Section C: Accountability

C.1 Financial and business reporting

Main principle: "The board should present a balanced and understandable assessment of the company's position and prospects."

The Annual Report and Accounts includes a Business Review which is a comprehensive review of the Group's financial and operational performance in 2011.

C.2 Risk management and internal control

Main principle: "The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems."

Risk management

The Board has a Group Risk Committee (GRC) which has delegated responsibility from the Board for the more detailed ownership of the Group's risk appetite, risk monitoring and risk and capital management framework.

The members of the GRC (and dates of changes to the committee's membership in 2011) are:

Ed Anderson, Society Chairman
Kate Barker, Non-executive Director
Ian Bullock, Sales & Marketing Director
Roger Burden, Non-executive Director (resigned 23 March 2011)
Andy Caton, Corporate Development Director
Lynne Charlesworth, Non-executive Director (GRC Chair)
Robin Churchouse, Finance Director
Iain Cornish, Chief Executive (resigned 30 December 2011)
Rachel Court, General Manager, Human Resources and Customer Service
Richard Davey, Society Vice Chairman
Mark Jenkins, General Manager, Commercial Development
David Paige, Non-executive Director
Chris Pilling, Chief Executive (appointed 31 December 2011)
Richard Wells, General Manager, Risk

Further details of the GRC and the Group's approach to risk management can be found in the Risk Management Report on pages 55 to 63.

Details on the system of internal control are set out in the Audit Committee Report on page 53.

C.3 Audit Committees and Auditor

Main principle: "The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors."

The Board has an Audit Committee which assists the Board in fulfilling the above responsibilities with the Group Risk Committee overseeing the risk management framework.

The members of the committee are:

Richard Davey, Society Vice Chairman
Philip Johnson, Non-executive Director, Committee Chairman
David Paige, Non-executive Director
Simon Turner, Non-executive Director

Details about the Audit Committee can be found in the Audit Committee Report on pages 52 to 54.

Section D: Remuneration

D.1 The level and components of remuneration

Main principle: "Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance."

The level and components of the remuneration for directors is set out in a separate Directors' Remuneration Report on pages 64 to 70.

D.2 Procedure

Main principle: "There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration."

The Remuneration Committee is responsible for considering and approving the remuneration of the executive directors and other General Managers as well as agreeing the remuneration policy for the whole organisation. With effect from 1 July 2011 the committee is also responsible for considering and approving the remuneration of the Chairman as a result of which the Chairman resigned from the committee. Further details of the committee, the remuneration policy and directors' service contracts can be found in the Directors' Remuneration Report on pages 64 to 70.

The members of the committee (and dates of changes to the committee's membership in 2011) are:

Ed Anderson, Society Chairman (resigned 1 July 2011)
Roger Burden, Non-executive Director (appointed 23 March 2011)
David Paige, Non-executive Director
Simon Turner, Non-executive Director (committee Chairman)

Section E: Relationship with Shareholders (Members)

E.1 Dialogue with Shareholders

Main principle: "There should be dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has a responsibility for ensuring that a satisfactory dialogue with shareholders takes place."

The Society's owners are its individual members who are made up of its investors (except deposit account holders) and borrowers. This is different to the shareholders of a listed company, whose owners may include institutional shareholders. The vast majority of the Society's customers are therefore its members and the Society encourages feedback from them on any aspect of the Society's activities.

This feedback takes various forms, including member 'Question Time' meetings and 'Meet the Chief Executive' events which give members the opportunity to meet and ask questions of the Chief Executive, the senior management team and local branch staff. The Members' Forum, currently made up of 16 members who are drawn from a cross-section of the Society's membership, meets twice a year to debate and obtain views on specific relevant issues. The non-executive directors are encouraged to attend at least one member event during the year to engage with members and understand any concerns that they may have.

The Society also operates a Member Panel, consisting of more than 8,500 members, who are invited to complete surveys on a variety of topical issues. In addition, a monthly customer satisfaction survey is undertaken, the results of which are a key performance indicator, which is monitored by the Board on a monthly basis.

E.2 Constructive use of the Annual General Meeting (AGM)

Main principle: "The board should use the AGM to communicate with investors and to encourage their participation."

At the AGM, the Chairman and Chief Executive give presentations on the previous financial year's performance and on future plans. The meeting also provides an opportunity for members to question the Chairman, Chief Executive and other directors on the resolutions to be proposed at the meeting and on any other aspect of the Society's business. All directors attend the AGM (unless their absence is unavoidable) including the chairs of all of the Board committees.

All members who are eligible to vote at the AGM receive a proxy voting form, which includes a 'vote withheld' option, and a pre-paid reply envelope to encourage them to exercise their vote through the appointment of a proxy if the member cannot attend and vote at the meeting. Members are also able to appoint a proxy online.

At the AGM, the Chairman calls for a poll on all resolutions so that all proxy votes are recorded. The results of the proxy votes, and the votes cast at the AGM, are published on the Society's website and in branches. They are also available on a telephone results line for a specified period after the AGM. A separate resolution is proposed on each issue, including a resolution on the Annual Report and Accounts.

Board and committee attendance record 2011

Set out below are details of the directors during 2011 and their attendance record at Board meetings and relevant Board committee meetings in the year. The figure in brackets indicates the number of meetings that the director was eligible to attend during 2011.

Director	Board Meetings	Board Committees				
		Audit	Chairman's	Nominations	Remuneration	Risk
Ed Anderson Chairman	13(13)	–	5(5)	4(4)	4(4)	6(7)
Kate Barker Non-executive Director	13(13)	–	–	–	–	7(7)
Ian Bullock Sales & Marketing Director	12(12)	–	–	1(1)	–	7(7)
Roger Burden Non-executive Director	13(13)	–	–	–	4(5)	1(2)
Andy Caton Corporate Development Director	11(12)	–	–	–	–	6(7)
Lynne Charlesworth Non-executive Director	13(13)	–	4(4)	2(2)	–	7(7)
Robin Churchouse Finance Director	10(12)	–	–	–	–	6(7)
Iain Cornish Chief Executive (resigned 30.12.2011)	10(12)	–	5(5)	1(2)	–	6(7)
Richard Davey Vice Chairman	12(13)	4(5)	4(5)	3(4)	–	4(7)
Philip Johnson Non-executive Director	13(13)	5(5)	–	–	–	–
David Paige Non-executive Director	12(13)	5(5)	–	–	6(7)	6(7)
Chris Pilling Chief Executive (appointed 31.12.2011)	0(0)	–	0(0)	0(0)	–	0(0)
Simon Turner Non-executive Director	12(13)	5(5)	–	2(2)	7(7)	–

Notes:
In addition to the above, the written resolution procedure under the Society's Rules was used on one occasion by the Board and on a further three occasions by the Chairman's Committee to conduct business.

On behalf of the Board

Ed Anderson
Chair

22 February 2012

AUDIT COMMITTEE REPORT

The Audit Committee is appointed by the Board and is made up of four non-executive directors. Audit Committee members are encouraged to obtain training relevant to this specific role. In Autumn 2011, a training session specifically for committee members (and also attended by the wider Board) was held covering areas including: governance developments, the regulatory landscape, accounting updates, changes to the tax regime, FSA Recovery and Resolution Plans, risk appetite approaches, Basel III and current issues in respect of forbearance.

Responsibilities of the committee

The responsibilities of the committee are in line with the provisions of the FRC Guidance on Audit Committees (the 'Smith Guidance') which was updated in December 2010. The main function of the committee is to assist the Board in fulfilling its oversight responsibilities, specifically the ongoing review, monitoring and assessment of:

- The integrity of the financial statements, any formal announcements relating to financial performance and significant financial reporting judgements contained in them.
- The effectiveness of the system of internal control processes.
- The internal and external audit processes.
- The Society's ethical and business standards.
- The appointment, re-appointment and removal of the external auditor and the periodic review of their performance and independence.
- The policy on the use of the external auditor for non-audit work.

Areas considered in 2011

During 2011 the committee met five times in the execution of its responsibilities and, in particular, considered reports on the following matters which were reported on by the independent Group Internal Audit (GIA) function, the Group Finance function and the external auditor, Deloitte LLP:

- The system of internal control. As well as regular reports from the internal and external auditors on control matters, the committee receives an annual paper from GIA which expresses their opinion on the effectiveness of the system of internal control and management's response to the observations. During 2011, the committee considered the impact of the merger with Norwich & Peterborough Building Society (N&P) and ensured that appropriate control reviews were scheduled over areas of significant or new risk to the Group. The impact of external events is also monitored. The committee considered the high profile trading control failures at UBS and how the Group's internal processes compared. A regular integrated assurance report is provided to the committee showing the sources of assurance provided to the Board over key risk areas and the resultant opinions on internal controls provided by these sources. During the year, the report was extended to illustrate this assurance by key processes in the Group. On an annual basis, the committee formally assesses the effectiveness of the Group's whistleblowing processes.
- The integrity of financial statements. A detailed paper on going concern is prepared for the committee as a matter of routine by the Group Risk function. The same approach is adopted for the interim accounts as at the year end and comprises a thorough analysis of a range of potential future scenarios, considering the impact on capital, liquidity and profitability of the Group. Particular attention has been paid to the potential impact on the availability of funding in the market in general as a result of events in Europe. Additional details on going concern are provided on pages 40 to 42 of the Directors' Report.
- New accounting policies and application of existing policies. The committee continues to monitor closely the approaches to impairment provisioning. Reports have been received from management and the external auditor on the appropriateness of the models used and the methodologies adopted to support the calculation of provisions and the approach adopted to forbearance. In terms of mortgage assets, the sensitivity of assumptions used on house price inflation, probability of default and emergence periods has been subject to scrutiny. The committee has carefully considered the potential for impairment on external loans and the Group's historic Irish loan exposures (which are detailed on pages 61 and 120). Focus has been given in 2011 to fair value accounting for mergers and acquisitions. The run-off of fair values made on the merger with Chelsea Building Society have been tracked with final adjustments made in April 2011 on the anniversary of the merger. No further adjustments can be made under Financial Reporting

Standards rules. The committee has considered proposed adjustments to be made on the merger with N&P and the acquisition of the savings and mortgage books from Egg Banking plc (Egg). Assurance has been sought from the external auditor on the calculations adopted. The Group has carefully considered the reporting requirements in respect of forbearance in light of publications made by the FSA.

- The activities of internal and external auditors. The committee receives regular reports from both Deloitte LLP and the GIA function and monitors closely all issues raised until they have been resolved satisfactorily by management. The external and internal auditors have separately met in private sessions with the committee during the year. The committee appraised the resource and skills available to internal audit in light of previous and current mergers and approved increases in headcount to reflect this growth.
- The effectiveness of the GIA function. Effectiveness is reviewed on an annual basis by the internal audit function self assessing practices against published standards (including those published by the Chartered Institute of Internal Auditors) and collating performance feedback from management. In 2011, the Finance Director has sought feedback from senior management and provided the results of this exercise to the committee along with the views of the external auditor. The review concluded that the GIA function operates effectively and exhibits many examples of leading practice. An independent assessment is performed every five years and is next scheduled in 2012.
- The performance of the external auditor. Feedback on performance was facilitated by GIA and comprised direct interviews with key stakeholders as well as questionnaires with personnel involved with the audit process. The committee is satisfied with the performance of Deloitte LLP and has recommended to the Board and members that they should be re-appointed at the 2012 AGM. The committee believes that effective, independent challenge has been provided to management and the judgements made in the financial statements.
- The effectiveness of the committee. A self assessment exercise, co-ordinated by GIA, is performed each year to monitor the effectiveness of the committee. This is undertaken using questionnaires and interviews with members and attendees at committee meetings and the results are reported to the Board. The 2011 review concluded that the committee has operated effectively during the year.
- The level of non-audit fees paid to the external auditor. As noted on page 87, the committee has reviewed the level of non-audit fees paid to the external auditor throughout the year and believes that these have not impaired the independence and objectivity of Deloitte LLP.

The committee is aware of the close nature of its agenda and that of the Group Risk Committee and addresses the risk of overlap/omission through commonality of some of its members and the consideration of the minutes of meetings. Further, the Chair of the Audit Committee receives the meeting papers for the Group Risk Committee meetings and vice versa.

System of internal controls

The Society recognises the importance of sound systems of internal control in the achievement of its objectives and the safeguarding of member and Society assets. Internal control also facilitates the effectiveness and efficiency of operations, helps to ensure the reliability of internal and external reporting and assists in compliance with applicable laws and regulations.

The Society operates in a dynamic business environment and, as a result, the risks it faces are continually changing. The internal control framework has been designed to ensure thorough and regular evaluation of the nature and extent of risk and the ability to react accordingly. It is the role of the Society's management to implement the Board's policies on risk and control. It is also recognised that all employees have responsibility for internal control as part of their accountability for achieving objectives. Staff training and induction is designed to ensure that they are clear on their accountabilities in this area and are competent to operate and monitor the internal control framework.

The GIA function provided independent assurance to the Board on the effectiveness of the internal control framework through the Audit Committee. The information received and considered by the committee provided reasonable assurance that during 2011 there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate internal control framework that met the principles of the Code and the supplementary Turnbull guidance.

Further details of actual risk management practices are provided in the Risk Management Report on pages 55 to 63.

External auditor

The current external auditors, Deloitte LLP, were appointed to their role in July 2009 as a result of a competitive tender process. The committee is happy with the service delivered by Deloitte LLP and therefore has no current plans for a retender process. There is no formal requirement for a competitive tender process to take place at a set frequency. However, the need for a periodic tender will be considered by the committee during 2012. There are no contractual arrangements which restrict the committee's choice of external auditors.

Non-audit fees to the external auditor

The Group has a policy on the use of the external auditor for non-audit work which is overseen by the Audit Committee. The purpose of this policy is to ensure the continued independence and objectivity of the external auditor. The policy sets out examples of services which the external auditor can and cannot perform. Fees for individual assignments which exceed pre-defined limits require prior notification to the Audit Committee Chairman who then decides if formal Audit Committee approval is needed. The level of fees incurred is regularly monitored. Details of the fees paid can be found in Note 7 on page 87.

The external auditor undertook a number of non-audit related assignments for the Group during 2011. These were conducted within the limits set out in the policy and are considered to be consistent with the professional and ethical standards expected of the external auditor in this regard.

These have principally related to due diligence work in respect of the merger with N&P and the acquisition of the savings and loan books of Egg. The committee would normally expect due diligence services to be provided by the external auditor. The objectivity and independence of the auditor has been safeguarded in this respect by the majority of the work being performed by partners and staff who, whilst having specialist knowledge regarding the sector, have no involvement in the audit of the financial statements. In addition, an independent audit partner reviews any audit work in the key judgement areas.

On behalf of the Board

Philip Johnson
Chair of the Audit Committee

22 February 2012

RISK MANAGEMENT REPORT

Introduction

The Group's risk management framework and governance structure provides a mechanism for proactively identifying and addressing the key risks to the achievement of the Group's objectives. It delivers comprehensive monitoring, control and ongoing management of the major risks to which the Group is exposed, so as to ensure the security of its members' funds. The Group's ability to properly identify, measure, monitor and report risk is critical to its soundness and its ability to provide value and fair outcomes to its membership and customers.

The Board is ultimately responsible for every aspect of the Group's activities. In particular, its role is to focus on the Group's strategy and ensure that the necessary resources are in place to meet its objectives and to ensure that robust financial controls and systems of risk management are in place. To assist the Board, a Group Risk Committee was established in 2006 (further details are given below) made up of non-executive directors and senior executives. This committee considers all risk matters relating to the Group, including credit risk, operational risk, market risk, liquidity risk, funding risk, business risk, and regulatory and prudential requirements.

The Group's overall statement of risk appetite is as follows:

'The organisation will not take, or retain, risk positions that threaten its ability to remain a sustainable and independent mutual organisation, therefore ensuring the sustainability of Yorkshire Building Society and thereby ensuring that no stakeholder can suffer a loss.'

The Group maintains an independent risk management function (Group Risk) that is responsible for ensuring that appropriate risk management techniques and measures are deployed. These seek to reflect leading practice, whilst remaining commensurate with the Group's strategic aims, its appetite for risk and the actual risks it faces at any time. The Group Risk function provides periodic independent reports on risk positions and risk management activities for consideration by the General Managers of the business, the Group Risk Committee, its sub-committees and the Board. The General Manager – Risk provides a formal update to each Board meeting covering all areas of risk management, including both routine reporting and ad hoc issues.

The Board recognises that risk in various forms arises naturally from the Group's provision of various financial services to members. The Group's Risk Vision is to direct and support financial security and commercial advantage for Yorkshire Building Society through appropriate conduct behaviour and prudential management, ensuring that the Group makes the right decisions that build deep, lasting and mutually beneficial relationships with customers whilst protecting all stakeholders. The Group's Risk Management Strategy that results from that vision has three core components:

- A series of Principles for Risk Management that set out the headline rules that are appropriate and relevant across all of our activities and that set a culture of risk management for the Group, ensuring professionalism, responsibility and fairness at all times.
- A Conduct Risk Philosophy that directs that we treat customers' interests as being equal to the Group's own interests.
- A Prudential Risk Philosophy that considers the macro-economic environment, the volatility of outlook for that environment, and the internal risk management capabilities of the Group to determine the appropriate risk appetite for individual areas of the business.

The Group has a framework of consistently articulated risk appetites and a regularly updated Group Risk Map by which the Group aims to identify the major sources of risk to its strategic objectives, its assets and operations. The Group then deploys appropriate measures to control and monitor those risks. The key risks are plotted on the Group Risk Map with their position determined by the assessment of net impact and likelihood of occurrence, together with an assessment of whether each risk is outside or within the Group's risk appetite. Supporting each risk assessment is a risk dashboard that integrates all the relevant information about the risk, including key risk indicators, control assessments, audit and compliance points, emerging issues, and actions being taken. The risk dashboards are updated monthly and reviewed by General Management in detail on a quarterly basis. The Group Risk Committee reviews the dashboards relating to the most significant risks on a quarterly basis.

At an operational level, these principal risks and uncertainties can be considered in a number of categories, around which the Group has constructed its systems of monitoring and control. The individual risks, and the Group's response to them, are considered in more detail below within the context of the sub-committees of the Group Risk Committee established to oversee them under delegated authority of the Board.

The categories are as follows:

- Credit risk – this risk arises from the Group's retail lending and wholesale investment activities and is overseen by Group Credit Committee (split operationally between Retail Credit Risk and Wholesale Credit Risk). It is the risk that retail borrowers or wholesale counterparties fail to repay monies due to the Group.
- Market, liquidity and funding risk – the Group's balance sheet and financial position is exposed to market, liquidity and funding risk through the normal course of the Group's business. Market risk arises from balance sheet positions that are exposed to changes in interest rates (or similar indices); liquidity risk arises from the need to maintain adequate liquidity to meet the Group's cash flow requirements as they arise, as well as to meet its ongoing regulatory requirements and funding risk pertains to the need to fund the business from the retail and wholesale markets. These risks are overseen by the Group Asset and Liability Committee.
- Operational and regulatory risk – overseen by the Group Operational and Regulatory Risk Committee, this encompasses the risk of direct or indirect loss resulting from inadequate or failed internal processes, from people and systems, and from external events; it includes the risk of non-compliance with laws and regulation, and the risk of internal or external fraud.
- Business risk – this is the risk to the Group's financial sustainability and ability to grow; it brings together several strands managed in the above-mentioned risk management sub-committees plus the Group Capital Committee, and is overseen by the Financial Management Committee which deals with areas where risk categories overlap and interact.

The environment in 2011 was dominated by the eurozone crisis and by reduced growth expectations across the Organisation for Economic Co-operation and Development (OECD) economies. In the UK, the Bank of England maintained interest rates at a historic low and expanded the policy of quantitative easing to inject money into the economy. 2012 may witness the unfolding of the eurozone crisis and carries with it the risk of a double-dip recession in that currency area and beyond.

The Group again increased in size through merger with the Norwich & Peterborough Building Society (N&P) and the acquisition of the Egg Banking plc (Egg) savings and mortgages books towards the end of the year. The changes have brought increased liquidity with the Egg savings book, and additional branches in the East of England, current accounts, commercial lending and a branch in Gibraltar with N&P. Each of these transactions was subject to due diligence and Board scrutiny.

At the end of 2011 and the beginning of 2012, the principal risks and uncertainties faced by the Group can be broadly summarised as follows:

- Financial markets remain in a state of flux, and key credit concerns appear to have shifted from institutions to sovereign states; the Group has divested itself of its exposures to high risk countries wherever possible, and suspended limits relating to those countries. Large-scale refinancing for the market as a whole may bring new risks that are as yet unclear.
- The Financial Services Compensation Scheme levy represents a significant risk to the profitability of the Building Society sector and this risk may be augmented by the uncertainty around the costs of the European deposit protection scheme.
- Although the UK economy is not technically in recession, the outlook is unclear and job losses may well increase. The housing market may also suffer further decline. As a result, the Group's exposure to potential retail credit losses will continue, and must continue to be monitored, analysed and managed very intensively.
- The view of ratings agencies has a significant impact on the way financial institutions are perceived by the market and changes to that view, or absence of expected improvement, may restrict the ability of the Group to react to new situations.
- There is further regulatory change in the offing over the next few years, not just with Basel III, the mortgage market review, and the retail distribution review, but with the regulatory regime itself where the FSA's responsibilities will be split between the Financial Policy Committee, the Prudential Regulation Authority, and the Financial Conduct Authority. In 2012, we expect there to be an increased focus on Conduct Risk, and in particular, on forbearance.
- Although the probability appears relatively unlikely in the near future, interest rate rises may have an adverse impact on the arrears levels within the Group's lending book and this is the subject of close analysis and monitoring; such rises may also have an impact on the availability of funding.

- On a wider view, the level of fraud and other financial crime within the UK retail financial services markets remains high and the current economic situation is likely to increase the pressures in this area. Whilst the Group has not been directly exposed to what it considers to be the higher risk areas of the market, it nonetheless continues to maintain a strong focus on minimising the level of fraud and other financial crime to which it and its customers are exposed.

Group Risk Committee (GRC)

The Group Risk Committee was established in 2006 by the Board to oversee the Group's risk governance framework and to provide an entity-wide perspective on all risk matters. It comprises non-executive directors and senior executives and is chaired by a non-executive director. Its primary responsibilities are:

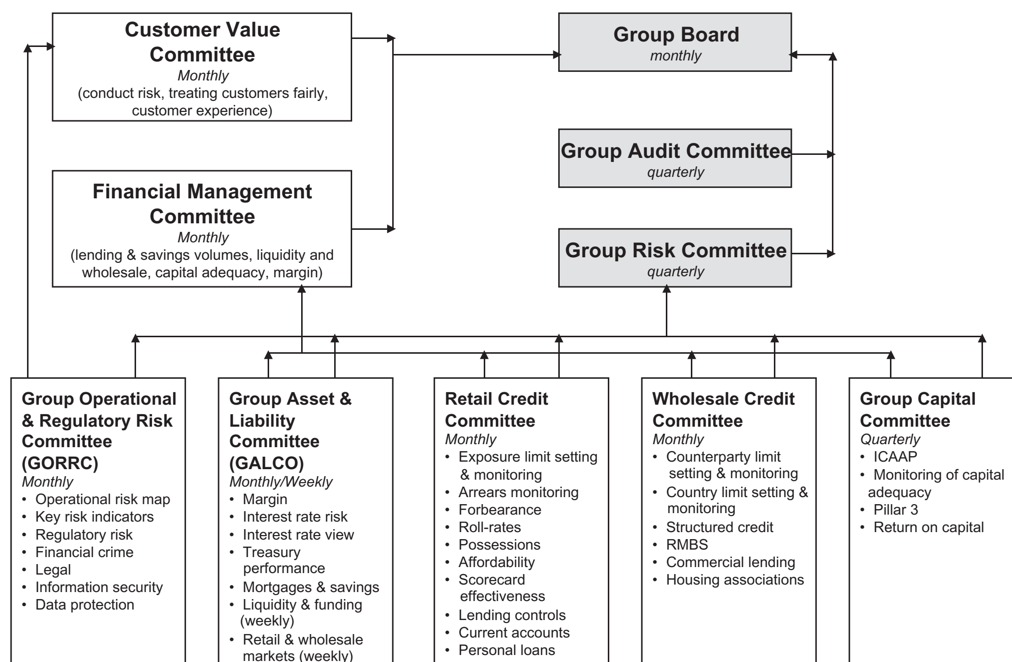
- Oversight of the Group Risk Profile and actions taken to manage key risks.
- Establishing methods for measuring risk appetite and risk positions.
- Approval of risk appetite and any proposed changes to it.
- Recommending the Group Risk Management policies, standards and limits for Board approval.
- Monitoring on-going risk positions and issues, in particular, for compliance with Group Risk Management policies, standards and limits.
- Annual review and approval of the Group's Internal Capital Adequacy Assessment Process, on recommendation from the Group Capital Committee.
- Approval of the Pillar 3 disclosure policy and annual review of Pillar 3 disclosures.
- Oversight of risk stress testing, including reverse stress tests.
- Annual review and approval of the Group Individual Liquidity Adequacy Assessment on recommendation from the Group Asset & Liability Committee.
- Review of the Money Laundering Reporting Officer's annual report.
- Review of the Group's current and proposed activities against its risk appetite and capital budgets.
- Review and approval of the Group's compliance with the new liquidity regime.
- Oversight of the scope and review of the due diligence process for major acquisitions.
- Establishment and monitoring of the relevant sub-committees and associated governance structures.

During 2011, the committee met seven times in the execution of its responsibilities and, in particular, considered the following matters:

- Formal oversight of all approaches to product risk acquisition and product portfolio management, including key risk outcomes and horizon risks.
- The risks connected to merger and acquisition activity, particularly that connected with N&P, the acquisition of the savings and mortgage accounts from Egg (including the risk policies to which they would operate), and the integration of Chelsea Building Society.
- Regulatory oversight including issues arising from all regulatory reviews, particularly those arising from the FSA's ARROW process.
- External economic and political risks including their potential impact on the Group.
- Liquidity risk management including stressed outcomes and regulatory limits.
- Capital risk management including stressed outcomes and regulatory limits.
- Consideration of any implications of the Society's reverse stress test outcomes.
- Review to establish whether the Society's compliance risk management processes represented best industry practice.
- Plans for the annual internal compliance oversight programme.
- Evaluations to ensure the committee is fulfilling its responsibilities.
- Consideration of the risks of entering new product sectors, e.g. buy-to-let mortgages.

- The changing trends in the financial crime risks faced by the Yorkshire.
- Asset encumbrance risks to the Group from wholesale funding.
- Checks that the Society complies with the FSA's remuneration code.
- A review to establish that a strong control framework is in place for the Society's agency partners.
- Agreement to a risk management strategy that would direct the Society's approach to best practice risk processes and a strong approach based on a mutual philosophy toward conduct risk management and prudential risk management.
- Agreement to a qualitative and quantitative risk appetite to frame the parameters for risk acquisition and risk management in 2012.
- Consideration of a gap analysis between the Society's present Standardised capital management approach and the more sophisticated Internal Ratings Based approach.

The GRC has established a number of sub-committees with day-to-day responsibility for risk management oversight. All of the sub-committees meet at least quarterly. Each is chaired by a senior manager with appropriate skills and each is attended by a number of executive directors and/or General Managers, as well as other senior managers and subject experts. Above the sub-committees, and to one side, sit the Financial Management Committee (FMC) and Customer Value Committee (CVC) that respectively take a broader, higher level view of prudential and conduct risk issues, and report them to the Board. The Risk Governance structure is shown diagrammatically below.



Group Capital Committee

This committee has been established to monitor, in the broadest sense, the Group's overall capital position and the allocation of capital across its various operations, portfolios and entities.

This includes:

- Monitoring in detail the Group's overall capital position, current and forecast, including allocation of capital across activities. This includes responsibility for approving, reviewing and maintaining the central consolidated capital models used under Basel Pillar II to calculate the Group's overall capital requirements.

- Reviewing the appropriateness of capital usage in the context of the risks inherent within different business lines and of the returns thereon.
- Establishing target returns on capital across the Group, monitoring performance against those targets and making proposals to GRC for changes to capital usage.

Capital and capital ratios are detailed in Note 31.

Group Asset and Liability Committee (GALCO)

This committee is responsible, under delegated authority of the Board, for managing the Group's liquidity, market risk and currency risk.

Liquidity risk

The Board recognises that a structural maturity mismatch inevitably exists within the Group's balance sheet, caused by the fundamental purpose of the Group's business, that is, providing its members with long-term mortgage advances funded, primarily, by contractually short-term retail savings accounts.

The Group's liquidity policy is to maintain sufficient liquid resources to cover a potential worst-case stress outflow. This is achieved through maintaining a prudent level of appropriate high-quality liquid assets, through maintaining appropriate wholesale funding facilities, and through the management of the growth of the business.

Following the production of the Group's first Individual Liquidity Adequacy Assessment or ILAA (the assessment of how much high-quality liquidity the Group deems it necessary to hold), the FSA have set an Individual Liquidity Guidance (ILG) for the Group. The Group chooses to manage liquidity to a level 10% above that guidance. The liquidity requirements of Egg and N&P businesses have been added to the Group's requirement; they will be fully integrated with YBS requirements at the next iteration of the ILAA in 2012. The 3 month forward projection of buffer liquidity versus the ILG is reported and reviewed daily within the business. In addition, daily liquidity stress tests are run for the wider liquidity measure of marketable assets and cash – these are also reviewed daily. The weekly GALCO meeting reviews an extended projection of funding and liquidity against a longer-term forecast for the two measures mentioned above. All three measures are reported monthly to GALCO, FMC and to the Board.

The Group has continued to maintain a presence in wholesale markets and has issued successfully during the year a £750m 7 year covered bond issue (the first UK issuer to target a 7 year maturity) and a £750m securitisation. 2011 also saw the Group make early repayment of all its Special Liquidity Scheme funding, part of its Government Credit Guarantee Scheme funding, and it also repaid €1.5bn covered bond funding.

Detail of actual exposures at the year-end is contained in Note 35.

Market risk

Market risk is the risk to earnings and capital arising from changes in interest rates, foreign currency exchange rates and the price of financial instruments.

The Group has a formal structure for managing its market risks including established risk limits, reporting lines, mandates and other control procedures. This structure is reviewed by GALCO at least monthly. The Board receives monthly summaries of risk positions and GALCO activity.

The Group's policies for the management of risks arising from movements in interest or currency exchange rates and the composition of the balance sheet provide the framework for the Group's Asset and Liability Management (ALM) and Treasury Risk Management activities. The primary purpose of the Group's ALM process is to ensure the accurate and timely identification, measurement and control of risk faced by the Group on its entire balance sheet. The primary purpose of the Treasury Risk Management process is to ensure that risks connected with all aspects of treasury activity are identified and that suitable measures and risk management practices are applied. Treasury Risk Management also monitors the suitability of, and compliance with, the operating limits set for the activities of the Group's Treasury function by the Board and it reports and recommends accordingly. ALM and Treasury Risk Management form part of the same team within the Group Risk function and both submit monthly reports to GALCO, Financial Management Committee and Board, with quarterly reporting to the Group Risk Committee.

The Group's principal source of market risk is interest rate risk and it focuses on four main measures for managing this:

- Value at Risk provides a measure of the maximum likely loss that could be sustained over a specified time period at a stated level of confidence.
- Basis point value sensitivity provides a measure of the sensitivity of the present value of the balance sheet to a one basis (0.01%) point parallel shift in interest rates.
- Balance sheet structural analysis monitors the composition of the balance sheet in terms of the different interest rate bases of assets and liabilities, in particular between LIBOR and other rates.
- Repricing gap analysis is used primarily for the identification of instrument repricing concentrations.

More details of these risk management measures can be found in Note 36.

The Board recognises that the above key measures for managing interest rate risk cannot be optimised in a simultaneous fashion. For instance, attempts to reduce the volatility of net interest income are likely to result in an increase in the volatility of the market value of the balance sheet. The Board therefore advocates the use of a wide variety of complementary risk indicators and measures and is disinclined to adopt a narrow definition or 'one figure' measure. An important factor in the risk measures is the degree of internal consistency between them. To facilitate this approach the above key measures are supplemented by other techniques including:

- Stress testing which is used to monitor the sensitivity of net interest income to extreme market conditions.
- Earnings at risk which provides a measure of the potential variability in net interest income for a given business mix over a given time period at a stated level of confidence.
- Scenario analysis which measures variability in net interest income using a number of possible interest rate scenarios.

Currency risk

The Group has certain money market instruments denominated in currencies other than sterling. Its policy is to eliminate currency risk, other than a small operational mismatch, through the use of cross-currency interest rate swaps and foreign exchange contracts.

Details of actual exposures are contained in Note 37.

Other risks

Other market risks are minimised by the use of derivative instruments which are used exclusively for this purpose and not for trading activities.

Group Credit Committee (Retail Credit Committee/Wholesale Credit Committee)

Credit risk is the potential risk of financial loss arising from the failure of a customer or other counterparty to settle their financial and contractual obligations as they fall due. The Group has in place a comprehensive set of controls and limits to monitor and govern the amount of such risk accepted. Credit risk is monitored on an ongoing basis within Group Risk, and the Group Credit Committee meets monthly to oversee risk management in this area. It falls into two distinct components – namely, credit risk from our retail lending activities and credit risk from investment of liquid assets with wholesale counterparties – the Group Credit Committee is therefore split operationally between the Retail Credit Risk and the Wholesale Credit Risk Committees.

Retail credit risk

The most significant credit risk that the Group is exposed to relates to its core business of providing loans secured on residential property. The Group lends to households across the UK and does not consider there to be any undue concentration of credit risk in any particular part of the UK.

The Group's mortgage lending is split into a number of separate books, including YBS Prime, Barnsley, Accord Prime, Accord Non Prime, Accord buy-to-let, CBS Prime, N&P Prime and Egg. Accord buy-to-let lending was only initiated in the latter quarter of 2011. 84% of balances of the merged entity comprise prime lending, and 8% are represented by buy-to-let properties.

The Group is well aware of the risk disparity between the books (albeit they are all retail credit portfolios) and differentiates its lending criteria, its pricing and its monitoring and management processes and techniques accordingly. Retail credit exposures are managed in accordance with the Board-approved Statement of Lending Policy and through the use of credit scoring systems that factor in the profile of the borrower, the nature of the loan, environmental conditions and the collateral that may be provided as security for the loan. These scoring systems, and the way they are used within the initial lending process, are varied to suit the different risks and profiles of the Group's loan portfolios. Actual and forecast retail exposures are monitored and managed against policy limits by the Group Credit Committee. In particular the committee monitors arrears, loan-to-value ratios, expected losses and scorecard performance.

The monitoring of retail credit risk is tailored to our different loan portfolios and to the economic and housing market conditions that prevail at any given time. The current focus is strongly on the impact of the housing downturn on our borrowers' behaviour and therefore on identifying, and seeking to help, those borrowers where the exposure to such a downturn is greatest. We have reviewed our forbearance policy in line with FSA guidance to ensure that it is clear and consistent, and that management information relating to forbearance is clear and comprehensive.

Retail credit risk management information is reported monthly to Retail Credit Committee, FMC, and Board with quarterly reports to Group Risk Committee.

Detail of actual retail credit risk exposures is contained in Note 39.

Wholesale credit risk

The Group Credit Committee also takes primary responsibility for the task of assessing and monitoring wholesale counterparty creditworthiness and conducting credit research and analysis. It does this by reviewing the Group's exposures and through setting limits to individual counterparties based on its internal ratings methodology. Limits are also set against the aggregate exposure to equally rated institutions and to all institutions based in any one country. Over the last three years, the Group has suspended a significant number of lines to other institutions, radically reducing the number of institutions with which it is prepared to place funds. Additionally, all new derivative transactions are covered by an International Swaps and Derivatives Association (ISDA) master agreement and a credit support annex that mitigates our exposure.

The investment of liquidity with institutional counterparties has reduced markedly over the last two years since the inception of the new liquidity regime. The regime militates against anything other than the highest quality liquid assets by only permitting government or supranational debt securities to be included in the liquidity buffer. It is this liquidity buffer that is measured against the individual liquidity guidance as the key regulatory metric over liquidity risk.

The radical reduction in banking exposures has meant that our vulnerability to consequences of the eurozone crisis is largely limited to second and third order effects. At 31 December 2011 we had direct exposure (floating rate notes) to three Irish financial institutions totalling £164m, however £51m of this matured and was received in full in February 2012; the remainder is due to mature by the end of July 2012. We have no sovereign exposures other than to the UK.

The Wholesale Credit Committee also maintains oversight of the Group's commercial lending books that were inherited from Chelsea (£151m) and N&P (£347m) building societies, and the Group's lending to registered social landlords (£50m). The Chelsea commercial book has been managed down from £151m at merger to £67m as at the year-end; commercial lending via the N&P brand is currently subject to a strategic review and the Group is also re-assessing the market for lending to registered social landlords.

Prior to the financial crisis, the Group invested a limited amount of funds into higher yielding, and hence higher risk, structured credit instruments. The purpose of this portfolio was to maintain a range of investments that contributed to the Group's earnings and made effective use of the capital and treasury management resources available to the Group. The Group has always been aware that this portfolio carries greater credit and market risk than the core liquidity it holds, and for that reason additional risk management techniques have, from inception, been applied to this portfolio. These additional credit monitoring and portfolio valuation techniques have been specifically designed to allow independent oversight of this portfolio's risks and performance.

The events of the past few years have adversely impacted the value of these structured credit investments, principally through the illiquid state of the market but also, in a number of cases, through underlying credit issues. The Group was aware that the value of these investments could be impacted by a liquidity shortage but, in common with nearly all institutions and regulatory authorities, it did not foresee the extent of the liquidity issues that have arisen. The Group's response to these events has been to further increase its levels of performance monitoring, including frequent liaison with

investment managers, particularly if any individual investments have displayed signs of stress. At the same time it has looked, where available, at all alternatives for the future structure of individual investments and has adopted a prudent approach to their valuation and treatment within the Group's financial statements. The stated wholesale credit risk appetite precludes any further investment in structured credit.

Wholesale credit risk management information is reported to Wholesale Credit Committee, FMC and Board on a monthly basis, and quarterly to Group Risk Committee.

Details of actual exposures are contained in Note 38. Structured credit investments are currently valued at £57m.

Group Operational and Regulatory Risk Committee

Operational risk is the potential risk of financial loss or impairment to reputation arising from failures in operational processes or the systems that support them. To minimise operational risk, the Group maintains a system of internal controls commensurate with the characteristics of the business, the markets in which it operates, leading practice principles and regulatory considerations.

The Group's operational risk management framework sets out the group-wide strategy for identifying, assessing and managing operational risk. The framework itself is not static and is updated periodically in line with changes in the business profile, product developments, internal management environment and external developments. The Operational Risk Management Programme is embedded in all business operations and provides management and their teams with a structure for managing risk and control issues and to assist management in decision making.

The Group has defined its key operational risks into the following categories:

Operational risk category	Definition
Legal & regulatory risk	External laws, regulations and codes (inclusive of anti-money laundering, mis-selling, Basel Committee or accounting regulations, data protection, Disability Discrimination Act, Consumer Credit Act, Financial Ombudsman Service, HM Revenue & Customs, building regulations, Building Society Acts 1986 & 1997, Financial Services and Markets Act 2000, mortgage regulation and Banking Code), may not be complied with in an effective manner that remains commercially sound.
Product & service risk	The Group's products or services may fail to maximise value and/or meet customer requirements and/or may not be distributed effectively or in a timely manner. External factors may not be identified, monitored and/or considered with appropriate action taken with respect to economic, technological, political, social, ethical, environmental and reputational risks, competitive behaviour and external pressures and developments.
Governance & strategy risk	The Group may not be governed effectively at a Group, divisional and business unit level and/or the strategy selected by the Group may be ineffective or inappropriate. Corporate governance in this context embraces the structures, systems and processes that provide direction, control and accountability for the Group and encompasses the provision and use of robust management information for decision-making purposes in a timely manner and the delivery of requirements within budget and timescales. Strategy risk is the risk of loss or reduced earnings due to inappropriate senior management/Board actions caused by unprepared or misjudged strategic decisions and/or the implementations of those decisions.
Process & system risk	Inadequate or failed internal processes and systems, and/or an inability to implement change effectively or realise the desired benefits, resulting in a financial loss and/or a failure to achieve both strategic and business unit objectives. This includes the risks associated with third party processing and outstanding arrangements.
People & resources risk	Staff may not be appropriately recruited, retained, trained and managed to achieve Group objectives whilst complying with external laws and regulations. Resources risk is the risk that physical resources, external suppliers or service providers may not satisfy the Group's requirements, and/or may not be managed effectively.
Theft & financial crime risk	The Group's assets may not be adequately protected resulting in fraud, theft, damage and other criminal acts.

The Group measures its operational risks based on both numerical and qualitative assessments of the risks it faces. These measures help to determine the level of control required to manage such risk within the overall risk appetite of the organisation. Operational and Regulatory risk management information is reported to Group Operational & Regulatory Risk Committee and to Board monthly, and quarterly to Group Risk Committee.

The Group aims to maintain a sound system of internal control that provides reasonable, but not absolute, assurance that it will not be hindered in achieving its business objectives, nor in the orderly and legitimate conduct of its business, by circumstances that may be reasonably foreseen. The focus is adapted to current conditions. For example, recent years have seen the development of more refined fraud and financial crime strategies and controls in response to increasing levels of such activity in the financial services market.

On behalf of the Board

Lynne Charlesworth
Chair of Group Risk Committee

22 February 2012

DIRECTORS' REMUNERATION REPORT

Introduction

This report:

- Explains to members the policy for the remuneration of executive directors, non-executive directors, general managers and certain other senior managers.
- Demonstrates how this policy complies with the Financial Services Authority's (FSA's) Remuneration Code, a revised version of which was implemented in December 2010.
- Meets the additional requirements of the FSA's new rules regarding remuneration disclosure published in December 2010, in compliance with the Capital Requirements Directive (CRD3).
- Voluntarily addresses the statutory disclosure requirements for listed companies in relation to directors' remuneration that are considered relevant to a building society.
- Includes a table showing each director's remuneration for the year ended 31 December 2011.

A summary of this report will be sent to all members eligible to vote at the 2012 Annual General Meeting and members will have the opportunity to vote on the report.

Remuneration Committee

The committee is responsible for determining, on behalf of the Board, the overall Group-wide remuneration policy (including bonus levels) for all staff. This includes the policy and the level of remuneration of the executive directors, General Managers and other senior managers, in particular, those with a material impact on the Society's risk profile (known as 'Code Staff'). The full terms of reference of the committee can be found at www.ybs.co.uk/committees.

The committee normally meets at least five times a year with additional meetings as required. In 2011, it met seven times. The committee takes independent external professional advice as appropriate, and monitors comparative remuneration packages within the financial sector. Towers Watson provided it with an overview of developing market trends in remuneration across financial services and beyond in June 2011, to ensure that the committee was aware of the latest developments.

The committee is made up of at least three non-executive directors. In 2011, they were David Paige, Roger Burden and Simon Turner (Chair of the committee). Ed Anderson (Chairman of the Society), resigned from the committee on 1 July 2011, following a change in the committee's terms of reference, whereby it acquired responsibility for agreeing the Chairman's fee, in keeping with the provisions of the UK Corporate Governance Code. He still attends meetings, however, other than when his own remuneration is being considered.

The Society's Chief Executive, the General Manager Human Resources and Customer Service and senior managers from the Society's Risk Management function present and comment upon proposals and supporting evidence as and when required and attend meetings at the committee's request.

Remuneration policy for non-executive directors

The committee does not set the remuneration of the non-executive directors other than the Chairman. Instead, their remuneration, including fees for committee membership, is reviewed on an annual basis by the executive directors and the General Manager Human Resources and Customer Service, using external benchmarking data, and with reference to the responsibilities, skills and time commitment required for the role.

A recommendation is made to the full Board which determines any change in the remuneration of non-executive directors. Any such changes take effect from 1 July. In 2011, the fees of non-executive directors were increased by 3%. The Chairman's fee was increased by 6.9%, to remain competitive in the market.

Additional fees (details of which are given on page 70) are paid to those non-executive directors who undertake additional duties and responsibilities requiring additional time commitment, including membership of certain Board committees. The Chairman does not receive additional fees for his committee memberships.

The non-executive directors are only entitled to receive fees and do not participate in any performance pay scheme, nor do they receive any pension arrangements or other benefits.

Remuneration policy for executive directors and other senior managers with a material impact on the Society's risk profile ('Code Staff')

The overall policy is that:

- The remuneration of executive directors, General Managers and other Code Staff should comply with the FSA's Remuneration Code, with an appropriate balance being struck between encouraging strong financial performance and sound risk management.
- The remuneration of executive directors (together with that of General Managers and other Code Staff) should be competitive with that of comparable organisations in the financial sector as well as reflecting the responsibilities and the intrinsic skills and capabilities required in the role, so as to attract and retain high calibre individuals with the relevant experience.
- A significant part of the remuneration of executive directors, General Managers and other Code Staff should be variable, based primarily on the Society's financial, risk and service performance (in particular, customer satisfaction). It should also be based on individual performance, using pre-determined targets to motivate and reward successful business and personal performance in the interests of current and future members. However, the proportion of variable pay is limited, to ensure that it is feasible for no bonus to be paid in years where business performance does not merit this.
- Personal reviews of the executive directors, General Managers and other Code Staff are carried out at least annually to assess their performance in meeting individual and strategic objectives. These reviews are reflected in pay reviews, which take effect from 1 May each year, as well as in awards of variable pay.
- The remuneration of senior staff in the Risk and Compliance function is independently considered by the Group Risk Committee, in addition to being approved by the Remuneration Committee.
- No executive director, General Manager or member of Code Staff is involved in deciding his or her own remuneration.

The policy in relation to the various elements of remuneration structures for executive directors, General Managers and other Code Staff is set out below.

(a) Basic salary

Basic pay will be market related (as it is for all employees), thus ensuring a competitive salary that fairly reflects the market rate, skill, experience and expertise for the role. Individual development and progression is reflected through the annual salary and personal review processes.

The committee considers external data from independent national salary surveys of the financial sector and a comparator group of financial institutions to ensure salaries remain competitive. Independent reward specialists carry out an overall review of senior management remuneration, generally once every three years. The last review was undertaken in 2010 by Towers Watson, and concluded that basic salaries at a senior level were broadly market-comparable. Other than as pension scheme actuaries and consultants, Towers Watson has no other connection to the Society.

(b) Performance incentive pay

In 2011 the executive directors, General Managers and other Code Staff participated in a non-pensionable annual performance incentive scheme, the elements of which reflected the Society's key measures of retail savings flow, gross mortgage lending, cost control, pre-tax profit and customer satisfaction. A scheme with similar characteristics was in place for all other staff. The scheme also contained risk threshold conditions approved by the Group Risk Committee regarding sustainable levels of capital and liquidity. In addition, executive directors (together with General Managers and other Code Staff) had an element of their performance pay based on the achievement of personal objectives.

If either profit had been less than 25% of the annual target in 2011, the risk threshold conditions had not been met or if individual performance had been unsatisfactory, then no bonus would have been payable under the scheme applicable to executive directors, General Managers and other Code Staff. In these circumstances, deferred elements from previous years would also have been forfeit.

The target levels for all measures in the scheme were set to provide stretching objectives, giving an incentive to perform at the highest level in a manner consistent with the long-term interests of members. The bonuses generated under the

2011 scheme reflect the strong overall financial performance of the Society in the year, and are lower than bonuses paid for 2010, notwithstanding a higher level of profit.

There was no minimum amount of performance pay and the maximum amount in the 2011 scheme, as a percentage of basic salary, was 65% for executive directors and General Managers, 90% for the Chief Executive and up to 45% for other Code Staff.

As part of their review of senior management remuneration in 2010, Towers Watson noted that bonus opportunity at senior level is generally lagging the financial services market as a whole, although it is broadly competitive against other building societies. This reflects the fact that the Society does not operate an additional long-term incentive plan. Nevertheless, the committee decided not to increase the earning potential for variable pay for 2011, since it believed that the current absolute amounts of, and ratio between, basic and variable pay achieve the optimum balance between incentivising financial performance and managing risk, as well as being in line with both the letter and spirit of regulation.

In order to meet the Society's desire to reward performance over a longer time period, as well as to comply with the requirements of the FSA Remuneration Code, deferral (subject to future performance conditions) was introduced into the annual performance incentive schemes from 2010 onwards for executive directors and certain senior managers. 60% of the annual bonus payment for executive directors and General Managers is deferred over a 3 year period (50% for certain other Code Staff and senior managers), with a third of the deferred amount due for payment annually during that period. The undeferred amount relating to the results of the 2011 annual performance incentive scheme is payable in 2012, together with the first deferred element from the 2010 scheme. These amounts are set out in the table on page 69. The performance conditions attaching to the first deferred element from the 2010 scheme have been met in full in 2011, and consequently, the first 20% deferred element will be paid to executive directors and General Managers in 2012 (16.66% for other senior managers). If future performance conditions for the remaining deferred elements are not met each year, payments will be reduced or withheld entirely. Deferred elements are also lost if an employee leaves the Society.

The FSA's Remuneration Code now requires 50% of all variable pay (both undeferred and deferred) to be paid in shares or share equivalent instruments. As a mutual organisation, the Society does not have the facility to make payments in this way at present, since no such share equivalent instrument currently exists. Consequently, the undeferred element of the 2011 bonus payment and first deferred element from the 2010 scheme will be paid entirely in cash in 2012, as permitted by the transitional provisions of the FSA Code. The Society will work with the FSA over the course of the next 12 months to determine how the Society can comply with this requirement for payments made from 2012 onwards. In the meantime, however, to match the retention requirements imposed on payments made in shares, 50% of the total payment made to executive directors in 2012 will be made in March, but the remaining 50% will be held in trust by the Society, and will not be released until September 2012, subject to satisfactory individual and Society performance.

Iain Cornish resigned from the Society on 30 December 2011, and consequently, will not qualify for any annual performance incentive payment for 2011, or for any payment of deferred bonus from the 2010 scheme.

Chris Pilling joined the Society as Chief Executive on 31 December 2011. Consequently, he will not receive any bonus from his previous employer, HSBC Bank Plc, for 2011 and loses deferred elements from previous years. To compensate for this, a one-off payment which honours those lost earnings with HSBC has been awarded, and the undeferred element of this is payable for 2011, as set out in the table on page 68. The remaining 60% will be deferred over a 3 year period, with annual pro-rata payments, and will be subject to future Society and individual performance conditions.

In summary, the committee can confirm that 2011 bonuses for executive directors, General Managers and other Code Staff meet with the requirements of the FSA's Remuneration Code, and considers that they represent an appropriate and proportionate reward in relation to the Society's overall 2011 performance. The committee will continue to review the operation of the annual performance incentive scheme in light of emerging best practice, taking into account the performance of the Society as a whole and the interests of its members.

(c) Benefits

Each executive director is provided with benefits which comprise a company car (or an equivalent allowance), pension arrangements, private medical insurance and permanent health insurance.

In addition, in common with all other staff, the executive directors can participate in a concessionary mortgage scheme

which is subject to a maximum concessionary amount of £160,000.

The executive directors are either members of the contributory defined benefit section (on a career average revalued earnings basis) or the defined contribution section of the Society's pension scheme.

The pension scheme also provides for dependents' pensions and a lump sum of four times basic salary on death in service.

Similar benefit structures exist for General Managers and other Code Staff.

(d) Service contracts

All the current executive directors have entered into contracts that can be terminated by either party on one year's notice or by the payment by the Society of an amount equivalent to one year's total remuneration.

Service contracts for General Managers and other Code Staff have notice periods varying between three months and up to one year, depending on the particular role.

Non-executive directors are appointed by letter for an initial term of three years. They will generally be expected to serve a second three year term. Where the Board considers that it is in the interests of the Society, a non-executive director may be asked to serve a further term of up to three years.

Aggregate remuneration data

The Prudential Sourcebook for Banks, Building Societies and Investment Firms (Remuneration Disclosures) Instrument 2010 now requires the publication of aggregate remuneration data for the Society as a whole, and in summary form for senior managers and members of staff whose actions have a material impact on the risk profile of the firm ('Code Staff'). The total fixed pay to employees in 2011 was £77.1m, total undeferred variable pay was £7.5m. Details of remuneration paid to Code Staff are as follows:

Fixed and variable pay

	Fixed Pay £000	Variable pay (undeferred) £000	Percentage of variable pay as cash	Deferred variable pay from previous years paid in 2011 £000	Outstanding deferred remuneration from 2010 and 2011 (100% invested – subject to future performance conditions) £000	Number of beneficiaries
Code Staff[1]	**5,181**	**1,022**	**100**	**265**	**1,617**	**43**

Sign on and severance payments

	Sign on payments[2] £000	Number of beneficiaries	Severance payments £000	Number of beneficiaries	Highest individual severance payment £000
Code Staff[1]	**389**	**1**	**–**	**–**	**–**

Notes

[1] Senior managers and staff whose actions have a material impact on risk profile (including executive and non-executive directors). Non-executive directors' fees are included under fixed pay. No variable pay was awarded to non-executive directors.

[2] Relates to the appointment of the new Chief Executive as explained on page 66.

The full cost of bonuses is recognised in the Income Statement in the same year as the performance to which it relates, irrespective of the fact that some of that bonus may be deferred and paid in future years.

The following bonuses are disclosed in directors' remuneration, below:

- Bonuses relating to performance in the reporting period (ie 2011) which are payable within 12 months of the end of that period (whether unconditional or not).
- Bonuses deferred from previous years which become payable as a result of the performance of the reporting period.

Audited information

Executive directors' remuneration

The following table sets out directors' remuneration for 2011, including those elements of 2011 bonuses which will be paid in 2012. In addition it shows bonuses which had been deferred from previous years which became unconditional as a result of 2011 performance and will be paid in 2012. The table does not include the deferred element of 2011 or earlier bonuses which become unconditional from 2012, subject to future performance and payable from 2013; these are shown on page 69.

	Salary[1] £000	Performance pay[2] £000	Deferred performance pay from 2010 due for 2011 £000	Taxable benefits[3] £000	Increase in accrued pension[4] £000	Society's contribution to pension scheme[5] £000	Total £000
Executive directors							
2011							
Ian Bullock	**276**	**63**	**32**	**13**	**–**	**27**	**411**
Andy Caton	**255**	**62**	**29**	**10**	**19**	**–**	**375**
Robin Churchouse	**276**	**63**	**32**	**11**	**–**	**27**	**409**
Iain Cornish (resigned 30.12.2011)	**697[6]**	**–**	**–**	**18**	**6**	**21**	**742**
Chris Piling (appointed 31.12.2011)	**–**	**156[7]**	**–**	**–**	**–**	**–**	**156**
	1,504	**344**	**93**	**52**	**25**	**75**	**2,093**
2010							
Ian Bullock	244	64	–	12	–	39	359
Andy Caton	241	58	–	10	10	–	319
Robin Churchouse (appointed 01.06.2010)	151	39	–	6	–	24	220
Iain Cornish	374	132	–	19	–	36	561
Andrew Gosling (retired 31.05.2010)	223[8]	54[8]	–	4	8	–	289
	1,233	347	–	51	18	99	1,748

Notes

[1] Basic pay plus cash pension allowance, see Note 5.

[2] Only includes payments for 2011 which are due to be paid in 2012. 50% of these payments are held in trust by the Society until September 2012, and may be reduced if performance deteriorates later in 2012.

[3] Principally the provision of a company car. Directors have elected to take a cash allowance in lieu, or partly in lieu, of a company car as follows: Ian Bullock £634, Andy Caton £8,853, Robin Churchouse £10,623 and Iain Cornish £6,245.

[4] The increase in accrued pension represents the change in the annual pension to which each director is entitled as a result of changes in pensionable earnings (excluding inflation) and increases in pensionable service during the year. For Andy Caton

and Iain Cornish, the value of executive directors' pension benefits includes those arising from unfunded arrangements.

[5] Defined contribution section contributions only. The defined contribution section and the defined benefit section of the YBS pension scheme are now paid by salary sacrifice. The employer contributions above do not include these additional contributions as they are effectively included in the pre-salary sacrifice basic salary figures, together with any cash pension allowance, up to a total pension benefit of 16% of salary.

[6] Includes £446,591 in relation to 2011 and £250,203 in relation to pay, pension allowance and benefits for the period between 31 December 2011 and the expiry of Iain Cornish's notice period on 1 July 2012 to which he was contractually entitled.

[7] Undeferred element of payment to honour lost earnings incurred by Chris Pilling on leaving HSBC.

[8] Includes amounts in relation to the period up to the expiry of Andrew Gosling's notice period in line with the disclosure of Iain Cornish's remuneration, see Note 6 above.

Executive directors' unpaid deferred elements:

Executive director	Year of award	Due 2013 £000	Due 2014 £000	Due 2015 £000	Total deferred £000
Ian Bullock	2010	32	32	–	64
	2011	32	32	32	96
	Total	**64**	**64**	**32**	**160**
Andy Caton	2010	29	29	–	58
	2011	31	31	31	93
	Total	**60**	**60**	**31**	**151**
Robin Churchouse	2010	31	31	–	62
	2011	32	32	32	96
	Total	**63**	**63**	**32**	**158**
Chris Pilling	2010	–	–	–	–
	2011	99	79	55	233
	Total	**99**	**79**	**55**	**233**

All deferred elements are subject to future performance conditions, and may be reduced or forfeit as appropriate.

Executive directors' pension benefits (defined benefit section) in 2011:

	Contributions from directors[1] £000	Increase in accrued pension £000	Accrued pension as at 31 December 2011 £000	Transfer value of accrued benefits as at 1 January 2011 £000	Transfer value of accrued benefits as at 31 December 2011 £000	Movement in transfer value less directors[1] contributions £000
Andy Caton	**–**	**19**	**109**	**1,415**	**1,740**	**325**
Iain Cornish	**–**	**6**	**196**	**3,294**	**3,704**	**410[2]**
	–	**25**	**305**	**4,709**	**5,444**	**735**

Notes

[1] With effect from 1 April 2010, pension contributions formerly made by members of Yorkshire Building Society Pension Scheme are now made on their behalf by the Society, with members instead sacrificing the equivalent amount of their salary. Andy Caton effectively contributed £20,000 in this way.

[2] Iain Cornish was an active member of the defined contribution section of the pension scheme until 30 December 2011. The figures shown above represent only the value of his deferred entitlement as a former member of the defined benefit section, with no additional contributions being paid to this scheme during 2011.

Chris Pilling, Ian Bullock and Robin Churchouse are members of the defined contribution section of the pension scheme and therefore are not included in the above table.

Non-executive directors' fees

	Committee fees (notes 1 and 2)		Basic fees		Total	
	2011	2010	**2011**	2010	**2011**	2010
	£000	£000	£000	£000	**£000**	£000
Ed Anderson (Chairman)	–	5*	**135**	104	**135**	109
Kate Barker (appointed 05.11.2010)	**7**	–	**42**	7	**49**	7
Roger Burden (appointed 01.04.2010)	**5**	5	**42**	30	**47**	35
Lynne Charlesworth	**24**	21	**42**	40	**66**	61
Richard Davey (Vice Chairman)	**14**	13	**61**	55	**75**	68
Philip Johnson	**17**	15	**42**	40	**59**	55
David Paige	**18**	16	**42**	40	**60**	56
Indira Thambiah (resigned 30.09.2010)	**–**	3	**–**	28	**–**	31
Simon Turner	**14**	13	**42**	40	**56**	53
	99	91	**448**	384	**547**	475

* Since 1 July 2010, no additional fee has been paid to the Chairman for committee membership.

Notes:

1. 2011 committee fees for non-executive directors consist of:
   - Member of the Audit Committee – £7,210 per annum (£7,000 per annum up to 30 June 2011).
   - Member of the Group Risk Committee – £7,210 per annum (£7,000 per annum up to 30 June 2011).
   - Member of the Remuneration Committee – £4,120 per annum (£4,000 per annum up to 30 June 2011).
   - Chair of the Audit Committee – £17,510 per annum (£17,000 per annum up to 30 June 2011).
   - Chair of the Group Risk Committee – £17,510 per annum (£17,000 per annum up to 30 June 2011).
   - Chair of the Remuneration Committee – £7,210 per annum (£7,000 per annum up to 30 June 2011).
   - 'Treating Customers Fairly' oversight role – £7,210 per annum (£7,000 per annum up to 30 June 2011).
2. Membership of these committees is set out in the Corporate Governance Report on pages 43 to 51. Significant changes in 2011 were:
   - Ed Anderson resigned from the Remuneration Committee on 1 July 2011.
   - Roger Burden became a member of the Remuneration Committee and resigned as a member of the Group Risk Committee on 23 March 2011.

On behalf of the Board

Simon Turner
Chair of the Remuneration Committee

22 February 2012

DIRECTORS' RESPONSIBILITIES STATEMENT

The following statement, which should be read in conjunction with the statement of the Auditor's responsibilities on page 72, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report.

The directors are required by the Building Societies Act 1986 (the Act) to prepare, for each financial year, annual accounts which give a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of the affairs of the Society and the Group as at the end of the financial year and which provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it.

The Act states that references to International Financial Reporting Standards (IFRS) accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing those Annual 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 Annual Accounts have been prepared in accordance with IFRS.
- Prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

In addition to the Annual 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 subsidiary undertakings.

The directors are responsible for the maintenance and integrity of statutory and audited information on the Society's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' responsibilities for accounting records and internal control

The directors are responsible for ensuring that the Society and its subsidiary undertakings:

- Keep accounting records in accordance with the Building Societies Act 1986.
- Take 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 Services Authority under the Financial Services and Markets Act 2000.

The directors have general responsibility for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

On behalf of the Board

Ed Anderson
Chairman

22 February 2012

INDEPENDENT AUDITOR'S REPORT
to the members of Yorkshire Building Society

We have audited the Group and Society financial statements of Yorkshire Building Society for the year ended 31 December 2011 which comprise the Group and Society Income statements, the Group and Society Statements of comprehensive income, the Group and Society Statements of financial position, the Group and Society Statements of changes in members' interests, the Group and Society Statements of cash flows and the related Notes 1 to 43. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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.

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

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements
In our opinion the financial statements:

- give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2011 and of the Group's and the Society's profit for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Building Societies Act 1986
In our opinion:

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

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Building Societies Act 1986 requires us to report to you if, in our opinion:

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

Stephen Williams (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Leeds, United Kingdom

22 February 2012

INCOME STATEMENTS

for the year ended 31 December 2011

		Group		Society	
	NOTES	**2011 £m**	2010 £m	**2011 £m**	2010 £m
Interest receivable and similar income	3	**1,377.5**	1,310.7	**1,320.3**	1,248.0
Interest payable and similar charges	4	**(1,048.9)**	(1,038.0)	**(1,088.5)**	(1,081.8)
Net interest income		**328.6**	272.7	**231.8**	166.2
Fees and commissions receivable		**48.0**	46.2	**44.2**	43.2
Fees and commissions payable		**(8.1)**	(9.0)	**(7.7)**	(8.6)
Net fee and commission income		**39.9**	37.2	**36.5**	34.6
Income from investments in subsidiaries	10	**–**	–	**20.2**	1.0
Net losses from fair value volatility on financial instruments	5	**(10.1)**	(10.5)	**(15.7)**	(11.4)
Net realised profits	6	**3.5**	15.2	**3.5**	15.2
Other operating income		**7.5**	6.2	**22.6**	16.7
Total income		**369.4**	320.8	**298.9**	222.3
Administrative expenses	7	**(177.4)**	(147.8)	**(174.5)**	(147.6)
Merger and acquisition costs	7	**(17.5)**	(10.4)	**(17.5)**	(10.4)
Depreciation and amortisation		**(14.7)**	(14.8)	**(14.0)**	(14.3)
Operating profit before provisions		**159.8**	147.8	**92.9**	50.0
Impairment of loans and advances to customers	9	**(30.1)**	(40.8)	**23.6**	(3.3)
Impairment of debt securities	9	**–**	(5.1)	**–**	(5.1)
Impairment of loans to subsidiaries	10	**–**	–	**(20.4)**	–
Operating profit before exceptional provisions		**129.7**	101.9	**96.1**	41.6
Financial Services Compensation Scheme levy	28	**(5.6)**	(3.6)	**(5.6)**	(3.6)
Operating profit		**124.1**	98.3	**90.5**	38.0
Negative goodwill	43	**5.6**	17.1	**5.6**	17.1
Profit before tax		**129.7**	115.4	**96.1**	55.1
Tax expense	11	**(23.5)**	(23.6)	**(6.9)**	(7.2)
Net profit		**106.2**	91.8	**89.2**	47.9

Net profit arises from continuing operations and is attributable to members.

The notes on pages 78 to 133 form part of these accounts.

STATEMENTS OF COMPREHENSIVE INCOME
for the year ended 31 December 2011

		Group		Society	
	NOTES	**2011 £m**	2010 £m	**2011 £m**	2010 £m
Available for sale investments:					
Valuation gains taken to equity		**69.0**	2.4	**69.0**	2.3
Amounts transferred to income statement		**1.9**	1.2	**1.9**	1.2
Cash flow hedges:					
Losses taken to equity		**(16.5)**	(1.9)	**(16.5)**	(1.9)
Amounts transferred to income statement		**12.7**	7.2	**12.7**	7.2
Actuarial gain on retirement benefit obligations	26	**18.7**	4.8	**18.7**	4.8
Tax on items taken directly to or transferred from equity	11	**(36.4)**	(7.6)	**(36.5)**	(7.6)
Net income not recognised directly in the income statement		**49.4**	6.1	**49.3**	6.0
Net profit		**106.2**	91.8	**89.2**	47.9
Total comprehensive income for the year		**155.6**	97.9	**138.5**	53.9

The notes on pages 78 to 133 form part of these accounts.

STATEMENTS OF FINANCIAL POSITION
as at 31 December 2011

		Group		Society	
		2011	2010	**2011**	2010
ASSETS	NOTES	**£m**	£m	**£m**	£m
Liquid assets					
Cash in hand and balances with the Bank of England	13	**1,598.4**	1,310.8	**1,598.4**	1,310.8
Loans and advances to credit institutions	14	**582.3**	935.8	**362.6**	725.4
Debt securities	15	**2,737.1**	3,615.2	**3,040.3**	3,506.6
Loans and advances to customers					
Loans secured on residential property	16	**26,659.3**	23,296.6	**18,267.1**	16,509.7
Other loans	16	**362.9**	74.1	**362.9**	74.1
Derivative financial instruments	34	**373.8**	579.8	**370.5**	297.8
Investments	10	**2.2**	2.1	**8,857.1**	10,488.1
Intangible assets	17	**30.4**	20.4	**30.2**	20.1
Investment properties	18	**25.5**	18.7	**25.3**	18.5
Property, plant and equipment	19	**109.6**	107.3	**91.3**	89.1
Deferred tax assets	20	**110.1**	107.8	**100.4**	96.4
Retirement benefit surplus	26	**32.9**	–	**32.9**	–
Other assets	21	**22.5**	17.7	**37.6**	50.2
Total assets		**32,647.0**	30,086.3	**33,176.6**	33,186.8
LIABILITIES					
Shares	22	**25,973.4**	21,382.5	**25,973.4**	21,382.5
Amounts owed to credit institutions	23	**765.4**	926.4	**765.4**	1,716.8
Other deposits	24	**510.3**	1,061.9	**1,589.5**	3,562.6
Debt securities in issue	25	**2,591.2**	4,348.4	**2,244.6**	4,348.4
Derivative financial instruments	34	**609.1**	472.3	**619.8**	472.3
Current tax liabilities		**22.3**	22.6	**7.6**	8.7
Deferred tax liabilities	20	**18.6**	13.7	**15.1**	9.1
Retirement benefit obligations	26	**1.2**	14.2	**1.2**	14.2
Other liabilities	27	**79.6**	74.2	**74.8**	71.6
Provisions	28	**110.4**	50.4	**110.4**	50.4
Subordinated liabilities	29	**230.9**	214.9	**230.9**	214.9
Subscribed capital	30	**177.0**	167.3	**177.0**	167.3
		31,089.4	28,748.8	**31,809.7**	32,018.8
Total equity attributable to members		**1,557.6**	1,337.5	**1,366.9**	1,168.0
Total liabilities		**32,647.0**	30,086.3	**33,176.6**	33,186.8

The accounts on pages 73 to 133 were approved by the Board of directors on 22 February 2012 and were signed on its behalf by:

Ed Anderson — Chairman
Richard Davey — Vice Chairman
Chris Pilling — Chief Executive

The notes on pages 78 to 133 form part of these accounts.

STATEMENTS OF CHANGES IN MEMBERS' INTEREST
for the year ended 31 December 2011

Group	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
At 1 January 2011	**1,408.1**	**(32.6)**	**(38.0)**	**1,337.5**
Transfer of engagements*	**60.2**	**–**	**4.3**	**64.5**
Current year movement net of tax	**113.6**	**(3.7)**	**45.7**	**155.6**
At 31 December 2011	**1,581.9**	**(36.3)**	**12.0**	**1,557.6**
At 1 January 2010	975.6	(36.0)	(39.8)	899.8
Transfer of engagements**	339.8	–	–	339.8
Current year movement net of tax	92.7	3.4	1.8	97.9
At 31 December 2010	1,408.1	(32.6)	(38.0)	1,337.5

Society	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
At 1 January 2011	**1,238.8**	**(32.6)**	**(38.2)**	**1,168.0**
Transfer of engagements*	**56.1**	**–**	**4.3**	**60.4**
Current year movement net of tax	**96.5**	**(3.7)**	**45.7**	**138.5**
At 31 December 2011	**1,391.4**	**(36.3)**	**11.8**	**1,366.9**
At 1 January 2010	839.8	(36.0)	(39.9)	763.9
Transfer of engagements**	350.2	–	–	350.2
Current year movement net of tax	48.8	3.4	1.7	53.9
At 31 December 2010	1,238.8	(32.6)	(38.2)	1,168.0

* Merger with Norwich and Peterborough Building Society, see Note 43.

** Merger with Chelsea Building Society.

The hedging reserve relates to fair value adjustments on derivative financial instruments designated as cash flow hedges. It is expected that the forecast transactions will largely occur over the next five years and the amount deferred will be recognised over this period.

The notes on pages 78 to 133 form part of these accounts.

STATEMENTS OF CASH FLOWS
for the year ended 31 December 2011

	NOTES	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Cash flows from operating activities:					
Profit before tax		**129.7**	115.4	**96.1**	55.1
Working capital adjustments	42	**71.0**	52.7	**26.5**	121.7
Net decrease in operating assets	42	**(809.6)**	1,008.1	**2,216.9**	650.6
Net decrease in operating liabilities	42	**881.7**	(3,293.2)	**(1,332.7)**	(2,648.3)
Net cash flows from operating activities		**272.8**	(2,117.0)	**1,006.8**	(1,820.9)
Cash flows from investing activities:					
Cash acquired on transfer of engagements		**251.5**	1,227.4	**251.5**	1,127.4
Purchase of property, plant and equipment and intangible assets		**(11.5)**	(7.7)	**(11.0)**	(7.5)
Proceeds from sale of property, plant and equipment		**1.5**	0.2	**1.5**	0.2
Purchase of debt securities		**(1,579.5)**	(4,270.2)	**(1,650.7)**	(3,958.3)
Proceeds from sale and redemption of debt securities		**2,725.0**	6,881.7	**2,493.0**	6,561.1
Net cash flows from investing activities		**1,387.0**	3,831.4	**1,084.3**	3,722.9
Cash flows from financing activities:					
Redemption of securities		**(2,963.3)**	(2,278.6)	**(2,909.5)**	(2,278.6)
Issue of securities		**1,178.0**	723.7	**778.0**	723.7
Interest paid on subordinated liabilities and subscribed capital		**(30.1)**	(26.5)	**(30.1)**	(26.5)
Net cash flows from financing activities		**(1,815.4)**	(1,581.4)	**(2,161.6)**	(1,581.4)
Taxation paid		**(24.4)**	(20.9)	**(10.2)**	(10.2)
Net (decrease)/increase in cash and cash equivalents		**(180.0)**	112.1	**(80.7)**	310.4
Opening balance		**2,335.7**	2,223.6	**2,016.7**	1,706.3
Total closing cash and cash equivalents		**2,155.7**	2,335.7	**1,936.0**	2,016.7
Cash and cash equivalents:					
Cash and balances with central banks		**1,573.4**	1,285.8	**1,573.4**	1,285.8
Loans and advances to banks	14	**582.3**	935.8	**362.6**	725.4
Debt securities		**–**	114.1	**–**	5.5
		2,155.7	2,335.7	**1,936.0**	2,016.7

The statement of cash flows has been prepared in compliance with 'IAS 7 Statement of Cash Flows' and has been presented under the indirect method.

For the purposes of the statements of cash flows, cash and cash equivalents comprise cash and other financial instruments with original maturities of less than three months.

The notes on pages 78 to 133 form part of these accounts.

NOTES TO THE ACCOUNTS

INTRODUCTION

Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) in issue that have been endorsed by the EU and are effective at 31 December 2011 and with those parts of the Building Societies Act 1986 and the Building Societies (Accounts and Related Provisions) Regulations applicable to societies reporting under IFRS.

The financial statements have been prepared on the historical cost basis, as modified by the revaluation of available for sale financial assets, derivative contracts and financial assets held at fair value through the Income Statement.

The financial statements have been prepared on the going concern basis. This is discussed in the Directors' Report on page 40, under the heading, 'Principal risks, uncertainties and going concern'.

The preparation of financial statements under IFRS requires the use of certain critical accounting estimates and judgement. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are set out in Note 2.

Accounting Developments

The following Accounting Standard amendments have been applied in 2011:

- Amendment to 'IFRS 7 Financial Instruments Disclosures' (October 2010) extends the scope of IFRS 7 disclosures but does not change the recognition or measurement of transactions in the financial statements.
- 'IAS 24 (Revised November 2009) Related Party Disclosures'. The application of this revised Standard does not have a material impact on the financial statements.
- 'IFRIC 14 (Amended November 2009) Prepayments of a Minimum Funding Requirement'. The application of this amendment does not have a material impact on the financial statements.
- 'IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments'. This Standard does not have a material impact on the financial statements.

The following Standards which have not been applied in these financial statements were in issue but not yet effective for the 2011 year end:

- 'IAS 32 (Amended) Classification of Rights Issue'. This amendment is not expected to have any impact on the financial statements.

The following Standard is neither adopted by the European Union nor effective for the 2011 year end:

- 'IFRS 9 Financial Instruments' was issued in December 2011 and is effective for periods commencing on or after 1 January 2015. This Standard is concerned with the classification of financial assets, which must be designated as either 'Held at amortised cost' or 'Held at fair value'; the 'Available for sale' category will no longer be available. IFRS 9 will have a significant impact for the Group although the full extent is not currently known.

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The Group financial statements consolidate the financial statements of the Society and its subsidiary undertakings. Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Inter-company transactions and balances are eliminated upon consolidation.

Interest income and expense

Interest income and expense on all financial instruments are recognised within interest receivable or payable on an effective interest rate basis.

The effective interest rate is the method used to calculate the amortised cost of financial instruments and to recognise interest receivable or payable over the relevant period. The effective interest rate is the rate that exactly discounts estimated cash flows (excluding credit losses) to zero, through the expected life of the instrument. The main impact for the Group relates to mortgage advances where fees, such as application and arrangement fees, and costs are incorporated in the calculation. This has the effect of spreading these fees and costs over the expected life of the mortgage. Expected lives are estimated using historic data and management judgement and the calculation is adjusted when actual experience differs from estimates, with changes in deferred amounts being recognised immediately in the Income Statement.

Fees and commissions

Fees payable and receivable in relation to the provision of loans are accounted for on an effective interest rate basis. Other fees and commissions are recognised on the basis of when the relevant service is provided.

Derivative financial instruments and hedge accounting

Derivative financial instruments

Derivative financial instruments are held at fair value with movements in value being recognised in the Income Statement. Fair values of exchange traded derivatives are valued using closing prices from the appropriate exchanges. Other derivatives are calculated using valuation techniques including discounted cash flow models.

Embedded derivatives

Certain derivatives are embedded in other financial instruments. These are treated as separate derivatives where the economic characteristics and risks are not closely related to the host instrument and the host instrument is not measured at fair value. These embedded derivatives are measured at fair value with movements in value being recognised in the Income Statement. Where the Group is unable to value the embedded derivative separately, the entire instrument is measured at fair value with changes in value being taken to the Income Statement.

Hedging

All derivatives entered into by the Group are for the purposes of providing an economic hedge. Full details of hedging strategies are contained in Note 34. Hedge accounting is an optional treatment but the specific rules and conditions in IAS 39 have to be complied with before it can be applied. The Group has classified the majority of its derivatives as fair value and cash flow hedges in order to reduce volatility in the Income Statement.

Fair value hedges

Where the fair value hedging requirements are met, changes in fair value of the hedged item arising from the hedged risk are taken to the Income Statement thereby offsetting the effect of the derivative. Where the hedge no longer meets the criteria, or is terminated for any other reason, the adjustment to the hedged item is released to the Income Statement, over its remaining life, using the effective interest rate method.

Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity and recycled to the Income Statement over the life of the forecast transaction. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately. If the forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss recognised in equity is then recognised immediately in the Income Statement.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment losses on loans and advances to customers

At each statement of financial position date the Group assesses whether or not there is objective evidence that individual financial assets (or groups of financial assets with similar credit characteristics) are impaired. In determining whether an impairment loss should be recognised, the Group makes judgements as to whether there is any evidence indicating a measurable decrease in the present value of cash flows expected from a financial asset or group of financial assets, resulting from an event (or events) that have occurred after initial recognition of the asset, but before the statement of financial position date.

Individual assessments are made of all loans and advances on properties which are in possession or in arrears by two months or more. All other loans and advances are grouped according to their credit characteristics and a collective review is undertaken of any evidence of impairment. Future cash flows are estimated on grouped credit characteristics in all cases.

Where there is objective evidence of impairment or that trigger events exist at the statement of financial position date, then the impairment loss is calculated as the difference between the assets' carrying value and the present value of the estimated cash flows from those assets. In assessing these cash flows a number of factors are taken into account, including the Group's historic default experience, historic and current loss emergence periods, the effect of changes in house prices and adjustments to allow for ultimate forced sales discounts.

Any increases or decreases in projected impairment losses are recognised through the Income Statement. If a loan is ultimately uncollectable, then any loss incurred by the Group on extinguishing the debt is written off against the provision for loan impairment. Any subsequent recoveries of amounts previously written off are recognised through the Income Statement as an adjustment to the loan impairment provision. If, in a subsequent period, the extent of impairment loss decreases, and that decrease can objectively be related to an event occurring after the initial impairment was recognised, then the impairment provision is adjusted accordingly and the reversal recognised through the Income Statement.

Impairment losses on debt instruments

At each statement of financial position date the Group assesses whether or not there is objective evidence that individual debt instruments are impaired. In determining whether there is any objective evidence of impairment the Group takes into account a number of factors including:

- Significant financial difficulties of the issuer or obligor.
- Any breach of contract or covenants.
- The granting of any concession or rearrangement of terms.
- The disappearance of an active market.
- Any significant downgrade of ratings.
- Any significant reduction in market value.

In some cases a significant adverse change in one of the above factors will cause the Group to determine that there is objective evidence of impairment. In other cases it may not be possible to identify a single event that identifies impairment. The Group may additionally determine that there is impairment where there are a number of factors contributing to that view.

Where the Group determines that there is objective evidence of impairment or that trigger events exist at the statement of financial position date, then, in the case of available for sale instruments, the cumulative loss that had been recognised directly in reserves is removed from reserves and recognised in the Income Statement. In the case of held to maturity instruments an appropriate charge is made to the Income Statement.

If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be related to an event occurring after the impairment loss was recognised through the Income Statement, the impairment loss shall be reversed, with the amount of the reversal recognised through the Income Statement.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Segmental reporting

The chief operating decision maker has been identified as the Board, which reviews the Group's internal reporting and is responsible for all significant decisions.

Financial information provided in the segmental reporting is consistent with that which is presented to the Board.

No segmental information is presented on geographical lines, because substantially all of the Group's activities are in the United Kingdom.

See Note 12 for further information.

Business combinations between mutual organisations

Identifiable assets and liabilities are measured at fair value. Intangible assets are amortised through the Income Statement over their estimated useful lives, being between one and ten years.

A deemed purchase price is calculated by measuring the fair value of the acquired business. Goodwill is measured as the difference between the adjusted value of the acquired assets and liabilities and the deemed purchase price. Goodwill is recorded as an asset; negative goodwill is recognised in the Income Statement.

Cash and cash equivalents

For the purposes of the Statement of Cash Flows, cash and cash equivalents comprise cash and other financial instruments with less than three months original maturity.

The Statements of Cash Flows have been prepared using the indirect method.

Financial assets

The Group classifies its financial assets into the following categories:

Loans and receivables

Loans and receivables are predominately mortgage loans to customers and money market advances held for liquidity purposes. They are initially recorded at fair value plus any attributable costs and less any attributable fees and are subsequently held at amortised cost less any impairment losses other than where an adjustment is made as part of a fair value hedging arrangement. Income is recognised on an effective interest rate basis.

Financial assets at fair value through the Income Statement

These comprise assets that have been specifically designated at inception and certain structured investments containing embedded derivatives where the Group has been unable to separately calculate the fair value of the embedded derivative. Where the embedded derivative has not been separated from the host instrument the entire (hybrid) instrument has been recorded at fair value with changes in value being taken to the Income Statement. Interest income is recognised on an effective interest rate basis.

Held to maturity

These comprise assets where the Group has both the intention and ability to hold to maturity. This category contains certain assets that have been specifically designated at inception and other assets that have been reclassified where we have the intention and ability to hold to maturity. They are initially recorded at fair value plus any attributable costs and less any attributable fees and are subsequently held at amortised cost less any impairment losses. Income is recognised on an effective interest rate basis.

Available for sale financial assets

Available for sale financial assets are securities held for liquidity and investment purposes. They comprise all non-derivative financial assets that are not classified as loans and receivables, held to maturity investments or financial assets at fair value through the Income Statement. These are recorded at fair value with changes in value being taken to reserves. Interest is recognised on an effective interest rate basis. Any profit or loss on sale is recognised in the Income Statement on disposal.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial liabilities

The Group records all of its financial liabilities at fair value less directly attributable transaction costs, and subsequently measures them at amortised cost, other than derivative financial instruments and where an adjustment is made as part of a fair value hedging arrangement. Expense is recognised on an effective interest rate basis.

Joint ventures

Joint ventures are those entities over whose activities the Group has joint control, established by contractual agreement and requiring unanimous consent for strategic financial and operating decisions. The consolidated financial statements include the Group's proportionate share of the entities' assets, liabilities, revenue and expenses on a line-by-line basis.

Investment properties, property, plant and equipment

Investment properties

Investment properties comprise freehold properties and parts of freehold properties that are not used in the business. These properties are generally flats and offices ancillary to branch premises and earn rental income. Investment properties are stated at cost less accumulated depreciation and impairment losses.

Property, plant and equipment

Buildings, major alterations to office premises, fixtures and fittings, equipment and other tangible fixed assets are stated at cost less accumulated depreciation and impairment losses.

Subsequent costs

Costs incurred after initial purchase of assets are expensed unless it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. Repairs and maintenance are treated as an expense.

Depreciation

Depreciation is provided by the Group to write off the cost (excluding land) less the estimated residual value by equal instalments over estimated useful economic lives as follows:

Freehold/long leasehold buildings (including investment properties)	–	50 years
Short leasehold property	–	Life of lease
Equipment, fixtures, fittings and vehicles	–	3 to 8 years

Land is stated at cost less accumulated impairment losses and is not depreciated. Any impairment in the value of assets is dealt with through the Income Statement as it arises.

Intangible assets

Computer software

Costs incurred in the development of computer software for internal use are capitalised as intangible assets where the expenditure leads to the creation of an identifiable non-monetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group. Acquired software is classified as an intangible asset where it is not an integral part of the related hardware. Computer software costs are amortised over their estimated useful lives, which are generally three to five years. Any impairment in the value of these assets is dealt with through the Income Statement as it arises.

Goodwill

Goodwill represents the excess of the consideration transferred for an acquisition over the fair value of the Group's share of the net identifiable assets (including the fair value of contingent liabilities) of the acquired business at the date of acquisition. Goodwill on acquisitions is included as an intangible asset.

A purchase resulting in negative goodwill arises when the fair value of net identifiable assets acquired exceeds the cost of an acquisition. Negative goodwill is recognised as a gain in the Income Statement.

Other intangibles

Other intangibles, which largely represent core deposit intangibles acquired by the Group, are amortised using the straight line method over their estimated useful lives of between one and ten years.

NOTES TO THE ACCOUNTS continued

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Employee benefits – Pension obligations

Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the Income Statement as incurred.

Defined benefit plans

The asset or liability recognised in the Statement of Financial Position in respect of the defined benefit pension schemes is the present value of the defined benefit obligation at the statement of financial position date less the fair value of plan assets, together with adjustments for unrecognised past service costs. The asset is recognised on the Statement of Financial Position to the extent that it is recoverable by the Group. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. Projected benefit obligations are discounted to present value using the rate of return available on high quality corporate bonds of equivalent currency and term to the obligations. Actuarial gains or losses are recognised in full in the period in which they occur in the Statement of Comprehensive Income. Past service costs are recognised immediately in the Income Statement to the extent that benefits are already vested or amortised on a straight-line basis over the average period until the benefits become vested.

Scheme surplus

The Group has received a legal opinion that it can recognise in full any surplus valuation of the scheme.

Tax

Tax comprises current tax and deferred tax. Tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case the tax is also recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted on the statement of financial position date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised providing for temporary differences between the carrying amount of certain assets and liabilities for accounting purposes and for taxation purposes. Deferred tax is provided using tax rates enacted or substantively enacted at the statement of financial position date, depending on the rate at which they are expected to reverse.

The following temporary differences are not provided for:

- The initial recognition of assets or liabilities that affect neither accounting nor taxable profit.
- Differences relating to investments in subsidiaries, to the extent that the parent company is able to control reversal of temporary differences and it is probable they will not reverse in the foreseeable future.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available, against which temporary differences can be utilised.

Leases

The leases entered into by the Group are operating leases. Operating lease rentals are expensed to the Income Statement on a straight-line basis over the period of the lease agreement.

Foreign currency

Assets and liabilities denominated in foreign currencies are translated into sterling at the appropriate rates of exchange prevailing at the year end date and exchange differences are recognised in the Income Statement as they arise. All income and expense is translated into sterling at the rate of exchange at the day of receipt or payment.

Derecognition of financial assets and liabilities

Financial assets are only derecognised when the contractual rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership. The Group has not derecognised the loans securing its issue of covered bonds because substantially all the risks and rewards are retained. Financial liabilities are only derecognised when the obligation is discharged, cancelled, or has expired.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Group's financial statements are prepared in accordance with IFRS, as adopted by the EU, and with its accounting policies, the most significant of which are set out in Note 1. The results are inevitably sensitive to certain estimates and judgements exercised by the Group, the most critical of which are described below:

Transfer of engagements – fair value adjustments

IFRS 3 'Business combinations' requires that assets and liabilities acquired on transfer of engagement are reflected in the Group's records at fair value which requires a series of adjustments to be made to their previous carrying value.

Note 43 sets out the adjustments made in relation to the merger with Norwich & Peterborough Building Society.

The most significant areas of management judgement in relation to these adjustments are those around the fair value of the savings balances.

The fair value adjustment in relation to savings balances takes account of the differential between market and product interest rates. The principal area of uncertainty relates to the attrition rate that is expected to occur. A 1% increase in the rate would result in a £6.4m reduction in the fair value ascribed at the date of the merger – and vice versa.

Impairment of mortgage assets

The creation of impairment provisions for a portfolio of mortgage loans is inherently uncertain and requires the exercise of a significant degree of judgement. Provisions are calculated using historic default and loss experience but require judgement to be exercised in predicting future economic conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time before impairments are identified (emergence period). The most critical estimate is the future level of house prices where a variance of 10% equates to £13.4m of provision. Other sensitivities include the emergence period, where a variance of three months equates to £4.4m, and the loss given default rate, where a 10% variance equates to £5.7m of provision.

Effective interest rate

IAS 39 requires that all of the cash flows directly associated with financial instruments held at amortised cost must be recognised in the Income Statement through the interest margin using the effective interest rate method. When this approach is applied to a mortgage portfolio, judgements must be made to estimate the average life of that portfolio. These judgements are applied to segments of the mortgage portfolio, taking into account factors including the terms of the particular products, historic repayment data and economic conditions. These estimates are updated in each reporting period to reflect the portfolio's actual performance. The most critical estimate is the estimated number of customers who will remain with the Society after the end of the initial product deal period. A 1% increase would increase the value of the loans on the Statement of Financial Position by approximately £0.1m.

Debt securities

The Group holds a small number of structured investments that are not quoted in active markets, and so fair values are determined internally using financial models based on directly observable market parameters such as asset credit ratings, credit spreads, defaults in underlying instruments and credit enhancement or subordination factors.

Financial Services Compensation Scheme (FSCS)

The amount provided is the latest estimate of the contribution required for the three years to 31 March 2013 based on the Group's share of industry protected deposits and projected forward interest rates. No provision has been made for capital losses should the loan from HM Treasury to the FSCS not be repaid in full, other than fair value adjustments on merger with Chelsea and Norwich & Peterborough building societies which require an estimate for capital losses when determining the fair value of the liability. The impact of a 1% increase in the interest rate assumption would be to increase the provision by £4.2m. More detail of the FSCS and the Society's provision are contained in Note 28.

Regulatory and other provisions

Note 28 provides details of regulatory and other provisions which includes amounts provided in relation to customer redress claims totalling £58.3m (including fair value adjustments made on merger with Norwich & Peterborough Building Society). These provisions have been calculated using information relating to claims received to date including uphold rates, the average amount of compensation paid and estimates of the population of potential future claims.

NOTES TO THE ACCOUNTS continued

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

Pensions

The Group operates two defined benefit pension schemes. Significant judgements (on areas such as future interest and inflation rates, membership levels and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme, and hence of the net surplus/deficit. These are outlined in Note 26. The impact of a 0.1% increase in the rate used to discount the future value of the liabilities would be to reduce the present value of the liabilities by £10.5m. The impact of a one year increase in each of the quoted life expectancies at age 60 would be to increase the present value of the liabilities by £14.1m.

3. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
On assets held at amortised cost				
Loans fully secured on residential property	**1,094.4**	1,006.0	**709.6**	644.0
Connected undertakings	**–**	–	**377.6**	366.1
Other loans	**3.8**	4.0	**3.8**	4.0
Other liquid assets/cash and short-term funds	**16.0**	11.6	**15.0**	10.5
On available for sale securities	**44.9**	47.1	**48.9**	46.4
On held to maturity securities	**12.3**	10.3	**12.3**	10.3
On financial instruments held at fair value through the Income Statement				
Derivatives	**204.9**	230.4	**151.9**	165.4
Other assets	**1.2**	1.3	**1.2**	1.3
Total interest receivable	**1,377.5**	1,310.7	**1,320.3**	1,248.0

Included within interest receivable and similar income is interest earned on impaired loans: Group £30.7m, Society £12.7m (2010 – Group £37.2m, Society £15.6m) which, once included in the mortgage balance, is considered within the impairment calculation.

4. INTEREST PAYABLE AND SIMILAR CHARGES

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
On liabilities held at amortised cost				
Shares held by individuals	**555.9**	475.0	**555.9**	475.0
Deposits from banks	**5.7**	3.3	**5.7**	3.3
Deposits from other financial institutions	**0.4**	0.7	**0.4**	0.7
Deposits from connected undertakings	**–**	–	**18.8**	36.4
Other deposits	**19.8**	21.4	**2.1**	2.9
Certificates of deposit	**0.2**	1.1	**0.2**	1.1
Other debt securities	**155.2**	157.5	**150.0**	157.5
Subordinated liabilities	**21.5**	17.9	**21.5**	17.9
Subscribed capital	**8.6**	8.6	**8.6**	8.6
Other interest payable	**1.2**	1.0	**1.4**	1.0
On financial instruments held at fair value through the Income Statement				
Deposits from connected undertakings	**–**	–	**40.2**	25.9
Derivatives	**280.4**	351.5	**283.7**	351.5
Total interest payable	**1,048.9**	1,038.0	**1,088.5**	1,081.8

5. NET LOSSES FROM FAIR VALUE VOLATILITY ON FINANCIAL INSTRUMENTS

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Assets held at fair value	**(0.8)**	1.1	**(0.8)**	1.1
Embedded derivatives	**(4.8)**	(5.9)	**(4.8)**	(5.9)
Derivatives and hedging	**(4.5)**	(5.7)	**(10.1)**	(6.6)
Net losses from fair value volatility on financial instruments	**(10.1)**	(10.5)	**(15.7)**	(11.4)

Assets held at fair value relate to structured assets containing profit participation features that meet the definition of embedded derivatives. The Society is unable to separate the value of the embedded derivative from the host item and so has to treat the whole asset as held at fair value through the Income Statement in accordance with 'IAS 39 Financial Instruments: Recognition and Measurement'.

The embedded derivative category relates to synthetic features contained in certain structured investments which can be valued separately from the host instruments.

The derivative and hedging category relates to changes in fair value of derivatives that provide effective economic hedges but where the Group has not achieved hedge accounting. Ineffectiveness on those cash flow and fair value hedges for which hedge accounting has been achieved is an immaterial amount.

6. NET REALISED PROFITS

Net realised profits arose on sales of debt securities.

7. ADMINISTRATIVE EXPENSES

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Staff costs				
Salaries and wages	**88.6**	80.5	**86.9**	79.7
Social security costs	**8.7**	7.8	**8.6**	7.7
Pension costs – defined benefit plans	**0.8**	2.4	**0.8**	2.4
Pension costs – defined contribution plans	**3.2**	2.5	**3.2**	2.5
Other staff costs	**5.7**	4.6	**5.7**	4.6
Operating lease rentals	**7.0**	6.4	**8.6**	8.7
Other expenses	**80.9**	54.0	**78.2**	52.4
	194.9	158.2	**192.0**	158.0
Less: merger and acquisition costs	**(17.5)**	(10.4)	**(17.5)**	(10.4)
	177.4	147.8	**174.5**	147.6

Merger costs comprises professional fees, external project management resource and termination payments.

The Society operates a salary sacrifice scheme whereby the employee agrees to a reduction in salary in return for the Society making the contributions that were previously paid by the employee. The amount shown above under Salaries and wages includes the headline salary (i.e. before the salary sacrifice deduction) and Pension costs excludes the additional contributions made by the Society as a result of the salary sacrifice scheme.

The Society's operating lease rentals include payments it makes to subsidiary companies which own properties and equipment.

7. ADMINISTRATIVE EXPENSES (continued)

Remuneration of the auditor and their associates	Group		Society	
	2011	2010	**2011**	2010
	£000	£000	**£000**	£000
Fees payable to the auditor and their associates for the audit of the annual accounts	**395**	287	**299**	235
Fees payable to the auditor and their associates for other services to the group				
Audit-related assurance services (review of interim accounts)	**36**	70	**36**	70
Tax advisory services	**67**	39	**67**	39
Corporate finance services (including due diligence)	**450**	–	**450**	–
Other services				
Information technology	**–**	25	**–**	–
Merger related costs – integration	**17**	684	**17**	684
All other services	**127**	92	**127**	84
	1,092	1,197	**996**	1,112

The above figures, relating to auditor's remuneration, exclude value added tax. Details of the Society's policy on non-audit work, which is implemented by the Audit Committee, is given in the Audit Committee Report on page 54.

Staff numbers

The average number of persons employed by the Group during the year (including executive directors) was as follows:	2011		2010	
	Full time	**Part time**	Full time	Part time
Building Society				
Central administration	**1,585**	**381**	1,425	356
Branches	**953**	**334**	828	298
Subsidiaries' offices	**13**	**–**	14	1
	2,551	**715**	2,267	655

8. REMUNERATION OF AND TRANSACTIONS WITH DIRECTORS

Total directors' remuneration amounted to £2,640,000 (2010 – £2,223,000).

Full details of directors' remuneration, bonuses and pensions are given in the Directors' remuneration report on pages 64 to 70. In addition, past directors' pensions in respect of services as directors (closed scheme) amounted to £17,000 (2010 – £31,000).

None of the directors had an interest in shares in, or debentures of, any associated body of the Society at any time during the financial year. Details of transactions with directors and loans held by directors and connected persons are disclosed in Note 41.

A register is maintained at the Head Office of the Society, containing details of loans, transactions and arrangements between the Society and its directors and connected persons. A statement of the appropriate details for 2011 will be available for inspection at the Head Office for a period of fifteen days up to and including the Annual General Meeting.

9. IMPAIRMENT

Loans and advances to customers

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
At 1 January				
Collective	**4.5**	3.7	**0.2**	0.1
Individual	**54.0**	47.0	**3.0**	2.1
	58.5	50.7	**3.2**	2.2
Amounts written off during the year				
Collective	**–**	–	**–**	–
Individual	**(33.8)**	(33.8)	**(1.6)**	(2.3)
	(33.8)	(33.8)	**(1.6)**	(2.3)
Impairment adjustment for the year				
Collective	**3.5**	0.8	**0.3**	0.1
Individual	**32.5**	40.8	**1.6**	3.2
	36.0	41.6	**1.9**	3.3
At 31 December				
Collective	**8.0**	4.5	**0.5**	0.2
Individual	**52.7**	54.0	**3.0**	3.0
	60.7	58.5	**3.5**	3.2
The charge for the year comprises:				
Impairment adjustment for loans and advances	**36.0**	41.6	**1.9**	3.3
Recoveries relating to amounts previously written off*	**(5.9)**	(0.8)	**(25.5)**	–
Net provision charge for the year	**30.1**	40.8	**(23.6)**	3.3

*Recoveries in 2011 included the proceeds of an insurance claim relating to loans which were part of the former Chelsea loan book (Group and Society – £5.0m) and the reversal of fair value adjustments (Society – £20.4m).

The interest arising from the unwind of the discount of expected future recoveries is not material.

Debt Securities

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
At 1 January	**12.9**	7.8	**12.9**	7.8
Impairment adjustment for the year	**–**	5.1	**–**	5.1
At 31 December	**12.9**	12.9	**12.9**	12.9

Provisions for impairment of debt securities relate to individually assessed cash collateralised debt obligations.

10. INVESTMENTS

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Equities	**2.1**	2.0	**2.1**	2.0
Joint ventures	**0.1**	0.1	**0.3**	0.3
Subsidiaries	**–**	–	**8,854.7**	10,485.8
	2.2	2.1	**8,857.1**	10,488.1

10. INVESTMENTS (continued)

Investment in equities

The Society has an equity investment in VocaLink Holdings Limited relating to its operation of cash machines, which is classified as an available for sale asset.

Investment in joint venture

The Group has a 50% interest in a joint venture, MutualPlus Ltd, a branch sharing company.

	2011 £m	2010 £m
Share of joint ventures		
Gross assets	**0.3**	0.3
Gross liabilities	**(0.2)**	(0.2)
	0.1	0.1

Investment in subsidiaries

Society	Shares £m	Loans £m	Total £m
Cost			
At 1 January 2011	**220.4**	**10,265.9**	**10,486.3**
Acquired on transfer of engagement	**1.7**	**218.9**	**220.6**
Additions	**–**	**691.7**	**691.7**
Repayments	**(0.1)**	**(2,522.9)**	**(2,523.0)**
At 31 December 2011	**222.0**	**8,653.6**	**8,875.6**
Impairment losses			
At 1 January 2011	**(0.5)**	**–**	**(0.5)**
Provided in year	**–**	**(20.4)**	**(20.4)**
At 31 December 2011	**(0.5)**	**(20.4)**	**(20.9)**
Net book value			
At 31 December 2011	**221.5**	**8,633.2**	**8,854.7**
Cost			
At 1 January 2010	212.4	9,662.1	9,874.5
Acquired on transfer of engagement	8.0	207.0	215.0
Additions	–	1,364.1	1,364.1
Repayments	–	(967.3)	(967.3)
At 31 December 2010	220.4	10,265.9	10,486.3
Impairment losses			
At 1 January 2010	(0.5)	–	(0.5)
Provided in year	–	–	–
At 31 December 2010	(0.5)	–	(0.5)
Net book value			
At 31 December 2010	219.9	10,265.9	10,485.8

Included within Shares for 2010 is an investment of £7.7m in Yorkshire Guernsey Ltd which was a credit institution.

The £20.4m impairment charge on loans to subsidiaries relates to a subsidiary that has a portfolio of equity release mortgages. The subsidiary was acquired as part of the Chelsea merger in 2010 at which time a fair value adjustment was made. Accordingly, there is no impact on the Group's profit.

Income from interest in subsidiaries

The Society has recognised dividend income of £20.2m (2010 – £1.0m) from its subsidiaries.

10. INVESTMENTS (continued)

The Society has the following subsidiary undertakings, all of which are consolidated:

	Principal activity
Accord Mortgages Ltd	Mortgage lending
Bank of East Anglia Ltd *	Non-trading
Barnsley Property Services Ltd *	Non-trading
BCS Loans and Mortgages Ltd	Loan and mortgage broker
Brass No. 1 PLC	Funding vehicle
Brokerline Ltd *	Non-trading
CBS Capital Ltd *	Non-trading
CBS Nominees Ltd *	Non-trading
CBS Property Services Ltd *	Non-trading
Chelsea Covered Bonds LLP	Non-trading
Chelsea Mortgage Services Ltd	Third party residential mortgage portfolios
East England Financial Services Group Ltd *	Non-trading
Flexible Choice Ltd	Non-trading
Lynch Wood Insurance Services Ltd *	Non-trading
Lynch Wood Services Ltd	Non-trading
Mortgage Loan Management Ltd *	Non-trading
Norwich and Peterborough Covered Bonds LLP	Society's covered bond
Norwich and Peterborough Estate Agents Ltd	Non-trading
Norwich and Peterborough Financial Services Ltd *	Non-trading
Norwich and Peterborough General Insurance Services Ltd *	Non-trading
Norwich and Peterborough Insurance Brokers Ltd	General insurance broking
Norwich and Peterborough Insurance Services Ltd *	Non-trading
Norwich and Peterborough Ltd *	Non-trading
Norwich and Peterborough (LBS) Ltd	Mortgage finance
Norwich and Peterborough (LP) Ltd *	Non-trading
Norwich and Peterborough Sharedealing Services Ltd	Non-trading
Phillip Schofield & Company *	Non-trading
Phillip Schofield (Property Management) *	Non-trading
Phonebank Ltd *	Non-trading
Waters Lunniss Nominees Ltd *	Non-trading
YBS Investments (No. 1) Ltd	Investments
YBS Investments (No. 2) Ltd	Investments
YBS Ltd *	Non-trading
YBS Properties (Edinburgh) Ltd	Property holding
YBS Properties (York) Ltd *	Non-trading
YBS Properties Ltd	Property holding
Yorksafe Insurance Company Ltd	Non-trading
Yorkshire Building Society Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds
Yorkshire Building Society Estate Agents Ltd	Non-trading
Yorkshire Computer Services Ltd *	Non-trading
Yorkshire Direct Ltd *	Non-trading
Yorkshire Estate Agents Ltd *	Non-trading
Yorkshire Guernsey Ltd	Non-trading
Yorkshire Insurance Services Ltd *	Non-trading
Yorkshire Investment Services Ltd	Investments
Yorkshire Key Services (No. 2) Ltd *	Non-trading
Yorkshire Key Services Ltd	Computer services
Yorkshire Life Assurance Services Ltd *	Non-trading
Yorkshire Mortgage Services Ltd *	Non-trading
Yorkshire Personal Financial Services Ltd *	Non-trading
Yorkshire Property Services Ltd *	Non-trading
Yorkshire Services Ltd *	Non-trading
Yorkshire Syndications Ltd *	Non-trading

* Dormant subsidiaries.

10. INVESTMENTS (continued)

Yorkshire Key Services (No. 2) Ltd is wholly-owned by Yorkshire Key Services Ltd.

YBS Investments (No. 2) Ltd is wholly-owned by Yorkshire Investment Services Ltd.

All the companies are registered in England and operate in the United Kingdom except for Yorkshire Guernsey Ltd and Yorksafe Insurance Company Ltd which are registered and operate in Guernsey.

All the entities are wholly owned except for Yorkshire Building Society Covered Bonds LLP, Chelsea Covered Bonds LLP and Brass No.1 PLC. The Society's interests in these entities are, in substance, no different than if they were 100% held subsidiary undertakings and consequently they are consolidated in the Group accounts.

11. TAX EXPENSE

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Current tax:				
UK corporation tax at 26.5% (2010 – 28%)	**37.2**	27.7	**22.1**	12.2
Corporation tax – adjustment in respect of prior periods	**(16.1)**	(5.3)	**(16.1)**	(5.3)
Overseas tax	**(0.1)**	(0.2)	**–**	–
Total current tax	**21.0**	22.2	**6.0**	6.9
Deferred tax (Note 20):				
Current year	**3.0**	0.7	**1.4**	(0.4)
Adjustment in respect of prior periods	**(0.5)**	0.7	**(0.5)**	0.7
Total tax expense in Income Statement	**23.5**	23.6	**6.9**	7.2

The actual tax expense for the year differs from that calculated using the standard rate of corporation tax in the UK. The differences are explained below:

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Profit before tax	**129.7**	115.4	**96.1**	55.1
Tax calculated at a tax rate of 26.5% (2010 – 28%)	**34.4**	32.3	**25.5**	15.4
Effects of:				
Lower tax rate on overseas earnings	**0.7**	(0.7)	**–**	–
Income not subject to tax	**(1.7)**	(5.1)	**(7.0)**	(5.1)
Expenses not deductible for tax purposes	**6.3**	1.4	**5.2**	1.5
Adjustment to tax charge in respect of previous periods	**(16.6)**	(4.5)	**(16.6)**	(4.5)
Change in tax rate	**0.4**	0.2	**(0.2)**	(0.1)
Total tax expense in income statement	**23.5**	23.6	**6.9**	7.2
Tax expense recognised directly in equity:				
Tax on available for sale securities	**18.8**	1.0	**18.8**	1.0
Tax on pension costs	**4.9**	1.3	**4.9**	1.3
Deferred tax on cash flow hedges	**(1.0)**	1.5	**(1.0)**	1.5
Adjustment to tax in respect of previous periods	**9.1**	0.5	**9.1**	0.5
Change in tax rate	**4.6**	3.3	**4.7**	3.3
	36.4	7.6	**36.5**	7.6

The main rate of corporation tax was reduced to 26% from 1 April 2011 and will reduce further to 25% from 1 April 2012.

12. SEGMENTAL REPORTING

This section analyses the Group's performance by business segment.

The chief operating decision maker has been identified as the Board, which reviews the Group's internal reporting and is responsible for all significant decisions. Financial information provided in the segmental reporting is consistent with that which is presented to the Board.

No segmental information is presented on geographical lines, because substantially all of the Group's activities are in the United Kingdom.

The Group's reportable segments under 'IFRS 8 Operating Segments', based on the information reviewed by the Board, have been determined according to similar economic characteristics and the nature of the products and service. Details of the segments are listed below:

- Retail – this comprises prime residential owner occupied lending, non-owner occupied lending (including buy-to-let), non-prime lending, traditional member savings, non-traditional savings, off-shore savings (in Yorkshire Guernsey Limited) and consumer banking.
- Commercial – the commercial lending portfolio.
- Head office – this consists of head office supporting functions, such as the treasury function.
- Other – this includes supporting non-core business units.

Given recent expansions, the Group is currently in the process of developing its divisional analysis. The information below shows the current principal analysis. Please note, at present there is no recharging of funding across the Group.

The majority of the Group's revenues are in the form of interest and the Board monitors the Group's net interest income, to assess performance and direct the Group. Therefore, interest receivable and similar income has been shown net of interest payable and similar expense.

Income and directly attributable costs have been allocated to each segment as applicable, with support costs being apportioned based on levels of income.

2011	Notes	Retail £m	Commercial £m	Head office £m	Other £m	Total £m
Net interest income		**517.3**	**7.2**	**(195.9)**	**–**	**328.6**
Non interest income and costs	a	**44.4**	**0.4**	**3.5**	**2.6**	**50.9**
Fair value		**–**	**–**	**(10.1)**	**–**	**(10.1)**
Management expenses	b	**(146.4)**	**(0.7)**	**(62.2)**	**(0.3)**	**(209.6)**
Operating profit before provisions		**415.3**	**6.9**	**(264.7)**	**2.3**	**159.8**
Impairment of loans and advances to customers		**(30.1)**	**–**	**–**	**–**	**(30.1)**
Impairment of debt securities		**–**	**–**	**–**	**–**	**–**
Provisions		**–**	**–**	**–**	**–**	**–**
Operating profit/(loss) before exceptional provisions		**385.2**	**6.9**	**(264.7)**	**2.3**	**129.7**
Financial Services Compensation Scheme levy		**(5.6)**	**–**	**–**	**–**	**(5.6)**
Operating profit/(loss)		**379.6**	**6.9**	**(264.7)**	**2.3**	**124.1**
Negative goodwill	c	**5.2**	**0.4**	**–**	**–**	**5.6**
Profit/(loss) before tax		**384.8**	**7.3**	**(264.7)**	**2.3**	**129.7**
Tax (expense)/credit		**(69.8)**	**(1.3)**	**48.0**	**(0.4)**	**(23.5)**
Net profit/(loss)		**315.0**	**6.0**	**(216.7)**	**1.9**	**106.2**
Total assets		**26,437.7**	**457.7**	**5,751.6**	**–**	**32,647.0**
Total liabilities		**26,322.9**	**–**	**4,766.5**	**–**	**31,089.4**
Equity		**–**	**–**	**1,557.6**	**–**	**1,557.6**

12. SEGMENTAL REPORTING (continued)

2010	Notes	Retail £m	Commercial £m	Head office £m	Other £m	Total £m
Net interest income		512.1	4.3	(243.7)	–	272.7
Non interest income and costs	a	42.5	0.1	15.2	0.8	58.6
Fair value		–	–	(10.5)	–	(10.5)
Management expenses	b	(111.9)	(0.4)	(60.5)	(0.2)	(173.0)
Operating profit before provisions		442.7	4.0	(299.5)	0.6	147.8
Impairment of loans and advances to customers		(40.8)	–	–	–	(40.8)
Impairment of debt securities		–	–	(5.1)	–	(5.1)
Provisions		–	–	–	–	
Operating profit/(loss) before exceptional provisions		401.9	4.0	(304.6)	0.6	101.9
Financial Services Compensation Scheme levy		(3.6)	–	–	–	(3.6)
Operating profit/(loss)		398.3	4.0	(304.6)	0.6	98.3
Negative goodwill	c	17.0	0.1	–	–	17.1
Profit/(loss) before tax		415.3	4.1	(304.6)	0.6	115.4
Tax (expense)/credit		(87.8)	(0.9)	62.3	(0.2)	(23.6)
Net profit/(loss)		330.5	3.2	(242.3)	0.4	91.8
Total assets		23,075.5	97.6	6,913.2	–	30,086.3
Total liabilities		22,280.4	–	6,468.4	–	28,748.8
Equity		–	–	1,337.5	–	1,337.5

Notes

a Non interest income and costs includes fees and commissions receivable, fees and commissions payable, income from investments in subsidiaries, net realised profits and other operating income.

b Management expenses includes administrative expenses, merger and acquisition costs and depreciation and amortisation.

c Negative goodwill arose from the merger with Norwich & Peterborough Building Society; the 2010 equivalent related to the merger with Chelsea Building Society. As such, this goodwill has been apportioned according to the constituent elements of each entity's balance sheets.

13. CASH IN HAND AND BALANCES WITH THE BANK OF ENGLAND

	Group		Society	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Cash in hand	**18.9**	14.2	**18.9**	14.2
Cash ratio deposit with the Bank of England	**25.0**	25.0	**25.0**	25.0
Other deposits with the Bank of England	**1,554.5**	1,271.6	**1,554.5**	1,271.6
	1,598.4	1,310.8	**1,598.4**	1,310.8

Cash ratio deposits are mandatory requirements of the Bank of England. They are not available for use in the Group's day to day operations. These balances are non-interest-bearing, whereas other deposits are at variable money market rates.

14. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Loans and advances to banks	**582.3**	935.8	**362.6**	725.4

Loans and advances to credit institutions are all due within one year.

15. DEBT SECURITIES

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Debt securities issued by:				
Public bodies	**1,448.2**	1,007.3	**1,448.2**	1,007.3
Other borrowers	**1,288.9**	2,607.9	**1,592.1**	2,499.3
	2,737.1	3,615.2	**3,040.3**	3,506.6
Analysis by type:				
Listed on a recognised investment exchange	**2,737.1**	3,501.1	**3,040.3**	3,501.1
Unlisted	**–**	114.1	**–**	5.5
	2,737.1	3,615.2	**3,040.3**	3,506.6

Debt securities of £2.0bn (2010 – £2.3bn) are due in over one year.

Group	Held at fair value through the income statement £m	Embedded Derivative £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1 January 2011	**17.5**	**(27.2)**	**2,820.4**	**804.5**	**3,615.2**
Acquired on transfer of engagements	**–**	**–**	**224.1**	**78.7**	**302.8**
Additions	**–**	**–**	**1,583.8**	**–**	**1,583.8**
Disposals and repayment	**–**	**–**	**(2,578.9)**	**(313.8)**	**(2,892.7)**
Exchange translation	**(0.6)**	**–**	**(0.5)**	**(2.4)**	**(3.5)**
Other changes in value	**(0.7)**	**(4.7)**	**133.1**	**3.8**	**131.5**
At 31 December 2011	**16.2**	**(31.9)**	**2,182.0**	**570.8**	**2,737.1**
Movements in debt securities during the year were:					
At 1 January 2010	17.1	(41.0)	3,874.2	711.9	4,562.2
Acquired on transfer of engagements	–	–	1,492.7	147.2	1,639.9
Additions	–	–	4,384.3	–	4,384.3
Disposals and repayments	–	18.0	(6,892.7)	(69.3)	(6,944.0)
Exchange translation	(0.5)	–	(13.7)	8.8	(5.4)
Other changes in value	0.9	(4.2)	(24.4)	5.9	(21.8)
At 31 December 2010	17.5	(27.2)	2,820.4	804.5	3,615.2

15. DEBT SECURITIES (continued)

Society	Held at fair value through the income statement £m	Embedded Derivative £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1 January 2011	**17.5**	**(27.2)**	**2,711.8**	**804.5**	**3,506.6**
Acquired on transfer of engagements	**–**	**–**	**224.1**	**78.7**	**302.8**
Additions	**–**	**–**	**1,305.0**	**350.0**	**1,655.0**
Disposals and repayments	**–**	**–**	**(2,191.7)**	**(360.9)**	**(2,552.6)**
Exchange translation	**(0.6)**	**–**	**(0.4)**	**(2.4)**	**(3.4)**
Other changes in value	**(0.7)**	**(4.7)**	**133.2**	**4.1**	**131.9**
At 31 December 2011	**16.2**	**(31.9)**	**2,182.0**	**874.0**	**3,040.3**
Movements in debt securities during the year were:					
At 1 January 2010	17.1	(41.0)	3,766.4	711.9	4,454.4
Acquired on transfer of engagements	–	–	1,492.7	147.2	1,639.9
Additions	–	–	3,963.8	–	3,963.8
Disposals and repayments	–	18.0	(6,472.9)	(69.3)	(6,524.2)
Exchange translation	(0.5)	–	(13.7)	8.8	(5.4)
Other changes in value	0.9	(4.2)	(24.5)	5.9	(21.9)
At 31 December 2010	17.5	(27.2)	2,711.8	804.5	3,506.6

The disposals and repayments for the held to maturity category relate entirely to repayments.

A number of debt securities are structured so that they can pay a return over and above their regular coupon. This feature is regarded as an embedded derivative. The Group is unable to value this element separately from the host instrument so, in accordance with IAS 39, has designated these securities as being held at fair value with movements in value being taken to the Income Statement.

The Group also holds synthetic collateralised debt obligations, which also contain embedded derivatives. These embedded derivatives are separated from the host instrument and movements in fair value are taken to the Income Statement. The embedded derivative component is held at fair value through the Income Statement.

16. LOANS AND ADVANCES TO CUSTOMERS

	Group		Society	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Loans and advances to customers comprise:				
Loans secured on residential property				
Loans fully secured on residential property	**26,408.3**	23,103.3	**18,057.0**	16,316.2
Other loans secured on residential property	**56.4**	52.8	**28.7**	22.1
Fair value hedging adjustments	**255.3**	199.0	**184.9**	174.6
Allowances for impairment	**(60.7)**	(58.5)	**(3.5)**	(3.2)
	26,659.3	23,296.6	**18,267.1**	16,509.7
Other loans				
Loans fully secured on land	**351.0**	74.1	**351.0**	74.1
Unsecured loans	**11.9**	–	**11.9**	–
	362.9	74.1	**362.9**	74.1

Loans and advances to customers are held at amortised cost, with interest and associated costs being recognised in the interest receivable and similar income line of the Income Statement on an effective interest rate basis. Amounts totalling £26.1bn (2010 – £22.7bn) are due in over one year.

Fair value hedging adjustments of £255.3m (2010 – £199.0m) have been made to certain fixed rate mortgages that are in fair value hedging relationships.

Note 39 details the extent to which these assets are encumbered.

17. INTANGIBLE ASSETS

	Goodwill £m	Software £m	Other £m	Total £m
Group				
Cost				
At 1 January 2011	**–**	**50.8**	**14.3**	**65.1**
Additions	**(5.6)**	**4.6**	**–**	**(1.0)**
Acquired on transfer of engagements	**–**	**–**	**12.6**	**12.6**
Written off in the year	**5.6**	**–**	**–**	**5.6**
Disposals	**–**	**(0.3)**	**–**	**(0.3)**
At 31 December 2011	**–**	**55.1**	**26.9**	**82.0**
Depreciation				
At 1 January 2011	**–**	**39.8**	**4.9**	**44.7**
Charged in year	**–**	**4.0**	**3.2**	**7.2**
Disposals	**–**	**(0.3)**	**–**	**(0.3)**
At 31 December 2011	**–**	**43.5**	**8.1**	**51.6**
Net book value				
At 31 December 2011	**–**	**11.6**	**18.8**	**30.4**
Cost				
At 1 January 2010	–	46.7	2.1	48.8
Additions	(17.1)	4.8	–	(12.3)
Acquired on transfer of engagements	–	0.1	12.2	12.3
Written off in the year	17.1	–	–	17.1
Disposals	–	(0.8)	–	(0.8)
At 31 December 2010	–	50.8	14.3	65.1
Depreciation				
At 1 January 2010	–	37.0	1.2	38.2
Charged in year	–	3.6	3.7	7.3
Disposals	–	(0.8)	–	(0.8)
At 31 December 2010	–	39.8	4.9	44.7
Net book value				
At 31 December 2010	–	11.0	9.4	20.4

Other intangible assets primarily comprise the intrinsic value of items acquired on mergers (current accounts, retail savings and brands) and an amount paid for the transfer of a number of employee sharesave schemes to the Society.

Depreciation is provided to write off the cost less the estimated residual value of intangible assets over their estimated useful economic lives of between one and ten years.

Any impairment in the value of intangible assets is dealt with through the Income Statement as it arises.

NOTES TO THE ACCOUNTS continued

17. INTANGIBLE ASSETS (continued)

	Goodwill £m	Software £m	Other £m	Total £m
Society				
Cost				
At 1 January 2011	**–**	**40.3**	**14.3**	**54.6**
Additions	**(5.6)**	**4.6**	**–**	**(1.0)**
Acquired on transfer of engagements	**–**	**–**	**12.6**	**12.6**
Written off in the year	**5.6**	**–**	**–**	**5.6**
Disposals	**–**	**(0.3)**	**–**	**(0.3)**
At 31 December 2011	**–**	**44.6**	**26.9**	**71.5**
Depreciation				
At 1 January 2011	**–**	**29.6**	**4.9**	**34.5**
Charged in year	**–**	**3.9**	**3.2**	**7.1**
Disposals	**–**	**(0.3)**	**–**	**(0.3)**
At 31 December 2011	**–**	**33.2**	**8.1**	**41.3**
Net book value				
At 31 December 2011	**–**	**11.4**	**18.8**	**30.2**
Cost				
At 1 January 2010	–	36.2	2.1	38.3
Additions	(17.1)	4.8	–	(12.3)
Acquired on transfer of engagements	–	0.1	12.2	12.3
Written off in the year	17.1	–	–	17.1
Disposals	–	(0.8)	–	(0.8)
At 31 December 2010	–	40.3	14.3	54.6
Depreciation				
At 1 January 2010	–	26.9	1.2	28.1
Charged in year	–	3.5	3.7	7.2
Disposals	–	(0.8)	–	(0.8)
At 31 December 2010	–	29.6	4.9	34.5
Net book value				
At 31 December 2010	–	10.7	9.4	20.1

18. INVESTMENT PROPERTIES

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Cost				
At 1 January	**22.9**	9.7	**22.7**	9.5
Additions	**0.1**	–	**0.1**	–
Acquired on transfer of engagements	**0.6**	11.8	**0.6**	11.8
Disposals	**(0.9)**	–	**(0.9)**	–
Transfers	**7.2**	1.4	**7.2**	1.4
At 31 December	**29.9**	22.9	**29.7**	22.7
Depreciation				
At 1 January	**4.2**	3.0	**4.2**	3.0
Charged in year	**0.4**	0.3	**0.4**	0.3
Impairment	**–**	0.6	**–**	0.6
Disposals	**(0.2)**	–	**(0.2)**	–
Transfers	**–**	0.3	**–**	0.3
At 31 December	**4.4**	4.2	**4.4**	4.2
Net book value				
At 31 December	**25.5**	18.7	**25.3**	18.5
Fair value				
At 31 December	**28.5**	22.8	**28.1**	22.4

Transfers relate to the reclassification of assets between investment properties and property, plant and equipment.

Investment properties are generally flats and offices, ancillary to branch premises and not used by the Group. Rental income of £2.3m on investment properties has been included within other operating income (2010 – £2.1m).

Depreciation is provided by the Group to write off the cost less the estimated residual value of investment properties (excluding land) by equal instalments over their estimated useful economic life of 50 years.

Land is not depreciated. Any impairment in the value of properties is dealt with through the Income Statement as it arises.

The fair value of the Group's investment properties at 31 December 2011 has been arrived at on the basis of a valuation carried out by the Group's Estates Manager.

The method used to estimate the fair value of investment properties is to obtain their market value as an approximation. Market value is calculated in accordance with the RICS Appraisal and Valuation Manual issued by the Royal Institution of Chartered Surveyors and is defined as "the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion, assuming that the buyer is granted vacant possession of all parts of the property required by the business".

19. PROPERTY, PLANT AND EQUIPMENT

	Construction in progress £m	Land and buildings £m	Equipment fixtures, fittings and vehicles £m	Total £m
Group				
Cost				
At 1 January 2011	**–**	**114.3**	**83.9**	**198.2**
Additions	**0.5**	**1.5**	**4.8**	**6.8**
Acquired on transfer of engagements	**–**	**10.0**	**–**	**10.0**
Disposals	**–**	**–**	**(1.6)**	**(1.6)**
Transfers	**–**	**(7.2)**	**–**	**(7.2)**
At 31 December 2011	**0.5**	**118.6**	**87.1**	**206.2**
Depreciation				
At 1 January 2011	**–**	**20.3**	**70.6**	**90.9**
Charged in year	**–**	**2.2**	**4.9**	**7.1**
Disposals	**–**	**–**	**(1.4)**	**(1.4)**
At 31 December 2011	**–**	**22.5**	**74.1**	**96.6**
Net book value				
At 31 December 2011	**0.5**	**96.1**	**13.0**	**109.6**
Cost				
At 1 January 2010	–	84.5	80.5	165.0
Additions	0.2	0.3	2.4	2.9
Acquired on transfer of engagements	–	30.8	1.6	32.4
Disposals	–	(0.1)	(0.6)	(0.7)
Transfers	(0.2)	(1.2)	–	(1.4)
At 31 December 2010	–	114.3	83.9	198.2
Depreciation				
At 1 January 2010	–	18.5	65.9	84.4
Charged in year	–	2.2	5.1	7.3
Disposals	–	(0.1)	(0.4)	(0.5)
Transfers	–	(0.3)	–	(0.3)
At 31 December 2010	–	20.3	70.6	90.9
Net book value				
At 31 December 2010	–	94.0	13.3	107.3

Transfers relate to the reclassification of assets between property, plant and equipment and investment properties.

19. PROPERTY, PLANT AND EQUIPMENT (continued)

	Construction in progress £m	Land and buildings £m	Equipment fixtures, fittings and vehicles £m	Total £m
Society				
Cost				
At 1 January 2011	**–**	**92.0**	**38.5**	**130.5**
Additions	**0.5**	**1.6**	**4.2**	**6.3**
Acquired on transfer of engagements	**–**	**9.8**	**–**	**9.8**
Disposals	**–**	**–**	**(1.6)**	**(1.6)**
Transfers	**–**	**(7.2)**	**–**	**(7.2)**
At 31 December 2011	**0.5**	**96.2**	**41.1**	**137.8**
Depreciation				
At 1 January 2011	**–**	**16.1**	**25.3**	**41.4**
Charged in year	**–**	**1.8**	**4.7**	**6.5**
Impairment	**–**	**–**	**–**	**–**
Disposals	**–**	**–**	**(1.4)**	**(1.4)**
At 31 December 2011	–	**17.9**	**28.6**	**46.5**
Net book value				
At 31 December 2011	**0.5**	**78.3**	**12.5**	**91.3**
Cost				
At 1 January 2010	–	62.2	35.3	97.5
Additions	0.2	0.3	2.2	2.7
Acquired on transfer of engagements	–	30.8	1.6	32.4
Disposals	–	(0.1)	(0.6)	(0.7)
Transfers	(0.2)	(1.2)	–	(1.4)
At 31 December 2010	–	92.0	38.5	130.5
Depreciation				
At 1 January 2010	–	14.7	20.7	35.4
Charged in year	–	1.8	5.0	6.8
Impairment	–	–	–	–
Disposals	–	(0.1)	(0.4)	(0.5)
Transfers	–	(0.3)	–	(0.3)
At 31 December 2010	–	16.1	25.3	41.4
Net book value				
At 31 December 2010	–	75.9	13.2	89.1

Transfers relate to the reclassification of assets between property, plant and equipment and investment properties.

20. DEFERRED TAX ASSETS AND LIABILITIES

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
The movement on the deferred tax asset/(liability) is as follows:				
At 1 January	**94.1**	25.4	**87.3**	26.7
Acquired on transfer of engagements	**33.2**	88.0	**32.3**	78.8
Income statement charge	**(2.5)**	(1.4)	**(0.9)**	(0.3)
Tax expense recognised directly in equity	**(33.3)**	(17.9)	**(33.4)**	(17.9)
At 31 December	**91.5**	94.1	**85.3**	87.3
Deferred tax assets and liabilities are attributable to the following items:				
Deferred tax assets				
Provision for loan impairment	**0.6**	0.8	**0.4**	0.6
Other provisions	**0.7**	1.8	**0.7**	1.8
Other temporary differences	**0.4**	0.1	**0.4**	0.1
Accelerated tax depreciation	**5.0**	3.2	**4.9**	3.2
Tax value of losses carried forward	**–**	8.5	**–**	8.5
Transfer of engagements – tax value of losses carried forward	**15.1**	–	**15.1**	–
Pensions and other post retirement benefits	**5.1**	5.4	**5.1**	5.4
Implementation of IAS 39 – mortgages and hedging	**1.5**	1.9	**1.2**	1.4
Cash flow hedging	**12.1**	12.0	**12.1**	12.0
Transfer of engagements – fair value adjustments	**69.6**	74.1	**60.5**	63.4
	110.1	107.8	**100.4**	96.4
Deferred tax liabilities				
Pensions and other post retirement benefits	**8.2**	–	**8.2**	–
Accelerated tax depreciation	**0.3**	0.3	**–**	–
Implementation of IAS 39 – mortgages and hedging	**5.3**	7.2	**4.5**	6.1
Overseas operations	**–**	0.1	**–**	–
Other temporary differences	**1.5**	1.9	**1.4**	1.8
Transfer of engagements – fair value adjustments	**3.3**	4.2	**1.0**	1.2
	18.6	13.7	**15.1**	9.1

The majority of the deferred tax asset balance is in respect of fair value adjustments and tax value of losses acquired on transfer of engagements, which are expected to be recoverable against future taxable profits (as projected in the latest Strategic Plan) within five to six years. The deferred tax assets have not been discounted.

The deferred tax charge in the Income Statement comprises the following temporary differences:

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Accelerated tax depreciation	**1.0**	0.6	**1.0**	0.6
Pensions and other post retirement benefits	**0.7**	0.8	**0.7**	0.8
Other provisions	**1.3**	0.1	**1.3**	–
Overseas operations	**–**	(0.3)	**–**	–
Other temporary differences	**(2.1)**	(1.3)	**(1.9)**	(1.1)
Release of fair value adjustments on merger	**1.6**	1.5	**(0.2)**	–
	2.5	1.4	**0.9**	0.3

21. OTHER ASSETS

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Prepayments and accrued income	**17.9**	12.3	**12.2**	12.0
Due from subsidiary undertakings	**–**	–	**22.2**	35.3
Other assets	**4.6**	5.4	**3.2**	2.9
	22.5	17.7	**37.6**	50.2

22. SHARES

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Shares comprising balances held by individuals	**26,145.4**	21,457.7	**26,145.4**	21,457.7
Fair value adjustments	**(172.0)**	(75.2)	**(172.0)**	(75.2)
	25,973.4	21,382.5	**25,973.4**	21,382.5

23. AMOUNTS OWED TO CREDIT INSTITUTIONS

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Amounts owed to:				
Banks	**761.4**	920.4	**761.4**	920.4
Group companies	**–**	–	**–**	790.4
Other credit institutions	**4.0**	6.0	**4.0**	6.0
	765.4	926.4	**765.4**	1,716.8

Amounts due to Group companies comprise balances due to the Society's offshore deposit-taking subsidiary Yorkshire Guernsey Ltd.

24. OTHER DEPOSITS

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Amounts owed to:				
Group companies	**–**	–	**1,198.1**	3,378.3
Other customers	**510.3**	1,061.9	**391.4**	184.3
	510.3	1,061.9	**1,589.5**	3,562.6

Amounts due to Group companies comprise balances due to Yorkshire Building Society Covered Bonds LLP.

25. DEBT SECURITIES IN ISSUE

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Certificates of deposit	**31.6**	25.8	**31.6**	25.8
Fixed rate notes	**1,985.3**	3,943.6	**1,985.3**	3,943.6
Floating rate notes	**488.1**	350.1	**141.5**	350.1
Fair value hedging adjustment	**86.2**	28.9	**86.2**	28.9
	2,591.2	4,348.4	**2,244.6**	4,348.4

Debt securities in issue include Group £1.7bn (2010 – £1.8bn) and Society £1.4bn (2010 – £1.8bn) secured on certain loans and advances to customers. Further information is given in Note 35.

26. RETIREMENT BENEFIT OBLIGATIONS

The Group operates one main employee benefit scheme (the Scheme), the costs of which are borne by the Society, with both defined benefit and defined contribution sections.

With effect from 1 November 2011, the Society operates a further additional defined benefit employee benefit scheme (the Norwich & Peterborough Scheme) in relation to the Society's transfer of engagements of Norwich & Peterborough Building Society.

The assumptions and figures below include the Norwich & Peterborough Scheme where appropriate.

In addition, the Group operates unfunded defined benefit pension schemes for certain current and former members of staff. The present value at 31 December 2011 of the defined benefit obligation in relation to these schemes was £5.5m (2010 – £4.4m) and the relevant disclosures have been aggregated with those of the main employee benefits scheme.

Defined contribution post-employment benefits

In addition to the defined benefit section (see below) the Group operates a defined contribution section of the main scheme for new employees and for existing employees who are not members of a defined benefit scheme. The Group also contributes to a group personal pension arrangement in relation to the Society's transfer of engagements of Chelsea Building Society. The total expense recognised for these defined contribution benefits is £4.8m (2010 – £3.5m).

Defined benefit post-employment benefits

The Group operates a funded defined benefit scheme for certain employees, providing benefits based on final salary. However, benefits earned by members of the defined benefit section of the main scheme since 1 April 2010 are based on career average revalued earnings. The assets of the scheme are held in a separate trustee-administered fund. Contributions are assessed in accordance with the advice of an independent qualified actuary using the projected unit method. The defined benefit section was closed to new employees in 2000.

The Group's policy for recognising actuarial gains and losses is to recognise them immediately on the Statement of Financial Position through the Statement of Comprehensive Income.

Summary of assumptions	**31 Dec 2011 %**	31 Dec 2010 %	31 Dec 2009 %	31 Dec 2008 %	31 Dec 2007 %
Retail Prices index (RPI) Inflation	**3.3**	3.8	3.8	3.2	3.4
Consumer price index (CPI) inflation	**2.3**	3.1	n/a	n/a	n/a
Discount rate	**4.9**	5.5	5.7	6.4	5.8
Expected return on assets	**4.9**	6.3	6.3	5.9	6.4
Rate of increase in pay	**4.3**	5.3	5.3	4.7	4.9
Rate of increase of pensions in payment*					
subject to a min of 3% and a max of 5%	**3.7**	4.0	4.0	3.4	3.6
subject to a min of 0% and a max of 5%	**3.1**	3.8	3.8	3.2	3.4
subject to a min of 0% and a max of 2.5%	**2.1**	2.4	2.4	n/a	n/a
Rate of increase for deferred pensions*					
subject to a min of 0% and a max of 5%	**2.3**	3.1	3.8	3.1	3.4
subject to a min of 0% and a max of 2.5%	**2.3**	2.3	n/a	n/a	n/a
subject to a min of 0% and a max of 2.5%	**2.3**	n/a	n/a	n/a	n/a

*In excess of any Guaranteed Minimum Pension (GMP) element.

The expected return on assets has been derived as the weighted average of the expected returns from each of the main asset classes. The expected return for each asset class reflects a combination of historical performance analysis, the forward looking views of the financial markets (as suggested by the yields available) and the views of investment organisations.

26. RETIREMENT BENEFIT OBLIGATIONS (continued)

The most significant non-financial assumption is the assumed rate of longevity. The assumptions made are equivalent to the following life expectancies for scheme members at age 60:

	2011 Years	2010 Years
For a current 60 year old male	**28.4**	26.3
For a current 60 year old female	**28.1**	27.6
For a current 45 year old male	**30.2**	27.9
For a current 45 year old female	**29.4**	28.6

Categories of assets	31 Dec **2011** **%**	31 Dec 2010 %	31 Dec 2009 %	31 Dec 2008 %	31 Dec 2007 %
Equities	**26**	32	44	42	44
Bonds	**63**	56	55	17	50
Cash and other	**11**	12	1	41	6
	100	100	100	100	100

Reconciliation of funded status	**31 Dec 2011 £m**	31 Dec 2010 £m	31 Dec 2009 £m	31 Dec 2008 £m	31 Dec 2007 £m
Present value of defined benefit obligation	**(532.9)**	(456.7)	(317.3)	(231.1)	(262.7)
Assets at fair value	**564.6**	442.5	313.0	259.9	270.7
Funded status/defined benefit asset/(liability)	**31.7**	(14.2)	(4.3)	28.8	8.0

The 2009 and 2008 balances include those of the Barnsley scheme, as follows:

	2009	2008
Present value of defined benefit obligation	(9.9)	(8.0)
Assets at fair value	6.8	6.1
Funded status/defined benefit liability	(3.1)	(1.9)

The 2010 balances include those of the Chelsea scheme, as follows:

	2010
Present value of defined benefit obligation	(116.9)
Assets at fair value	106.6
Funded status/defined benefit liability	(10.3)

The 2011 balances include those of the Norwich & Peterborough scheme, as follows:

	2011
Present value of defined benefit obligation	**(79.5)**
Assets at fair value	**78.3**
Funded status/defined benefit liability	**(1.2)**

Statement of comprehensive income (SCI)	**2011 £m**	2010 £m	2009 £m	2008 £m	2007 £m
Actuarial gain/(loss) recognised in SCI	**18.7**	4.8	(50.4)	17.8	33.8
Cumulative actuarial gains/(losses) recognised at 1 January	**2.1**	(2.7)	47.7	29.9	(3.9)
Cumulative actuarial gains/(losses) recognised at 31 December	**20.8**	2.1	(2.7)	47.7	29.9

26. RETIREMENT BENEFIT OBLIGATIONS (continued)

Experience gain and losses	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
(Loss)/gain on change of assumptions	**(19.4)**	(5.9)	(80.0)	45.2	37.0
Gain on other experience	**30.8**	0.5	4.0	8.6	1.0
Experience gain/(loss) on assets	**7.3**	10.2	25.6	(36.0)	(4.2)
Actuarial gain/(loss) recognised in SCI	**18.7**	4.8	(50.4)	17.8	33.8

Components of pension expense as shown in the income statement	2011 £m	2010 £m
Service cost	**5.0**	5.1
Interest cost	**25.5**	22.7
Expected return on assets	**(28.3)**	(24.4)
Total pension expense	**2.2**	3.4

Service cost is the Group's cost, net of employee contributions and inclusive of interest to the reporting date.

Reconciliation of present value of defined benefit obligation	2011 £m	2010 £m
Present value of defined benefit obligation at 1 January	**456.7**	317.3
Acquired on transfer of engagements	**73.6**	119.2
Defined benefit service cost	**5.0**	5.1
Interest cost	**25.5**	22.7
Defined benefit employee contributions	**–**	0.4
Actuarial loss	**(11.4)**	5.4
Defined benefit actual benefits paid	**(16.5)**	(13.4)
Present value of defined benefit obligation at 31 December	**532.9**	456.7

Movement in defined benefit fair value of assets		
Fair value of assets at 1 January	**442.5**	313.0
Acquired on transfer of engagements	**75.8**	102.8
Expected return on assets	**28.3**	24.4
Actuarial gain on assets	**7.3**	10.2
Defined benefit actual company contributions	**27.2**	5.1
Defined benefit employee contributions	**–**	0.4
Defined benefit actual benefits paid	**(16.5)**	(13.4)
Fair value of plan assets at 31 December	**564.6**	442.5

None of the assets were invested in the Group's own financial instruments (2010 – £nil) or property (2010 – £nil).

Estimated contributions in 2012	2012 £m
Society contributions	**10.5**
Employee contributions	**–**
Total contributions	**10.5**

Society contributions include £1.7m in relation to a salary sacrifice scheme whereby employees have accepted a reduction in salary in return for the Society agreeing to make the contributions that were previously paid by the employee.

27. OTHER LIABILITIES

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Accruals and deferred income	**31.6**	28.1	**26.7**	26.4
Income tax deducted at source	**40.8**	37.4	**40.8**	37.0
Other	**7.2**	8.7	**7.3**	8.2
	79.6	74.2	**74.8**	71.6

28. PROVISIONS

Movements in provisions during the year were as follows:

	FSCS Levy £m	Regulatory and other £m	Total £m
Group			
At 1 January 2011	**40.8**	**9.6**	**50.4**
Acquired on transfer of engagements	**9.5**	**54.3**	**63.8**
Amounts utilised during the year	**(8.1)**	**(1.3)**	**(9.4)**
Provision charge during the year	**5.6**	**–**	**5.6**
At 31 December 2011	**47.8**	**62.6**	**110.4**
At 1 January 2010	12.1	0.5	12.6
Acquired on transfer of engagements	33.7	9.3	43.0
Amounts utilised during the year	(8.6)	(0.2)	(8.8)
Provision charge during the year	3.6	–	3.6
At 31 December 2010	40.8	9.6	50.4
Society			
At 1 January 2011	**40.8**	**9.6**	**50.4**
Acquired on transfer of engagements	**9.5**	**54.3**	**63.8**
Amounts utilised during the year	**(8.1)**	**(1.3)**	**(9.4)**
Provision charge during the year	**5.6**	**–**	**5.6**
At 31 December 2011	**47.8**	**62.6**	**110.4**
At 1 January 2010	12.1	0.4	12.5
Acquired on transfer of engagements	33.7	9.3	43.0
Amounts utilised during the year	(8.6)	(0.1)	(8.7)
Provision charge during the year	3.6	–	3.6
At 31 December 2010	40.8	9.6	50.4

Financial Services Compensation Scheme

During 2008 and 2009 the Financial Services Compensation Scheme (FSCS) was instrumental in safeguarding depositors' money following the failures of Bradford and Bingley plc, Kaupthing Singer & Friedlander Limited, Heritable Bank Plc, Landsbanki Islands hf, London Scottish Bank Plc and Dunfermline Building Society.

The FSCS has borrowings of £18bn in the form of loans from HM Treasury. The FSCS is liable to pay interest on these loans for the first three years, the principal of the loans becoming due in April 2012 by which time it was hoped that there would have been substantial recoveries from the assets of the failed institutions. The FSCS is currently engaged in discussions with HM Treasury about the re-financing of the loans and hopes to bring these negotiations to a conclusion before the end of March 2012 and will make a further announcement at that time.

28. PROVISIONS (continued)

Financial Services Compensation Scheme (continued)

The Group has recognised in this year's results a provision for a levy of £8.7m for the scheme year 2012/13, based on its share of industry protected deposits, and a release of £3.1m for earlier scheme years due to interest rates being lower than anticipated.

The amounts above do not take any account of any compensation levies which may arise from any ultimate payout on claims. However, on merger with the Norwich & Peterborough Building Society, in accordance with 'International Financial Reporting Standard 3 Business Combinations (Revised)', a fair value adjustment was made relating to potential compensation levies in respect of the savings balances acquired. In addition, a further fair value assumption was made to provide for future interest costs on the HM Treasury loan on the assumption that not all of it will have been repaid by April 2012.

Regulatory and other

Other provisions have been made in respect of various customer claims, including claims in relation to previous sales of payment protection insurance. It is expected that the liability will predominantly crystallise over the next 12 to 24 months. In addition, on merger with the Norwich & Peterborough Building Society, in accordance with 'International Financial Reporting Standard 3 Business Combinations (Revised)', fair value adjustments were made in respect of potential customer claims, mainly relating to financial advice mis-selling and sales of payment protection insurance (PPI).

29. SUBORDINATED LIABILITIES

Group and Society	2011 £m	2010 £m
6.63% Subordinated Bonds 2015	**10.2**	–
Floating Subordinated Bonds 2018	**5.0**	–
6% Subordinated Bonds 2019	**25.9**	25.8
11⅜% Subordinated Bonds 2022	**25.3**	25.3
6⅜% Subordinated Bonds 2024	**51.7**	51.6
13½% Convertible Tier 2 Capital Notes 2025	**99.9**	99.8
Fair value hedging adjustments	**12.9**	12.4
	230.9	214.9

All subordinated liabilities are denominated in sterling. The following notes are repayable at the dates stated or earlier at the option of the Society and with the prior consent of the Financial Services Authority under the following conditions:

- Redemption of all (but not some only) of the 6% Notes at par on 7 May 2014 after giving not less than fifteen nor more than thirty days' notice to the holders. In the event the Society does not redeem the notes on 7 May 2014 the fixed rate of interest will become the aggregate of 2.03% and the then current five year benchmark Gilt rate.
- Redemption of all (but not some only) of the 11⅜% Notes at par on 27 November 2017 after giving not less than thirty nor more than sixty days' notice to the holders. In the event the Society does not redeem the notes on 27 November 2017 the fixed rate of interest will become the greater of 11⅜% and an aggregate of 3.10% and the then current five year benchmark Gilt rate.

During 2010, the Society issued £100m nominal value of 13½% Convertible Tier 2 Capital Notes. The redemption of these notes will occur on 1 April 2025 unless the notes are converted to Profit Participating Deferred Shares (PPDS) under the following condition:

- The 'Conversion Trigger' shall occur if on any Calculation Date the Society's Consolidated Tier 1 Capital Ratio, as confirmed in a report of the auditor to the Society and addressed to the Board of Directors of the Society, is less than 5%.

The rights of repayment of the holders of subordinated debt are subordinated to the claims of all depositors, creditors and members holding shares in the Society, as regards the principal of their shares and interest due on them.

Should the Conversion Trigger occur on the 13½ % Convertible Notes and these notes convert into PPDS, the PPDS will be perpetual in nature, ranking *pari passu* with the currently issued Subscribed Capital (detailed in Note 30).

30. SUBSCRIBED CAPITAL

Group and Society	2011 £m	2010 £m
5.649% Permanent Interest Bearing Shares	**151.4**	151.2
Fair value hedging adjustments	**25.6**	16.1
	177.0	167.3

All Permanent Interest Bearing Shares (PIBS) are unsecured and denominated in Sterling. Interest is payable half yearly on 27 March and 27 September. PIBS are repayable at the option of the Society, in whole, in March 2019 or any interest payment date thereafter.

Repayment requires the prior consent of the Financial Services Authority. If the PIBS are not repaid on a call date the interest rate is reset at a margin to the then prevailing LIBOR rate. They are deferred shares of the Society and the rights of repayment of the holders of PIBS are subordinated to the claims of all depositors, creditors, members holding shares in the Society and holders of subordinated debt, as regards the principal of their shares and interest due on them. The interest rate risk arising from the issuance of fixed rate PIBS has been mitigated through the use of interest rate swaps.

31. CAPITAL MANAGEMENT

More detail of capital management strategies can be found in the Risk Management Report on pages 58 and 59.

	Group	
	2011 £m	2010 £m
Tier 1		
General reserve	**1,581.9**	1,408.1
Subscribed capital	**177.0**	167.3
Pension fund adjustments *	**(29.4)**	8.6
Intangible fixed assets	**(30.4)**	(20.4)
Deductions from Tier 1 capital	**(19.9)**	(1.8)
	1,679.2	1,561.8
Tier 2		
Subordinated liabilities	**227.4**	214.9
Collective allowances for impairment	**8.0**	4.5
Deductions from Tier 2 capital	**(19.9)**	(1.8)
	215.5	217.6
Other items excluded	**(2.6)**	(1.2)
Total capital	**1,892.1**	1,778.2
Risk weighted assets	**11,964.6**	11,205.2
Core Tier 1 ratio (%)	**12.6%**	12.4%
Tier 1 ratio (%)	**14.1%**	13.9%
Solvency ratio (%)	**15.8%**	15.9%

* The regulatory capital rules allow a pension fund surplus/deficit to be deducted from/added back to regulatory capital and a deduction taken instead for an estimate of the additional contributions to be made in the next five years, less associated deferred tax.

The above ratios, deductions and definitions are in accordance with Financial Services Authority (FSA) guidelines.

Throughout the year the Group Capital Committee has kept the Group's capital position under review as well as considering the current market conditions for capital issuance.

32. FINANCIAL COMMITMENTS

	Group and Society	
	2011	2010
	£m	£m
Committed undrawn standby facilities	**155.0**	96.2

The Society has an obligation under the Building Societies Act 1986 to discharge the liabilities incurred up to 11 June 1996 of all subsidiaries in so far as those subsidiaries are unable to discharge the liabilities out of their own assets. The Society has given undertakings whereby it has agreed to discharge the liabilities incurred after 11 June 1996 by certain of its subsidiaries, including Yorkshire Guernsey Ltd, in the event that these subsidiaries may be unable to discharge them out of their own assets. The Society accounts for these guarantees in accordance with 'IFRS 4 Insurance Contracts'.

Capital commitments contracted for at 31 December 2011, but for which no provision has been made in the accounts, amounted to Group £0.6m and Society £0.5m (2010 – Group £0.5m and Society £0.4m).

Amounts payable under non-cancellable operating leases are as follows:

	2011		2010	
Group	**Land and buildings**	**Other**	Land and buildings	Other
	£m	**£m**	£m	£m
Within one year	**4.7**	**1.1**	4.7	0.4
Between one and five years	**15.1**	**2.7**	14.6	0.4
Over five years	**18.4**	**–**	15.7	–
	38.2	**3.8**	35.0	0.8

The Group is not in default on any of its financial liabilities or commitments.

33. FINANCIAL INSTRUMENTS

The table below summarises the main financial instruments, their significant terms and conditions and the accounting treatment adopted.

Financial instrument	Significant terms and conditions	Accounting treatment
Cash in hand and balances with the Bank of England	Short-term cash balances and Statutory deposits Fixed, variable and non-interest bearing rates	Amortised cost
Loans and advances to credit institutions	Short-term Fixed and variable interest rates	Amortised cost*
Debt securities	Short-term, medium-term and long-term Fixed and variable interest rates	Generally held at fair value as available for sale assets. Certain investments are held at fair value through the income statement or held to maturity at amortised cost. Detail is given in Note 15
Loans fully secured on residential property	Loan period is typically up to 25 years A variety of mortgage products offering fixed and variable interest rates	Amortised cost*
Derivative financial instruments	Primarily medium-term Value derived from underlying price, rate or index	Fair value through income statement
Intercompany deposit from Covered Bond Limited Liability Partnerships	Long-term Fixed and variable interest rates	Fair value through income statement
Investments	Investment in subsidiary companies	Amortised cost
Shares	Deposits made by individuals Varying withdrawal notice periods Fixed and variable interest rates	Amortised cost*
Amounts owed to credit institutions and other customers	Primarily short-term Time Deposits Fixed and variable interest rates	Amortised cost*
Debt securities in issue	Short-term and medium-term Fixed and variable interest rates	Amortised cost*
Subordinated liabilities	Long-term Fixed and variable interest rates	Amortised cost*
Subscribed capital	Long-term Fixed interest rates	Amortised cost*

* Except where hedge accounting allows a fair value adjustment to be made for interest rate risk.

34. DERIVATIVE FINANCIAL INSTRUMENTS

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

Derivatives are only used by the Group in accordance with the Building Societies Act 1986. This means that such instruments are not used in trading activity or for speculative purposes and accordingly they are only used to reduce the risk of loss on core assets or liabilities arising from changes in interest rates, currency rates or other factors of a prescribed description.

The principal derivatives used in balance sheet risk management are interest rate swaps, interest rate options, cross-currency interest rate swaps, forward rate agreements, futures contracts and foreign exchange contracts. These are used to hedge Group exposures arising from fixed rate mortgage lending and savings products, funding and investment activities.

The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the type of derivatives which are typically used in managing such risks. Such risks may alternatively be managed using 'on-balance sheet' instruments as part of the Group's integrated approach to risk management.

Activity	Risk	Type of hedge
Management of the investment of reserves and other net non-interest bearing liabilities	Sensitivity to changes in interest rates	Interest rate swaps
Fixed rate savings products and options, forward fixed rate funding	Sensitivity to changes in interest rates	Interest rate swaps, forward rate agreements and futures
Fixed rate mortgage lending and options, forward fixed rate investments	Sensitivity to changes in interest rates	Interest rate swaps, forward rate agreements and futures
Management of the interest basis risk arising from differences in the underlying pricing basis of assets and liabilities	Sensitivity to changes in relationships between interest rate bases	Interest rate swaps where one leg is referenced to LIBOR and the other to bank base rate
Equity linked investment products	Sensitivity to changes in equity indices	Equity linked interest rate swaps
Investment and funding in rate swaps and foreign currencies	Sensitivity to changes in foreign exchange rates	Cross-currency interest rate swaps and foreign exchange contracts

The Group's objective is to manage risk within its risk tolerance, irrespective of the accounting treatment.

Those derivative products which are combinations of more basic derivatives are used only in circumstances where the underlying position being hedged contains the same risk features. In such cases the derivatives used will be designed to match the risks of the underlying asset or liability and therefore to hedge the associated market risk.

Certain financial instruments (including some retail products) contain features that are similar to derivatives. In the majority of such cases, the Group manages the associated risks by entering into derivative contracts that match these features.

Whilst all derivatives have been entered into for hedging purposes, only certain ones have been designated as such for accounting purposes. In some cases a natural offset can be achieved without applying the requirements of IAS 39. The Group only designates hedges where a high degree of effectiveness can be achieved.

Fair value hedges are designated where interest rate swaps are used to minimise the variability in the fair value of fixed interest financial instruments (mainly fixed rate mortgages).

Cash flow hedges are designated where interest rate swaps are used to convert the interest rate variability on short-term financial instruments into fixed rates.

34. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The following tables summarise the notional and fair value of all derivative financial instruments held at the year end and the hedging designations in place at that date.

Group

	Contract/notional	Fair values	
	amount	Assets	Liabilities
At 31 December 2011	£m	£m	£m
Interest rate swaps designated as fair value hedges	**5,448.8**	**55.8**	**273.1**
Interest rate swaps designated as cash flow hedges	**1,107.5**	**17.0**	**59.5**
Cross-currency interest swaps designated as fair value hedges	**1,251.4**	**100.2**	**–**
Derivatives not designated as hedges:			
Interest rate swaps	**12,245.4**	**171.1**	**161.0**
Cross-currency interest rate swaps	**58.5**	**14.2**	**–**
Equity linked interest rate swaps	**447.9**	**11.1**	**5.7**
Call options	**12.9**	**3.2**	**–**
Forward foreign exchange	**349.9**	**0.8**	**12.8**
Interest rate options	**117.0**	**0.2**	**–**
Forward rate agreements	**550.0**	**0.2**	**0.1**
Equity release swaps	**200.9**	**–**	**96.9**
Total derivatives held for hedging	**21,790.2**	**373.8**	**609.1**

Society

At 31 December 2011			
Interest rate swaps designated as fair value hedges	**5,448.8**	**55.8**	**273.1**
Interest rate swaps designated as cash flow hedges	**1,107.5**	**17.0**	**59.5**
Derivatives not designated as hedges:			
Interest rate swaps	**12,245.4**	**171.1**	**171.7**
Cross-currency interest rate swaps	**58.5**	**14.2**	**–**
Equity linked interest rate swaps	**447.9**	**11.1**	**5.7**
Call options	**12.9**	**3.2**	**–**
Forward foreign exchange	**349.9**	**0.8**	**12.8**
Interest rate options	**117.0**	**0.2**	**–**
Forward rate agreements	**550.0**	**0.2**	**0.1**
Equity release swaps	**401.7**	**96.9**	**96.9**
Total derivatives held for hedging	**20,739.6**	**370.5**	**619.8**

The Group continues to use discount curves based on term Libor rates to fair value both collateralised and non-collateralised positions. There is an increasing trend in the market for collateral held to be based on Overnight Index Swap (OIS) rather than Libor and the Group is currently assessing the implications of this.

Credit risk on derivative exposures is significantly mitigated within the Group through the positioning of cash collateral. A significant proportion of our derivative counterparties operate under a daily cash collateralisation process and as a consequence no credit value adjustment is made on derivative assets and no debit value adjustment is made on derivative liabilities.

34. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Group

At 31 December 2010	Contract/notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Interest rate swaps designated as fair value hedges	8,367.3	113.6	332.6
Interest rate swaps designated as cash flow hedges	1,393.7	34.0	39.5
Cross-currency interest swaps designated as fair value hedges	1,808.1	328.6	–
Derivatives not designated as hedges:			
Interest rate swaps	8,385.6	51.5	91.1
Cross-currency interest rate swaps	146.3	47.2	–
Equity linked interest rate swaps	151.3	1.8	5.3
Forward foreign exchange	250.9	2.7	3.2
Interest rate options	202.0	0.4	–
Interest rate futures	50.0	–	0.6
Total derivatives held for hedging	20,755.2	579.8	472.3

Society

At 31 December 2010	Contract/notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Interest rate swaps designated as fair value hedges	8,367.3	113.6	332.6
Interest rate swaps designated as cash flow hedges	1,393.7	34.0	39.5
Derivatives not designated as hedges:			
Interest rate swaps	8,583.6	98.1	91.1
Cross-currency interest rate swaps	146.3	47.2	–
Equity linked interest rate swaps	151.3	1.8	5.3
Forward foreign exchange	250.9	2.7	3.2
Interest rate options	202.0	0.4	–
Interest rate futures	50.0	–	0.6
Total derivatives held for hedging	19,145.1	297.8	472.3

35. LIQUIDITY RISK

Liquidity risk is an intrinsic part of the Group's business as long-term mortgages are funded by short-term retail customer balances. Most mortgages have a contractual maturity date of around 25 years but in practice are frequently repaid early; currently the estimated average life of a mortgage is approximately five years. Conversely, experience shows that retail deposits, nominally repayable on demand or with short notice periods, actually remain with the Society for relatively long periods. It is this inherent mismatch in the maturity profiles of retail assets and liabilities that creates liquidity risk.

The Group's liquidity management policy is designed to ensure maintenance of adequate investments in liquid assets to cover statutory, regulatory and operational requirements. The primary function of liquidity is the provision of sufficient assets in realisable form to ensure the Group is able to meet its liabilities as they arise and to absorb potential cash flow requirements created by the maturity mismatches referred to above or by a liquidity stress scenario. The policy is further designed to delegate liquidity management, within limits and a structure established by the Board, as well as to monitor the composition of liquidity in line with risk management objectives.

The Group's liquidity management comprise the following key areas:

- Limits are established by the Board that govern the quantity, quality and marketability of and returns from the Group's portfolio of liquidity investments. The portfolio is managed by the Treasury function, monitored by the Risk function and overseen by the Group Asset and Liability Committee (GALCO) under a series of delegated authorities.

- The Group conducts a series of daily stress tests that are designed to ensure that its liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include ones caused by both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding. They are constructed on various timescales as far out as six months.

- Following submission of its first Individual Liquidity Adequacy Assessment (ILAA) in 2010, the Society received its first full Individual Liquidity Guidance in April 2011, and this replaced the FSA's Individual Liquidity Guidance for Backstop Purposes (ILG for BP) that had been in place during 2010. This revised the amount of highly liquid collateral (government and supranational debt securities and cash) that the Society is required to hold based on the details and assessments carried out through the ILAA process from the generic ILG for BP levels.

There are three key measures that the Group considers key to monitoring its liquidity position:

- Buffer liquidity – which analyses daily the amount of highly liquid collateral that it is deemed necessary to hold in a liquidity buffer, to absorb the worst-case stress scenario over the ensuing three months.
- Liquidity stress tests – where, as noted above, the Group models how far its liquid asset holdings would fall under a number of different stress scenarios.
- Wholesale refinancing gap – which sets a maximum permitted net wholesale outflow limit over the following two weeks.

Liquidity risk in subsidiary companies, with the exception of other deposits, is mitigated by the use of appropriate inter-company loans and deposits.

35. LIQUIDITY RISK (continued)

Pledged assets ('Encumbrance')

Certain debt securities in issue (funding) are secured against the Group's assets.

The Society established Yorkshire Building Society Covered Bonds LLP in November 2006. The LLP provides security for issues of covered bonds made by the Society to external counterparties and also for the purposes of creating collateral. In April 2011 the Society issued a £750m 7 year deal and in November 2011 a €1,500m 5 year covered bond issue matured.

The Group established its Brass No.1 PLC securitisation structure, on 6 June 2011, with a £750m issue secured against certain loans of Accord Mortgages Ltd, of which £350m was retained by the Yorkshire Building Society for use as collateral for 'repo' operations. The table below illustrates the remaining balance of external secured funding after redemptions in the mortgage pool since issuance.

	2011		2010	
	Assets pledged £m	**Secured funding £m**	Assets pledged £m	Secured funding £m
Secured against loans and advances to customers:				
Covered bonds	**4,253.3**	**1,350.4**	5,891.4	1,820.3
Securitisation	**421.1**	**346.5**	–	–
Secured against liquid assets	**–**	**–**	1,310.8	650.0

Pledged assets include those available to Yorkshire Building Society Covered Bonds LLP and Brass No.1 PLC to provide collateral to support external funding transactions. Secured funding disclosed above, however, is that obtained from issuance to external counterparties and does not include self issued bonds which may be used as collateral for 'repo' and other similar type operations. As a result, the relationship between pledged assets and secured funding above is not representative of the 'haircut' applied to collateral values in determining the available level of funding.

All of the assets pledged are retained in the originators' balance sheet as they substantially retain the risks and rewards relating to the loans.

The covered bond programme operates under a Mortgage Sale Agreement, where there is an equitable assignment of the loans from the Society to the LLP. Legal title remains with the Society and full transfer of title is not affected until the occurrence of certain 'perfection' events such as a failure to pay or breach of obligation on behalf of the Society or the insolvency of the Society or the LLP.

The securitisation programme operates under a Mortgage Sale Agreement, where there is an equitable assignment of the loans from the Seller (Accord Mortgages Limited) to the Issuer (Brass No.1 PLC). Legal title remains with Accord and full transfer of title is not affected until the occurence of certain 'perfection' events such as it being directed by a regulatory authority, the Courts or the Society.

35. LIQUIDITY RISK (continued)

The tables below show contractual cash flows for all financial liabilities including interest payments. Further details of liquidity management are contained within the Risk Management Report on page 59.

Group	Repayable on demand and up to one year £m	In more than one year but not more than five years £m	Over five years £m	Total £m
As at 31 December 2011				
Shares	**20,167.6**	**6,237.5**	**4.3**	**26,409.4**
Amounts owed to credit institutions	**278.4**	**353.4**	**136.6**	**768.4**
Other deposits				
Society	**395.1**	**–**	**–**	**395.1**
Subsidiaries	**110.7**	**–**	**–**	**110.7**
	505.8	**–**	**–**	**505.8**
Debt securities in issue	**913.9**	**1,105.9**	**785.6**	**2,805.4**
Subordinated liabilities	**21.8**	**86.4**	**337.0**	**445.2**
Subscribed capital *	**8.5**	**33.9**	**42.4**	**84.8**
Operating lease payments	**5.8**	**17.8**	**18.4**	**42.0**
Derivative financial liabilities	**230.7**	**395.2**	**328.9**	**954.8**
Total	**22,132.5**	**8,230.1**	**1,653.2**	**32,015.8**

Group				
As at 31 December 2010				
Shares	17,494.0	5,090.0	35.8	22,619.8
Amounts owed to credit institutions	733.2	162.0	33.2	928.4
Other deposits				
Society	180.7	4.8	–	185.5
Subsidiaries	822.8	63.7	–	886.5
	1,003.5	68.5	–	1,072.0
Debt securities in issue	2,289.3	2,204.8	–	4,494.1
Subordinated liabilities	14.3	57.1	322.1	393.5
Subscribed capital *	8.5	33.9	42.4	84.8
Operating lease payments	5.1	15.0	15.7	35.8
Derivative financial liabilities	265.0	362.9	350.7	978.6
Total	21,812.9	7,994.2	799.9	30,607.0

* Interest payments on subscribed capital are £8.5m per year. The liquidity table includes these for ten years.

36. MARKET RISK

Value at Risk (VaR)

VaR is a risk management tool which evaluates the potential losses that may be incurred as a result of movements in market conditions over a specified holding period and to a given level of confidence. The model used is based on a 10 day holding period and a 99% confidence level.

The VaR model calculates potential movements in market prices by reference to market data from the last 90 days and incorporates underlying risk factors based on historic interest rate volatilities and correlations.

VaR for the Treasury portfolios is calculated and reported on a daily basis and for the Group Statement of Financial Position on a monthly basis. A quarterly back test of the VaR model is performed to test the validity of the assumptions and parameters within the model.

A number of limitations should be considered in relation to the VaR model:

- Historic data is not necessarily a good guide to future events.
- The model, by definition, does not capture potential losses outside the 99% confidence level, particularly those events that are extreme in nature.
- VaR is calculated on the basis of exposures outstanding at the close of business and, therefore, does not necessarily reflect intra-day exposures.

VaR measures below are based upon full balance sheet positions excluding the investment of the Group's free reserves.

Structural risk analysis (basis risk)

An analysis of interest bearing items by rate type is performed to illustrate key areas of structural mismatch. It identifies mismatches between administered rates, fixed rates and other rates including those linked to Bank Base Rate and LIBOR. The effect of LIBOR mismatches within the Statement of Financial Position is measured as the impact on net interest income (for a 12 month rolling period) of an isolated increase in LIBOR of one basis point (0.01%).

Basis point value (BP) sensitivity

This measure calculates the change in value of the assets and liabilities resulting from a one basis point parallel shift in interest rates. Within the Treasury portfolio this is calculated and reported on a daily basis separately for each currency and at the full statement of financial position level on a monthly basis.

Repricing gap analysis

Repricing dates are analysed, primarily to avoid repricing risk concentrations – the situation where too great a proportion of the Group's assets and liabilities see the interest rates earned or charged on them resetting within a given time period. The aim is to prevent excessive volatility in the net interest margin that could arise if rates shifted adversely within a given time period, and since the Group cannot dictate interest rate movements themselves, the best approach is to limit the amount of assets or liabilities that are exposed in this way. The analysis identifies the net asset/liability repricing position across a series of time intervals. Positions are calculated using nominal amounts and exclude interest flows. General reserves, fixed assets and other liabilities are classified as having 'non-specific' repricing characteristics with a zero rate of interest. The measure is calculated as a reverse cumulative gap.

36. MARKET RISK (continued)

All market risk is managed in the Society on behalf of the Group, hence the tables below apply to both the Group and the Society.

2011	Year-end £000	Average £000	Maximum £000	Minimum £000
VaR	**4,200**	**3,535**	**7,557**	**660**
Basis risk	**67**	**33**	**145**	**(98)**
BP sensitivity	**(123)**	**(77)**	**25**	**(147)**

	Greater than one year £m	Greater than five years £m	Greater than 10 years £m
Repricing gap	**25**	**(5)**	**(12)**

2010	Year-end £000	Average £000	Maximum £000	Minimum £000
VaR	6,346	3,806	6,346	1,062
Basis risk	(8)	(27)	67	(116)
BP sensitivity	(149)	(15)	222	(149)

	Greater than one year £m	Greater than five years £m	Greater than 10 years £m
Repricing gap	577	(8)	–

Detail of how the Group manages its interest rate risk is included in the Risk Management Report on pages 59 to 60.

37. CURRENCY RISK

Currency exchange risk is monitored daily and the Group seeks to minimise its net exposure to assets and liabilities denominated in currencies other than sterling. Maximum positions throughout the year represented less than 0.01% of total assets. More detail of this policy can be found in the Risk Management Report on page 60. Actual exposures were:

	2011 £m	2010 £m
Year end	**0.1**	0.5
Maximum	**1.9**	1.6

38. WHOLESALE CREDIT RISK

The Group's wholesale credit risk arises principally from assets held for liquidity purposes. The risk is that counterparties with whom the Group invests liquid assets fail to repay those investments when they fall due. The Group, through the Group Risk function, undertakes its own internal rating of all its counterparties and sets individual limits accordingly. These limits are reviewed at least annually, with revocation or suspension taking place where considered appropriate. The ratings are compared with those produced by external rating agencies at least annually.

Whilst recognising that exposures will be maintained across a spectrum of counterparties the Board has adopted a low risk appetite for wholesale credit risk resulting in our inter-bank exposures being limited to operational requirements subject to our internal ratings process. This means that principal liquidity holdings are buffer eligible and restricted to the Bank of England, UK Government and Multilateral Development Banks. Individual exposure limits are set according to the credit rating applied to a given institution, i.e. lower limits for lower rated institutions. Limits are in place governing the types of instrument in which the Group will invest, as well as geographic and sector limits designed to prevent over-exposure to a given country or business type. The following table breaks down exposures using Basel methodology and composite external ratings and includes RMBS and Structured Credit Investments.

	2011	2010
	%	%
AAA	**81**	69
AA+ to AA-	**7**	17
A+ to A-	**7**	9
Other	**5**	5
	100	100

The Society uses an internal credit ratings model and process to help identify potential risks. Wholesale related credit risks are reported and discussed at the Group Wholesale Credit Committee and this has resulted in the avoidance of both Sovereign and direct counterparty exposures to countries such as Portugal, Italy and Greece. The Society has minimal exposure to Belgium through a current account facility and to Spain through a UK banking arm which is off balance sheet and covered by a CSA agreement.

The Society has no direct Sovereign exposures outside the UK. At the year end, Sovereign exposure to the UK was £1,369m (2010 – £996m) in UK Government bonds (Gilts) and £1,579m (2010 – £1,297m) to the Bank of England.

All wholesale exposures (including structured credit and RMBS) are to financial institutions within major industrial countries. The largest exposure to a single institution (other than the UK Government & Multilateral Development Banks) was £195m (2010 – £513m) in both instances to a UK clearing bank.

38. WHOLESALE CREDIT RISK (continued)

Country	Wholesale Exposures (including RMBS & Structured Credit Investments) at 31 December 2011 (£m)*	Wholesale Exposures (including RMBS & Structured Credit Investments) at 31 December 2010 (£m)*
United Kingdom	3,971.7	4,413.7
Multilateral Development Banks	321.7	346.7
Ireland	249.3	301.9
Australia	85.3	156.0
Switzerland	23.4	12.3
Austria	55.1	55.1
Netherlands	28.8	45.9
United States	20.0	22.5
Cayman Islands	22.9	27.5
Germany	9.0	85.3
Luxembourg	8.4	8.6
France	2.1	229.2
Denmark	1.2	52.3
Belgium	0.1	5.0
Spain	0.1	16.3
Canada	–	47.5
Sweden	–	16.2
Norway	–	14.0
Finland	–	10.2
Italy	–	45.0
Greece	–	–
Portugal	–	–

*Exposures quoted are market value plus accrued interest plus a calculated modified uplift.

The Society no longer has a risk appetite to lend to Ireland, Portugal, Italy and Greece and any remaining assets are currently in run off. The maximum gross exposure to any one country other than the UK and Multilateral Development Banks as at 31 December 2011, (including structured and money market fund exposures) was £249.3m (2010 – £301.9m). This consists of £163.6m (2010 – £216.1m) exposure to three Irish Banks, £51.0m was repaid in February 2012 with the remainder being due for repayment later in 2012. The remaining £85.7m is exposure to assets domiciled in Ireland.

None of these exposures was either past due or impaired and there are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

In addition to the above direct exposures the Group regularly monitors its indirect exposures (the primary exposures of our counterparties) to establish whether any second order concentration risks exist. This is performed on a best efforts basis given the inconsistency and timings of information that exists in the public domain with regard to this information.

The key trigger events used to evaluate impairments are set out in Note 1 on page 80.

38. WHOLESALE CREDIT RISK (continued)

Wholesale credit risk is recorded in the following statement of financial position captions:

	2011 £m	2010 £m
Cash in hand and balances with the Bank of England	**1,598.4**	1,310.8
Loans and advances to credit institutions	**582.3**	935.8
Debt securities	**2,737.1**	3,615.2
Derivative financial instruments	**373.8**	579.8
Investments (Note a)	**2.2**	2.1
Total wholesale credit risk	**5,293.8**	6,443.7

Debt securities, which are shown after fair value and impairment adjustments, can be further analysed as:

	2011 £m	2010 £m
UK Government securities	**1,448.2**	1,007.3
Medium-term notes issued by financial institutions	**664.5**	1,620.8
Certificates of deposit	**–**	114.1
Mortgage backed securities (Note b)	**567.6**	801.6
Combination note (Note c)	**10.0**	10.9
Synthetic collateralised debt obligations (Note d)	**25.2**	31.9
Cash collateralised debt obligations (Note e)	**21.6**	28.6
	2,737.1	3,615.2

(a) Principally the equity investment in VocaLink Holdings Limited which is associated with the Group's operation of cash machines.

(b) Mortgage backed securities are all backed by AAA rated UK prime residential mortgages.

(c) The combination note is structured to pay a return over and above its regular coupon.

(d) There are five holdings in synthetic credit investments. These contain embedded derivatives that have been separated with changes in fair value being taken directly to the income statement.

(e) There are investments in five cash based collateralised debt obligations, each of which continues to perform and there is no evidence of any impairment. These investments have been classified as available for sale.

The maximum exposure to wholesale credit risk at 31 December 2011 is as reported in the Statement of Financial Position.

39. CREDIT RISK ON LOANS AND ADVANCES TO CUSTOMERS

Credit risk management

The Group articulates its desired level of credit risk through a series of risk appetite statements. These statements are supported by a number of qualitative and quantitative measures that are monitored closely by the Group Risk function and reported monthly to the Group's credit risk committees. Further challenge and oversight is provided by the Group Risk Committee which reviews credit risk reporting as part of their quarterly meetings.

The Group acquired the retail books of Egg Banking plc (Egg) on 31 October 2011 and completed the merger with Norwich & Peterborough Building Society (N&P) a day later. These transactions increased the Group's mortgage exposures and, in the case of N&P, added a modest amount of personal loans and current account exposures. In addition, the N&P merger significantly increased the size of the Group's commercial loan book, however, this remains only 1.5% of the total loan exposure.

Work prior to these transactions ensured that all significant areas of N&P and Egg's lending policies were, from the effective dates, aligned with those of the wider Group, and that analysis and control of their loan portfolios were integrated within the Group's credit risk governance practices.

The Group's exposure to retail credit risk can be broken down as follows:

	Group		Society	
	2011 £bn	2010 £bn	**2011 £bn**	2010 £bn
Retail mortgages	**26.8**	23.3	**18.4**	16.5
Commercial lending	**0.4**	0.1	**0.4**	0.1
Retail unsecured lending	**<0.1**	–	**<0.1**	–
Total gross exposure (contractual amounts)	**27.2**	23.4	**18.8**	16.6
Impairment, fair value and hedging adjustments	**(0.2)**	–	**(0.2)**	–
Total net exposure	**27.0**	23.4	**18.6**	16.6

Retail mortgages

The Group's exposure to mortgage related credit risk is monitored closely by the Retail Credit Risk area within Group Risk. Reporting on risk exposures is provided monthly to the Retail Credit Risk Committee. Reports include analysis of the movement of loans into arrears and between arrears bands by differing loan portfolios and loan characteristics (e.g. loan-to-value), as well as monitoring of the overall characteristics of the loan portfolios (e.g. geographic location, indexed loan-to-value concentrations and income multiples). In addition, Group Risk undertakes a number of stress tests that subject the mortgage portfolios to different levels of default, house price deflation and other factors to identify the potential loan losses under the different economic conditions represented by those stress tests.

At an operational level, adherence to the Group's retail credit risk appetite is supported through the use of a suite of tools used in activities such as credit decisioning, portfolio management and arrears management. During 2011 a major project (the Arrears Transformation Programme) commenced to transform the way arrears are managed across the Group. The programme is looking at the way the Group uses data, systems and resources in the arrears management process, and incorporates the latest best practice guidelines, including the FSA's guidance note, "Forbearance and Impairment Provisions – Mortgages", published in October 2011.

Geographic distribution of retail mortgage balances	**2011 %**	2010 %
Scotland	**8**	8
North East	**4**	7
Yorkshire & Humberside	**11**	13
North West	**11**	9
Midlands	**12**	13
East of England	**6**	4
South West	**6**	7
Greater London	**17**	16
South East	**20**	18
Wales & Northern Ireland	**5**	5
	100	100

39. CREDIT RISK ON LOANS AND ADVANCES TO CUSTOMERS (continued)

Substantially, all retail mortgage balances are secured on property. As part of the portfolio monitoring process, these properties are subject to regular updates in respect of their loan-to-value by way of an indexation process. This is applied to provide some measure of relative house price movements across the UK and their impact on relative property values. Although the indexation approach is very broad (typically at the regional level) it is an industry standard for providing senior management with a view as to the value and risk of the properties on which retail mortgages are secured. The Retail Credit Risk area maintains oversight of the suitability of the indexation approach, process and its application on a regular basis.

Loan-to-value distribution of retail mortgage balances	Book		New Lending	
	2011	2010	**2011**	2010
	%	%	**%**	%
Greater than 90%	**18**	22	**–**	–
75% to 90%	**25**	24	**30**	32
50% to 75%	**33**	30	**60**	56
Less than 50%	**24**	24	**10**	12
	100	100	**100**	100

The Group has continued to restrict the loan-to-values permitted on new lending. The average indexed loan-to-value, based on a simple average of each loan's indexed loan-to-value, is 54% (2010 – 56%).

Retail mortgage customer type	Book		New Lending	
	2011	2010	**2011**	2010
	%	%	**%**	%
First time buyer	**17**	16	**24**	26
Other buyers, i.e. movers	**40**	41	**45**	51
Remortgage	**34**	32	**31**	23
Buy-to-let	**8**	10	**–**	–
Other	**1**	1	**–**	–
	100	100	**100**	100

Retail mortgage arrears	Group		Society	
	2011	2010	**2011**	2010
Arrears outstanding as a percentage of debt	**%**	%	**%**	%
No arrears	**93.61**	91.91	**95.04**	93.86
Less than three months	**4.13**	5.38	**3.56**	4.49
Three to six months	**1.12**	1.37	**0.70**	0.82
Six to 12 months	**0.60**	0.72	**0.35**	0.41
12 months or over	**0.23**	0.24	**0.15**	0.16
Property in possession	**0.31**	0.38	**0.20**	0.26
	100.00	100.00	**100.00**	100.00
Number of properties in possession at the year end	**545**	629	**283**	332

The percentage of retail mortgages with arrears of three months or more has fallen during 2011 despite the challenging economic environment. The Group's retail mortgage arrears ratio is below CML comparables. The Group's Arrears Transformation Programme will seek to further reduce arrears and possessions. Arrears on more recent lending are minimal, reflecting the Group's credit risk appetite.

Commercial lending

Commercial lending credit risk exposures are monitored by Group Risk and reported to the Group Wholesale Credit Committee. Reporting includes analysis of the movement of loans into arrears and between arrears bands by differing loan portfolios and loan characteristics (e.g. loan-to-value, risk grades), as well as monitoring of the overall characteristics of the loan portfolios (e.g. geographic location, risk grade, indexed loan-to-value concentrations).

39. CREDIT RISK ON LOANS AND ADVANCES TO CUSTOMERS (continued)

The properties on which commercial mortgages are secured are located across England, Wales and Scotland and comprise a range of industrial and commercial premises, offices, leisure and retail units spanning a range of business sectors. Loans against specialist properties are strictly limited, with only a single property, a sporting facility, falling into this category. There are no loans secured against land only. Properties are re-valued periodically using third party valuation data which takes into account the property type and geographical location.

Following the merger with N&P, the Group now has a commercial lending book of £419m. The N&P's commercial loan portfolio is managed by a specialist team using a combination of statistical credit models, lending policy rules, underwriting and close relationship management to assess new applicants and manage existing loans.

This proactive approach to account management has resulted in just 0.17% of accounts being more than three months in arrears at the year end. While arrears and losses to date have been low, as part of the merger, N&P's commercial loans were subject to a fair value adjustment to reflect likely future losses on the portfolio.

The Chelsea commercial loan portfolio is in run-off with only six loans remaining. There are no arrears on any accounts.

The commercial loan portfolio is spread throughout the UK as follows:

Geographic distribution of commercial mortgage balances	**2011**	2010
	%	%
Scotland	**3**	19
North East	**2**	–
Yorkshire & Humberside	**4**	–
North West	**10**	33
Midlands	**13**	3
East of England	**10**	–
South West	**7**	–
Greater London	**28**	42
South East	**21**	–
Wales & Northern Ireland	**2**	3
	100	100

The average indexed loan-to-value of the commercial mortgage balances is 65%.

Retail unsecured lending

The merger with N&P also introduced unsecured lending onto the Group's balance sheet. As at 31 December 2011, unsecured lending balances stood at £20.9m. This comprised personal loans of £16.2m and current account overdrafts of £4.7m. Within the Group, unsecured lending is managed by the Retail Credit Risk area within Group Risk, with monthly reporting provided to the Retail Credit Risk Committee. Reporting includes analysis of accounts in arrears and overdraft limits.

Current account overdrafts are assessed and managed using a combination of statistical credit models, lending policy rules and underwriting, with all overdraft limits reviewed on at least a monthly basis. Accounts are monitored closely for early signs of distress and advice offered to customers where deemed appropriate. Customers who are unable to repay overdrafts when due are passed to the Collections Department who review individual customer circumstances before deciding what appropriate action to take.

The personal loan portfolio is currently in run-off. Customers who are unable to repay personal loans are passed to the Collections Department who review individual customer circumstances before deciding what appropriate action to take. As at 31 December 2011, accounts three or more months in arrears stand at 16.2% of the portfolio.

At the point of merger, as with all N&P loan books, a fair value adjustment was applied against unsecured lending.

39. CREDIT RISK ON LOANS AND ADVANCES TO CUSTOMERS (continued)

Impairment

All loans (retail mortgage, commercial and unsecured) are reviewed on a monthly basis for indications of impairment. As at the year end, impairment on the overall loan balances is as follows:

	Group		Society	
	2011	2010	**2011**	2010
Not impaired:	**£m**	£m	**£m**	£m
Neither past due nor impaired	**25,369.5**	21,458.2	**17,788.0**	15,535.8
Past due but not impaired	**829.3**	940.7	**525.5**	592.4
Impaired	**1,000.3**	1,043.7	**490.6**	493.1
Total loans and advances	**27,199.1**	23,442.6	**18,804.1**	16,621.3

Loans acquired from the Norwich & Peterborough and Egg (and last year from the Chelsea) have been fair valued on a basis which makes allowances for anticipated losses over the remaining life of the loans. Impaired loans totalling £405.7m in the above analysis for 31 December 2011 have thus been fair valued and are, therefore, unlikely to contribute any significant further losses to the Group.

The following table shows a prudent assessment of collateral held against total loans and advances. The collateral is calculated as the lower of the value of the property and the outstanding loan amount. It is not the overall value of properties secured against the loans.

Group	Loans and advances		Collateral	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Neither past due nor impaired	**25,369.5**	21,458.2	**25,095.5**	21,342.0
Past due but not impaired	**829.3**	940.7	**810.8**	927.4
Impaired	**1,000.3**	1,043.7	**948.7**	1,010.9
Total loans and advances	**27,199.1**	23,442.6	**26,855.0**	23,280.3
Society				
Neither past due nor impaired	**17,788.0**	15,535.8	**17,587.9**	15,473.9
Past due but not impaired	**525.5**	592.4	**513.6**	584.8
Impaired	**490.6**	493.1	**464.6**	481.1
Total loans and advances	**18,804.1**	16,621.3	**18,566.1**	16,539.8

Impairment is assessed based on the arrears of each loan. Where retail or commercial mortgages are in arrears by two months or more, they are individually assessed for impairment. All such mortgages that are past due but not impaired are less than two months in arrears. Where retail or commercial mortgages are less than two months in arrears they are assessed for collective impairment.

Note 1 on page 80 describes the Group's approach to impairment provisioning and the key factors used in the calculation. The key assumptions underpinning the current mortgage impairment provisions (shown in Note 9) are as follows:

Factor	Value or range		Derivation
Forecast house price inflation/(deflation)	2012	(2.50%)	Judgemental
	2013	(2.50%)	
	2014	0.00%	
	2015	3.00%	
Probability of default*	10% to 75% for impaired accounts depending on the degree of impairment		Judgemental and experience
Emergence period	3 to 6 months		Experience
Loss given default*	20% to 30% for impaired accounts		Current experience
Forced sale discount	20%		Current experience

* 'Default' is defined as the property being in possession.

39. CREDIT RISK ON LOANS AND ADVANCES TO CUSTOMERS (continued)

No overlays are applied in the calculation and there have been no changes in approach during 2011.

Personal loans are individually assessed for impairment where they are more than one month in arrears and assessed for collective impairment if they are one month or less in arrears.

All overdrawn balances on current accounts are assessed for impairment. The default rate applied being dependent on the period which has elapsed since the account was last in credit.

Forbearance

The Group uses forbearance tools where they are deemed appropriate for an individual customer's circumstances, and are used in line with industry guidance. Forbearance tools which the Group may offer include capitalisation, temporary interest only concessions, payments arrangements, payment holidays and term extensions. The use of account management tools are either fully recognised within provisioning or are low in materiality. The Arrears Transformation Programme will provide greater data granularity around the use of forbearance across the Group and its impact on provisions, enabling more comprehensive reporting in future years.

The analysis below sets out a total of £1.2bn retail mortgage balances which are subject to some form of forbearance in its widest sense. Balances totalling £0.4bn are more than two months in arrears and therefore fall within the Group's individual provision calculation. The remaining £0.8bn are covered by the Group's collective provision through the assumptions surrounding emergence period. There is nothing in the forbearance data to suggest that the impairment provisioning methodology or assumptions do not provide adequate cover in respect of lending which is subject to forbearance. To the extent that these balances are deemed to be impaired, £33.0m is already provided either through balance sheet provisions or fair value adjustments.

Some of these forbearance tools are also applied on a small number of commercial mortgages with minimal values.

	Positive arrears arrange-ments* £m	Negative arrears arrange-ments** £m	Capital-isation £m	Payment holidays £m	Permanent interest only £m	Temporary interest only £m	Term extension £m	Direct debit suspension £m	Total £m
Not in arrears	98.8	0.5	10.2	13.3	188.2	87.7	16.4	36.1	**451.2**
Less than one month	96.9	1.0	0.1	0.6	2.6	5.1	0.1	2.4	**108.8**
One to two months	150.3	0.1	1.0	0.7	8.6	12.8	0.4	8.9	**182.8**
Two to three months	102.3	0.1	–	0.3	2.5	7.4	0.1	1.4	**114.1**
Three to six months	163.4	0.8	0.2	0.2	5.5	12.9	0.2	1.7	**184.9**
Six to 12 months	76.8	0.4	0.1	–	3.1	5.2	–	0.3	**85.9**
12 months or over	20.1	0.3	–	–	1.1	1.2	–	–	**22.7**
Property in possession	7.0	–	–	–	0.1	0.3	–	–	**7.4**
	715.6	**3.2**	**11.6**	**15.1**	**211.7**	**132.6**	**17.2**	**50.8**	**1,157.8**

* A positive arrears arrangement is one where the customer's regular monthly repayment is in excess of their contractual repayment amount in order to reduce their arrears.

** A negative arrears arrangement is one where an agreement is in place, due to the borrower's circumstances, that allows the customer to repay less than their contractual repayment amount for a short period. In this circumstance arrears will continue to accrue on the unpaid amounts.

40. FAIR VALUES

The tables below are a comparison of book and fair values of the Group's financial instruments by category as at the statement of financial position date. Where external market prices are available they have been used to determine fair value. Otherwise, internal pricing models using external market data have been used.

	2011		2010	
	Book Value	**Fair Value**	Book Value	Fair Value
Group	**£m**	**£m**	£m	£m
Cash in hand and balances with the Bank of England	**1,598.4**	**1,598.4**	1,310.8	1,310.8
Loans and advances to credit institutions	**582.3**	**582.3**	935.8	935.8
Debt securities – fair value	**16.2**	**16.2**	17.5	17.5
Debt securities – embedded derivative	**(31.9)**	**(31.9)**	(27.2)	(27.2)
Debt securities – available for sale	**2,182.0**	**2,182.0**	2,820.4	2,820.4
Debt securities – held to maturity	**570.8**	**560.6**	804.5	787.6
Loans and advances to customers	**27,022.2**	**27,612.4**	23,370.7	23,652.7
Investments	**2.2**	**2.2**	2.1	2.1
Liabilities				
Shares	**25,973.4**	**25,973.4**	21,382.5	21,382.5
Amounts due to credit institutions	**765.4**	**765.4**	926.4	926.4
Other deposits	**510.3**	**510.3**	1,061.9	1,061.9
Debt securities in issue	**2,591.2**	**2,546.9**	4,348.4	4,343.6
Subordinated liabilities	**230.9**	**205.1**	214.9	208.5
Subscribed capital	**177.0**	**95.9**	167.3	109.3
Society				
Assets				
Cash in hand and balances with the Bank of England	**1,598.4**	**1,598.4**	1,310.8	1,310.8
Loans and advances to credit institutions	**362.6**	**362.6**	725.4	725.4
Debt securities – fair value	**16.2**	**16.2**	17.5	17.5
Debt securities – embedded derivative	**(31.9)**	**(31.9)**	(27.2)	(27.2)
Debt securities – available for sale	**2,182.0**	**2,182.0**	2,711.8	2,711.8
Debt securities – held to maturity	**874.0**	**860.4**	804.5	787.6
Loans and advances to customers	**18,630.0**	**18,950.4**	16,583.8	16,761.0
Investments	**8,857.1**	**8,857.1**	10,488.1	10,488.1
Liabilities				
Shares	**25,973.4**	**25,973.4**	21,382.5	21,382.5
Amounts due to credit institutions	**765.4**	**765.4**	1,716.8	1,716.8
Other deposits	**1,589.5**	**1,589.5**	3,562.6	3,562.6
Debt securities in issue	**2,244.6**	**2,204.4**	4,348.4	4,343.6
Subordinated liabilities	**230.9**	**205.1**	214.9	208.5
Subscribed capital	**177.0**	**95.9**	167.3	109.3

Fair values of derivative financial instruments are shown in Note 34.

The fair values of all cash in hand, balances with the Bank of England and loans and advances to credit institutions have been recorded at par as they are all due in under one year and there is no impairment.

The fair values of debt securities are determined wherever possible from external market prices. Where reliable prices are not available, valuations are determined using models and externally verifiable market factors. The main inputs used in these models are underlying asset credit ratings, credit spreads, defaults in underlying instruments and credit enhancement or subordination factors.

40. FAIR VALUES (continued)

The fair value of loans and advances to customers has been calculated on an individual loan basis taking into account factors such as impairment and interest rates. It is not considered appropriate to value them collectively as a portfolio sale. Impairment is calculated on an incurred loss basis except to the extent that acquired mortgage books have been fair valued on a basis which makes allowances for anticipated losses over the remaining life of the loans.

The table below classifies all financial instruments held at fair value according to the method used to establish the fair value.

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 (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Investments classified as Level 3 are principally unquoted equity investments related to the operation of cash machines (see Note 10).

Group	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
As at 31 December 2011				
Debt Securities – fair value	**6.2**	**9.9**	**–**	**16.1**
Embedded derivatives	**–**	**(31.9)**	**–**	**(31.9)**
Debt Securities – available for sale	**2,126.2**	**55.8**	**–**	**2,182.0**
Investments	**–**	**–**	**2.2**	**2.2**
Derivative assets	**–**	**373.8**	**–**	**373.8**
Derivative liabilities	**–**	**(609.1)**	**–**	**(609.1)**
	2,132.4	**(201.5)**	**2.2**	**1,933.1**

41. RELATED PARTIES

Identity of related parties

The Group and Society have related party relationships with their subsidiaries, joint venture, the pension schemes and key management personnel. The Group considers its key management personnel to be its directors.

Contributions to the pension scheme

The Society paid contributions of £32.0m to the pension scheme (2010 – £8.6m).

Key management compensation

The key management personnel compensations are as follows:

	No. of key management personnel	**2011 £000**	No. of key management personnel	2010 £000
Short-term employee benefits		**2,540**		2,106
Post employment benefits		**100**		117
Total key management personnel compensation	**13**	**2,640**	14	2,223

41. RELATED PARTIES (continued)

Transactions with key management personnel

Key management personnel and their close family members have undertaken the following transactions with the Society under normal business terms.

	No. of key management personnel 2011	**Amounts in respect of key management personnel and their close family members 2011 £000**	No. of key management personnel 2010	Amounts in respect of key management personnel and their close family members 2010 £000
Mortgage loans				
At 1 January		**758**		551
Net movements in the year		**(250)**		207
At 31 December	**2**	**508**	3	758
Deposit accounts and investments				
At 1 January		**796**		1,367
Net movements in the year		**(62)**		(571)
At 31 December	**12**	**734**	12	796

Mortgage loans made to key management personnel and their close family members were granted in the ordinary course of business and are subject to repayment under normal lending terms. The maximum outstanding balances during the year were £757,293.

Amounts deposited by key management personnel and their close family members earn interest at the same rates offered to the public.

Key management personnel and their close family members paid interest totalling £22,141 (2010 – £30,764), received interest totalling £15,122 (2010 – £14,765), and paid no fees and commissions during the year. Interest paid reflects amounts relating to 'offset' mortgages where savings balances are used to reduce the interest bearing balance of mortgage loans.

41. RELATED PARTIES (continued)

Transactions with subsidiaries

The Society enters into a number of transactions with its subsidiaries in the normal course of business. These include loans and shares. The value of related party transactions, outstanding balances at the year end and related income and expense for the financial year are as follows:

	2011 £m	2010 £m
Shares in subsidiaries		
At 1 January	**219.9**	211.9
Acquired on transfer of engagements	**1.7**	8.0
Net movements	**(0.1)**	–
At 31 December	**221.5**	219.9
Loans to subsidiaries		
At 1 January	**10,265.9**	9,662.1
Acquired on transfer of engagements	**218.9**	207.0
Net movements	**(1,851.6)**	396.8
At 31 December	**8,633.2**	10,265.9
Deposits from subsidiaries		
At 1 January	**4,172.4**	3,705.9
Net movements	**(2,974.3)**	466.5
At 31 December	**1,198.1**	4,172.4
Interest receivable on loans	**377.6**	366.1
Interest payable on deposits	**(59.0)**	(62.3)
Fees and expenses receivable	**18.5**	13.6
Fees and expenses payable	**(2.6)**	(2.6)

Transactions with joint ventures

The Society holds 50% of the share capital of MutualPlus Ltd, a branch sharing company. The outstanding balances at 31 December 2011 and 31 December 2010 are less than £0.1m.

42. CASH FLOWS FROM OTHER OPERATING ACTIVITIES

	Group		Society	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Working capital adjustments:				
Depreciation and amortisation	**14.7**	15.5	**14.0**	14.9
Profit on sale of assets	**(0.6)**	–	**(0.6)**	–
Interest on subordinated liabilities and subscribed capital	**30.1**	26.5	**30.1**	26.5
Provisions	**35.7**	49.5	**2.4**	12.0
Gain attributable to transfer of engagements	**(5.6)**	(17.1)	**(5.6)**	(17.1)
Fair value of subordinated liabilities and subscribed capital	**14.4**	111.2	**14.4**	111.2
Profit on realisation of debt securities	**(3.5)**	(15.2)	**(3.5)**	(15.2)
(Increase)/decrease in other assets	**(11.6)**	(13.9)	**1.5**	(6.2)
Decrease in other liabilities	**(2.6)**	(103.8)	**(26.2)**	(4.4)
Working capital adjustments	**71.0**	52.7	**26.5**	121.7
(Increase)/decrease in operating assets:				
Loans and advances to credit institutions	**56.0**	101.1	**50.0**	100.2
Loans and advances to customers	**(1,167.0)**	789.6	**278.5**	1,264.2
Investments	**–**	–	**1,855.4**	(396.8)
Derivative financial instruments	**301.4**	117.4	**33.0**	(317.0)
Net (increase)/decrease in operating assets	**(809.6)**	1,008.1	**2,216.9**	650.6
Increase/(decrease) in operating liabilities:				
Shares	**1,897.8**	(2,362.0)	**1,897.8**	(2,362.0)
Amounts owed to credit institutions	**(166.0)**	(726.7)	**(956.4)**	(433.6)
Other deposits	**(850.1)**	(204.5)	**(2,274.1)**	147.3
Net increase/(decrease) in operating liabilities	**881.7**	(3,293.2)	**(1,332.7)**	(2,648.3)

43. TRANSFER OF ENGAGEMENTS

On the 1 November 2011 the Society acquired the business of the Norwich & Peterborough Building Society (N&P) following the approval of the shareholding and borrowing members of N&P.

The assets and liabilities acquired and the associated accounting adjustments are set out below:

Assets	Notes	Cessation Accounts £m	Reclassi-fications £m	Adjustments £m	**Take on balances £m**
Cash in hand and balances with the Bank of England		251.5	–	–	**251.5**
Loans and advances to credit institutions		56.0	–	–	**56.0**
Debt securities		302.8	–	4.3	**307.1**
Loans and advances to customers					
Loans secured on residential property	c	2,323.5	–	(99.9)	**2,223.6**
Other loans		314.9	–	–	**314.9**
Derivative financial instruments	e	–	6.4	21.5	**27.9**
Investments		–	–	0.1	**0.1**
Intangible assets	d	0.7	–	11.9	**12.6**
Property, plant and equipment	e	18.4	(0.6)	(7.8)	**10.0**
Investment properties	e	–	0.6	–	**0.6**
Other assets and prepayments	e	17.4	(9.4)	(2.7)	**5.3**
Retirement benefit obligations		1.6	0.5	–	**2.1**
Deferred tax	e	–	2.5	30.7	**33.2**
Total assets		3,286.8	–	(41.9)	**3,244.9**
Liabilities					
Shares		2,799.3	–	(106.2)	**2,693.1**
Deposits from banks and credit institutions		5.0	–	–	**5.0**
Due to customers		298.5	–	–	**298.5**
Debt securities in issue		5.5	–	–	**5.5**
Derivative financial instruments	e	–	5.1	83.0	**88.1**
Other liabilities		4.7	–	–	**4.7**
Provision for liabilities and charges	e	22.8	1.2	39.9	**63.9**
Accruals and deferred income	e	11.1	(6.4)	–	**4.7**
Subordinated liabilities	e	15.0	0.1	(3.8)	**11.3**
Reserves		124.9	–	(54.8)	**70.1**
Total liabilities		3,286.8	–	(41.9)	**3,244.9**
Goodwill					
Fair value of net assets					**70.1**
Less: deemed purchase consideration	f				**64.5**
Negative goodwill	g				**5.6**

43. TRANSFER OF ENGAGEMENTS (continued)

Notes and adjustments

a The Income and Expenditure Account for N&P for the period to 31 October 2011 is reported in the table below for information only and these amounts have not been included in the Income Statements of the Society or the Group. Following the transfer of engagements, N&P ceased to exist, becoming part of Yorkshire Building Society. It is thus not possible to separate its results from 1 November 2011.

b The cessation accounts of N&P have been prepared in accordance with UK GAAP. Certain reclassifications have been made and balances have been adjusted in accordance with 'IFRS 3 Business Combinations'.

c A fair value adjustment to reflect estimated future losses has been made. In addition, mortgage balances have been adjusted to fair value by comparing them with the Society's current product range.

d Identifiable intangible assets relate to the intrinsic value of the retail savings and current account books. They will be amortised over their useful lives of between five and ten years.

e Interest accruals have been reclassified from other assets and prepayments/accruals and deferred income to derivative financial instruments and subordinated liabilities, certain properties ancillary to branches and not used by the business have been reclassified from property, plant and equipment to investment properties. Deferred tax has been reclassified from other assets and prepayments and provisions relating to the FSCS scheme have been reclassified from accruals and deferred income to provision for liabilities and charges.

f The combination of the two societies did not result in any transfer of consideration. The deemed purchase price has been calculated by measuring the fair value of the N&P business. This calculation has been based on a forward projection of cash flows generated by the business assuming modest growth in business assets and a saving in management expenses due to synergies. These projections have been discounted at a rate of 6.4% which approximates to the estimated long-term cost of capital.

g Negative goodwill results from the transaction and has been recognised in the Income Statement.

Income and Expenditure Account of the Norwich & Peterborough Building Society
For the period 1 January 2011 to 31 October 2011

	£m
Net interest income	**22.8**
Net fee and commission income	**13.0**
Administrative expenses	**(38.5)**
Depreciation	**(1.7)**
Impairment losses on loans and advances	**(0.1)**
Provision for indemnity claims	**(0.9)**
Operating loss before exceptional provisions	**(5.4)**
Provision for investment advice	**(20.0)**
Loss before tax	**(25.4)**
Taxation	**(3.4)**
Net loss for the period *	**(28.8)**

* The above income and expenditure relates to the cessation accounts of N&P and these amounts have not been included in the Income Statements of Yorkshire Building Society or the Group. They are reported here for information only. It is not felt to be practicable to disclose what the results for the enlarged Society would have been for the period to 31 October 2011 if the merger had taken place on 1 January 2011.

ANNUAL BUSINESS STATEMENT

1. STATUTORY PERCENTAGES

	2011 %	Statutory Limit %
Lending limit	**3.5**	25.0
Funding limit	**12.9**	50.0

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 not in the form of loans fully secured on residential property.

The Funding limit measures the proportion of shares and borrowings (excluding offshore deposits held by individuals) not in the form of shares.

The statutory limits are as laid down under the Building Societies Act 1986 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

	2011 %	2010 %
As a percentage of shares and borrowings:		
Gross capital	**6.59**	6.20
Free capital	**6.06**	5.69
Liquid assets	**16.48**	21.15
Profit after tax for the financial year as a percentage of mean total assets	**0.34**	0.35
Management expenses as a percentage of mean total assets	**0.67**	0.66
Management expenses as a percentage of mean total assets adjusted for the effects of mergers, acquisitions and closures (using monthly mean assets)	**0.61**	0.56

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

- 'Shares and borrowings' represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.
- 'Gross capital' represents the aggregate of general reserve, hedging reserve, available for sale reserve, subordinated liabilities and subscribed capital.
- 'Free capital' represents the aggregate of gross capital and collective impairment provision less property, plant and equipment, intangible assets and investment properties.
- 'Liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets.
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- 'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

3. INFORMATION RELATING TO THE DIRECTORS AND OTHER OFFICERS AT 31 DECEMBER 2011

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
E. J. S. Anderson, BSc, CPFA 22 December 1950	Company Director	19 May 2003	Airport Operators Association Ltd Leeds International Pianoforte Competition Leeds Trinity University College Mid Yorkshire Hospitals NHS Trust St. Gemma's Hospice University of Leeds
Ms K. M. Barker, CBE 29 November 1957	Economist	5 November 2010	Electra Private Equity Plc Essex Community Foundation Kate Barker Ltd Pro Bono Economics Taylor Wimpey Plc The National Institute of Economic and Social Research
I. J. Bullock, BSc, FIA 7 November 1960	Building Society Sales and Marketing Director	12 April 2007	Accord Mortgages Ltd BCS Loans & Mortgages Ltd MutualPlus Ltd
R. F. Burden, PhD (hon), FCIB, MBCS, FRSA 3 June 1946	Company Director	1 April 2010	Football Association Ltd Gloucester Football Association Ltd The Football Foundation
A. M. Caton, BA 27 July 1963	Building Society Corporate Development Director	1 July 2004	CBS Capital Ltd CBS Nominees Ltd Chelsea Building Society Charitable Foundation Chelsea Mortgage Services Ltd YBS Investments (No. 1) Ltd YBS Investments (No. 2) Ltd Yorksafe Insurance Company Ltd Yorkshire Building Society Charitable Foundation Yorkshire Guernsey Ltd Yorkshire Investment Services Ltd
Mrs L. F. Charlesworth, BA, MBA 24 August 1956	Company Director	31 December 2006	St. James Investments Ltd St. James Investment Company UK No. 3 Ltd
R. J. Churchouse, MA, ACA 16 January 1966	Finance Director	1 June 2010	BCS Loans and Mortgages Ltd CBS Capital Ltd CBS Nominees Ltd Chelsea Mortgage Services Ltd Flexible Choice Ltd Norwich and Peterborough General Insurance Services Ltd Norwich and Peterborough Sharedealing Services Ltd Waters Lunniss Nominees Ltd YBS Investments (No. 1) Ltd YBS Investments (No. 2) Ltd Yorkshire Building Society Estate Agents Ltd Yorkshire Investment Services Ltd Yorkshire Key Services Ltd Yorkshire Key Services (No. 2) Ltd

3. INFORMATION RELATING TO THE DIRECTORS AND OTHER OFFICERS AT 31 DECEMBER 2011 (continued)

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
R. H. Davey, BA 22 July 1948	Company Director	27 September 2005	Amlin Plc London Capital Group Holdings Plc Severn Trent Plc Severn Trent Water Ltd
P. R. Johnson, FCA 12 October 1946	Chartered Accountant	1 June 2007	Cheadle Hulme School
D. V. Paige, BSc, FCA 3 July 1951	Company Director	31 December 2006	Aegon Direct Marketing Services Europe Ltd Cornerstone International Holdings Ltd Scottish Equitable Plc Scottish Equitable Holdings Ltd Stonebridge International Insurance Ltd Willis Ltd
C. J. Pilling, BSc 30 March 1965	Building Society Chief Executive	31 December 2011	Department of Health
S. Turner, BSc 29 November 1951	Company Director	13 October 2005	Identive Group Inc Netretail Holding BV TradeDoubler AB

The standard contractual notice period for all executive directors is one year. Mr I. J. Bullock, Mr A. M. Caton and Mr R. J. Churchouse entered into renegotiated contracts in 2009 and Mr C. J. Pilling entered into a contract on 31 December 2011 on this basis.

Documents may be served on the above-named directors: Ref. 'Yorkshire Building Society' c/o Deloitte LLP at the following address: 1 City Square, Leeds LS1 2AL.

3. INFORMATION RELATING TO THE DIRECTORS AND OTHER OFFICERS AT 31 DECEMBER 2011 (continued)

Officer	Business Occupation	Directorships
Mrs R. D. Court, BA	General Manager, Human Resources and Customer Service	Yorkshire Guernsey Ltd
Mrs A. L. FitzPatrick, LLB	Group Secretary and Head of Legal	Bank of East Anglia Ltd Brokerline Ltd East England Financial Services Group Ltd Mortgage Loan Management Ltd Norwich and Peterborough Financial Services Ltd Norwich and Peterborough Insurance Services Ltd Norwich and Peterborough Ltd Phillip Schofield & Company Phillip Schofield (Property Management) Phonebank Ltd YBS Ltd Yorkshire Direct Ltd Yorkshire Estate Agents Ltd Yorkshire Insurance Services Ltd Yorkshire Life Assurance Services Ltd Yorkshire Mortgage Services Ltd Yorkshire Personal Financial Services Ltd Yorkshire Property Services Ltd Yorkshire Services Ltd Yorkshire Syndications Ltd
D. N. Henderson, BSc	General Manager, Group Services and Chief Information Officer	Barnsley Property Services Ltd CBS Property Services Ltd Lynchwood Services Ltd Norwich and Peterborough (LP) Ltd YBS Properties Ltd YBS Properties (Edinburgh) Ltd YBS Properties (York) Ltd Yorkshire Computer Services Ltd Yorkshire Key Services Ltd Yorkshire Key Services (No 2) Ltd
M. R. Jenkins, BA, FCA, DipL	General Manager, Commercial Development	BCS Loans and Mortgages Ltd Lynch Wood Insurance Services Ltd Norwich and Peterborough General Insurance Services Ltd Norwich and Peterborough Insurance Brokers Ltd Norwich and Peterborough Insurance Services Ltd Norwich and Peterborough (LBS) Ltd Norwich and Peterborough Sharedealing Services Ltd Waters Lunniss Nominees Ltd
R. S. Wells, FCIB	General Manager, Risk	Accord Mortgages Ltd

GLOSSARY

The following glossary defines terminology used within the Annual Report and Accounts to assist the reader and to facilitate comparison with publications by other financial institutions:

Arrears	A customer is defined as in arrears when they fall behind in meeting their obligations to pay their mortgage and as a result there is an outstanding loan commitment that is overdue.
Audit Committee	To assist the Board in fulfilling its oversight responsibilities specifically the ongoing review, monitoring and assessment of internal control processes, internal and external audit processes and the integrity of the financial statements.
Basel II	The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses.
Buffer liquidity	Cash and investments with the UK government (deposits with the Bank of England or holdings of UK Gilts and similar investments) and with supranational institutions. The limit is set by the Financial Services Authority (FSA).
Buy-to-let (BTL)	A method of lending on property that is to be let to individuals.
Chairman's Committee	A Board committee whose main function is to decide on any items that require attention before the following Board meeting except for specific issues that have to be determined by the full Board.
Collateralised Debt Obligations	Investment in cash and synthetic credit investments.
Commercial lending	Loans secured on commercial property.
Contractual maturity	The final payment date of a loan or financial instrument, at which all the outstanding loan and interest is repayable.
Core Tier 1 capital	The highest quality regulatory capital resources, comprising of retained earnings less regulatory adjustments.
Core Tier 1 ratio	The ratio of Core Tier 1 Capital to Risk Weighted Assets.
Cost:income ratio	A ratio that represents management expenses as a percentage of total income.
Council of Mortgage Lending (CML)	A not-for-profit organisation and a trade association for the mortgage lending industry.
Covered bonds	A type of wholesale funding backed by cash flows from mortgages.
Credit risk	The risk of financial loss arising from a failure of a customer or counterparty to settle their financial and contractual obligations as they fall due.
Currency risk	The exposure to risk from assets and liabilities denominated in currencies other than sterling.
Debt Securities In Issue	Transferable certificates of indebtness of the Group to the bearer of the certificates. These include certificates of deposits, fixed rate and floating rate notes.

Term	Definition
Derivative Financial Instruments	Contracts or agreements whose value is derived from one or more underlying price, rate or index inherent in the contract or agreement, such as interest rates, exchange rates or stock market indices. Examples of derivatives include interest rate swaps, forward rate agreements and futures.
Earnings at risk	A measure of potential variability in net interest income for a given business mix over a given period of time at a stated confidence level.
Effective interest rate	The method used to calculate the amortised cost of financial instruments and to recognise interest receivable or payable over the relevant period. The effective interest rate is the rate that exactly discounts estimated cash flows (excluding credit losses) to zero, through the expected life of the instrument.
Expected loss	An estimate of the potential losses on current exposures due to potential defaults on a mid-cycle assumption.
Exposure	The maximum loss that a financial institution might suffer if a borrower, counterparty or group fails to meets its obligations to the Group.
Fair value movements/adjustments	The value of the assets based on either the external market price or internal pricing models (using external data).
Financial Ombudsman Service (FOS)	An independent service which provides a service for settling disputes between financial service providers and their customers.
Financial Services Authority (FSA)	The current regulator of the financial services industry in the UK.
Financial Services Compensation Scheme (FSCS)	A protection fund for depositors of failed institutions. This is funded by the financial services industry and each firm including the Society is obliged to pay an annual levy.
Free capital	The aggregate of gross capital and collective impairment provision less property, plant and equipment, intangible assets and investment properties.
FSA Remuneration Code	Guidance provided by the FSA on directors' remuneration.
Funding limit	The proportion of shares and borrowings (excluding offshore deposits held by individuals) not in the form of shares.
Funding ratio	A ratio that calculates the proportion of total shares and borrowings (excluding offshore deposits held by individuals) that are not in the form of shares.
Goodwill	Goodwill is measured as the difference between the adjusted value of the acquired assets and liabilities and the deemed purchase price. Goodwill is recorded as an asset in the Statement of Financial Position and negative goodwill is recorded in the Income Statement.
Gross capital	Represents the aggregate of general reserve, hedging reserve, available for sale reserve, subordinated liabilities and subscribed capital.
Group Asset and Liability Committee	This committee is responsible for, under delegated authority of the Board, managing the Group's liquidity, market and currency risks.
Group credit committee	A committee which oversees credit risk management in one of the two key areas of retail lending and investment in liquid assets in wholesale counterparties.

Term	Definition
Group Operational and Regulatory Risk Committee	The committee monitors the risk management framework put in place by the Group for identifying, assessing and managing operational and regulatory risks. The Group identifies operational risk to include the following; legal and regulatory, product and service, governance and security, process and system, people and resources and theft and financial crime.
Group Risk Committee	The Group Risk Committee has responsibility to the Board and detailed ownership of the Group's risk appetite, risk monitoring and risk and capital management framework.
Impaired loans	Loans which have been assessed and there is evidence to suggest that the Group will not receive all of the cash flows or there is an expectation that these will be received at a later date.
Impairment allowances	Anticipated losses on loans assessed by the arrears status of each mortgage and the anticipated losses over the remaining life of the loans.
Individual Liquidity Adequacy Assessment (ILAA)	The Group's internal assessment of the levels of liquidity that need to be held by the Society to meet its regulatory liquidity requirements.
Individually and collectively assessed	At each statement of financial position date the Group assesses whether or not there is objective evidence that individual financial assets (or groups of financial assets with similar credit characteristics) are impaired.
Integration/merger costs	The expenses incurred from merger activity within the year.
Internal Capital Adequacy Assessment Process (ICAAP)	The Group's internal assessment of the levels of capital that need to be held by the Society to meet its regulatory capital requirements.
Internal ratings methodology	An assessment of wholesale counterparties and the risks they pose to the Group with limits set accordingly.
International Financial Reporting Standards (IFRS)	International Accounting Standards as adopted by the European Union.
Investors in People	An accreditation which recognises the support the Group provides for its people.
Lending limit	The proportion of business assets not in the form of loans fully secured on residential property.
Liquid assets	Total of cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets.
Liquidity risk	The risk that the Group does not hold sufficient liquidity, in terms of quantity and quality, to meet its liabilities as they fall due.
Loan to value ratio	A ratio showing a mortgage as a percentage as the value of the property.
Management expenses ratio	A ratio that represents the management expenses as a percentage of mean assets.
Market risk	Risk to earnings and capital arising from changes in interest rates, foreign currency exchange rates, and the price of financial instruments.
Mean total assets	The amount produced by halving the aggregate of mean assets at the beginning and at the end of the year.
Medium-term notes (MTN)	Corporate notes continuously offered by a company to investors through a dealer. Investors can choose from differing maturities.

GLOSSARY continued

Member	A person who has a share account or a mortgage with the Society.
Mortgage backed securities	Assets which are referenced to underlying mortgages.
Net interest income	The difference between the interest received on assets and the interest paid on liabilities.
Net interest margin	This ratio calculates the net interest income as a percentage of mean assets.
Nominations Committee	A Board committee which considers matters relating to the composition of the Board and succession planning.
Non-prime lending	Mortgage lending to borrowers with adverse credit histories or self-certification lending where borrowers are not required to provide their income levels.
Operational risk	The risk of direct and indirect loss resulting from inadequate or failed internal processes, people and systems or from external events.
Other income	The income received from selling non-mortgage and savings products (e.g. home and contents insurance, investment products and other insurances).
Permanent Interest Bearing Shares (PIBS)	Unsecured and denominated in sterling. PIBS are repayable at the option of the Society and are Tier 1 capital instruments.
Possessions	A property taken back into ownership by the Society as a result of borrowers inability to make contractual loan repayments.
Prime lending	The Group's core business of providing residential mortgages to customers with no known default history.
Probability of default	The likelihood of an account hitting a particular default definition in a 12 month period. This is used when calculating impairment provisions on loans.
Provisions	A measurement of how far assets have failed to perform from a credit risk perspective. This includes actual losses incurred as a result of defaulting borrowers, and our estimate of potential losses on mortgages and other assets that are deemed to be already impaired.
Remuneration Committee	This committee is responsible for considering and approving the remuneration of executive directors and other General Managers as well as agreeing the remuneration policy for the whole organisation.
Repo/reverse repo	A repurchase agreement that allows a borrower to use financial security as collateral for a cash loan at a fixed rate of interest.
Retail credit risk	The risk of financial loss arising from a failure of a retail loan customer to settle their financial and contractual obligations as they fall due.
Risk appetite	The level of risk that the Group is willing to take (or not take) in order to safeguard the interest of members whilst achieving business objectives.
Risk weighted asset	A regulatory measure that adjusts the value of assets to reflect their level of risk when calculating capital requirements.
Shares	Money deposited by members in a retail savings account with the Society and held as a liability in the Statement of Financial Position.
Shares and borrowings	The total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

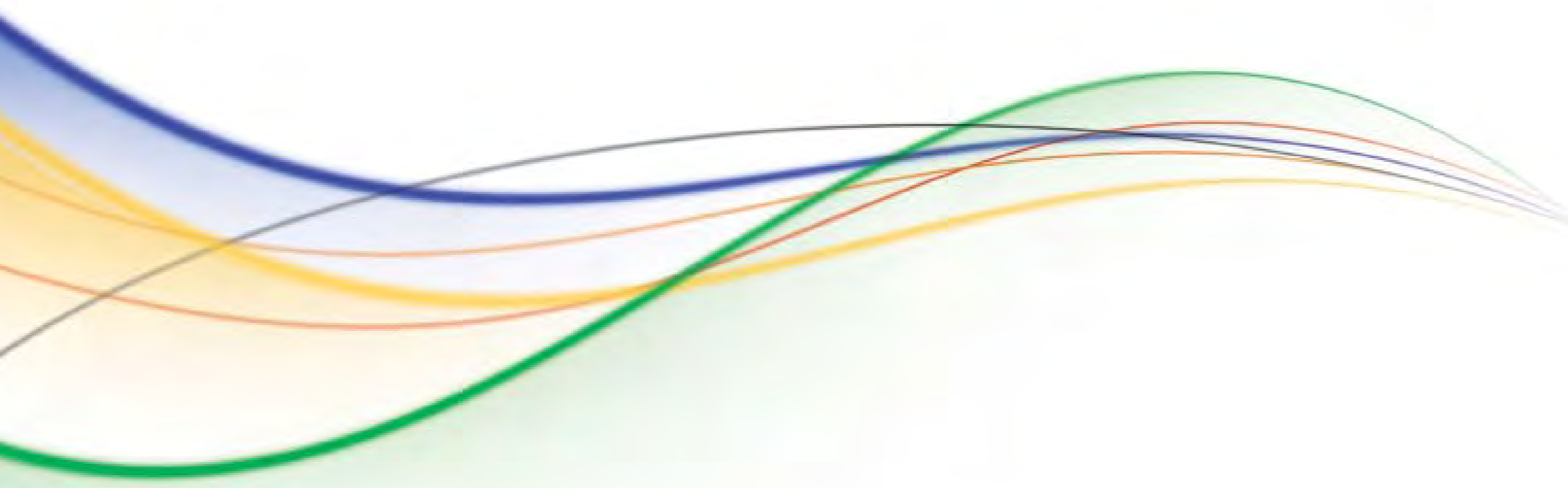
Term	Definition
Small Change Big Difference (SCBD)	Our unique scheme which allows each member to donate the pence of their interest to the Yorkshire Building Society Charitable Foundation.
Solvency ratio	The ratio of Total Capital to Risk Weighted Assets.
Standardised approach	A method of calculating capital requirements under Basel II.
Structured credit investments	A small percentage of Group liquidity invested in high risk and higher yielding treasury investments.
Subordinated debt	Tier 2 capital that is subordinated to the claims of all depositors, creditors and members holding shares in the Society (other than holders of PIBS).
Tier 1 capital	A measure of high-quality regulatory capital, comprising retained earnings and PIBS, less regulatory adjustments.
Tier 1 ratio	The ratio of Tier 1 Capital to Risk Weight Assets.
Tier 2 capital	A measure of regulatory capital that includes subordinated debt and general provisions, less regulatory adjustments.
Total capital	The total capital resources, including retained earnings, PIBS, general provisions and subordinated debt, less regulatory adjustments.
UK Corporate Governance Code	The UK code on corporate governance, published by the Financial Reporting Council in June 2010, which sets out standards of good practice in relation to Board leadership and effectiveness, remuneration and accountability.
Value at Risk (VaR)	A risk management tool which evaluates the potential losses that may be incurred as a result of movements in market conditions over a specified holding period and to a given level of confidence.
Weighted average maturity	Provides a measure of the weighted average remaining term of outstanding wholesale funding.
Wholesale credit risk	The risk that counterparties with whom the Group invests liquid assets fail to repay those investments when they fall due.
Wholesale funding	The funding that is available between banks and other financial or commercial institutions. Examples of wholesale funding include covered bonds, cash and government guarantees.
Wholesale ratio	A ratio that calculates the proportion of the total funding that is from wholesale sources, from banks and other financial or commercial institutions.
YBS Share Plans	Saving Related Share Option schemes which allow employees of a company to buy company shares with money they have contributed to a savings scheme.

NOTES

NOTES

Principal Office:
Yorkshire House, Yorkshire Drive, Bradford BD5 8LJ. www.ybs.co.uk

Auditors:
Deloitte LLP, 1 City Square, Leeds LS1 2AL.



‘Small Change, Big Difference’™ is the registered trademark of Yorkshire Building Society.

Head Office: Yorkshire Building Society, Yorkshire House, Yorkshire Drive, Bradford BD5 8LJ.

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