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

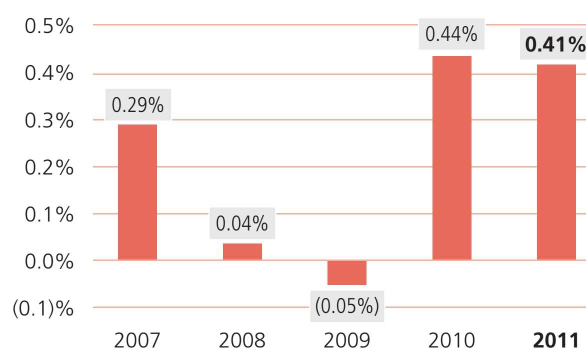
This section looks at our profit before tax on both a statutory and a core operating basis, with commentary that explores the underlying drivers of the Group's performance. Both measures indicate a strong financial performance in 2011, building on 2010's performance.

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.

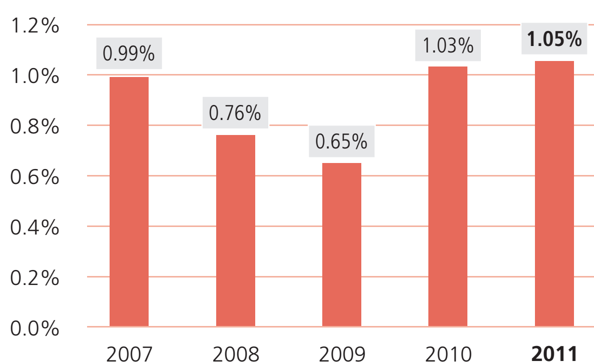
Against this, core operating items that improved in absolute terms were:

- 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.

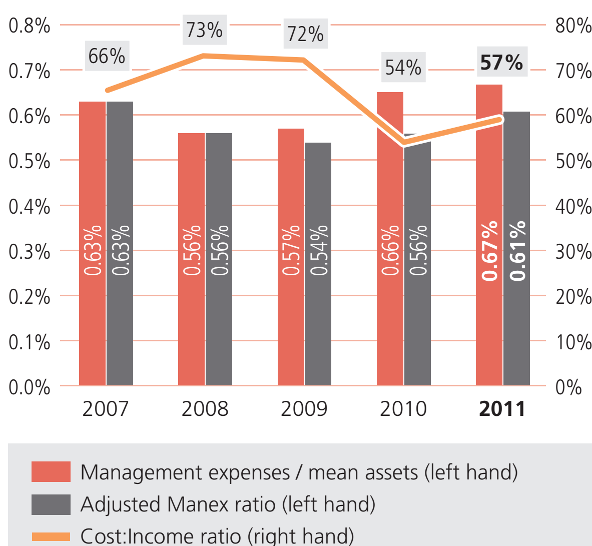
The factors behind the continuation of the increase in cost ratios seen last year include:

- 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



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:

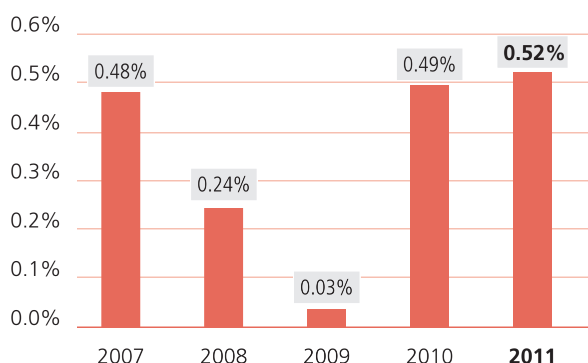
- Impaired investments – despite the reduction in the value of our structured investments discussed earlier, there is no evidence of any further impairment of individual assets and so, unlike in the previous two years, no provisions charge has been made this year.
- Other items – the credits in 2009 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%.

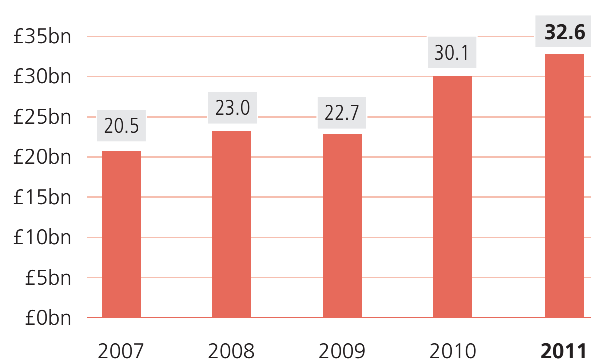
Balance Sheet overview

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:

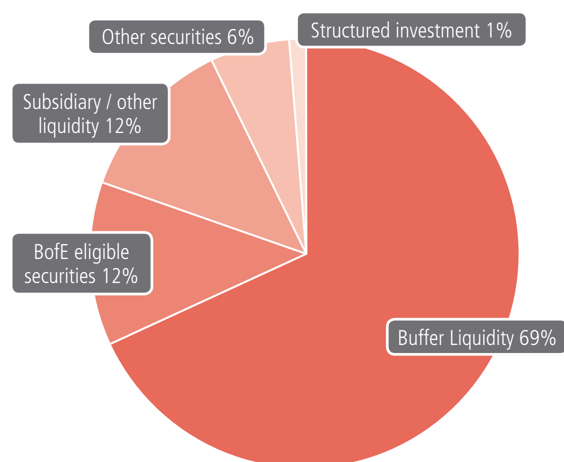
Liquid assets

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.

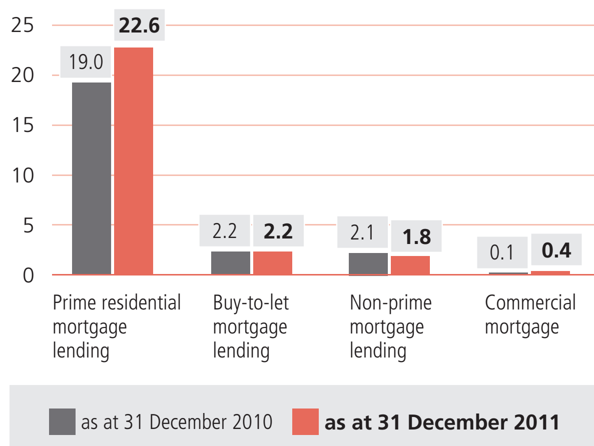
2011 has seen the continuation and deepening of the difficulties affecting a number of eurozone countries, and concerns persist about institutions based in these countries, whether or not they are guaranteed by their own governments. The only one of these countries where the Group has a direct exposure 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.

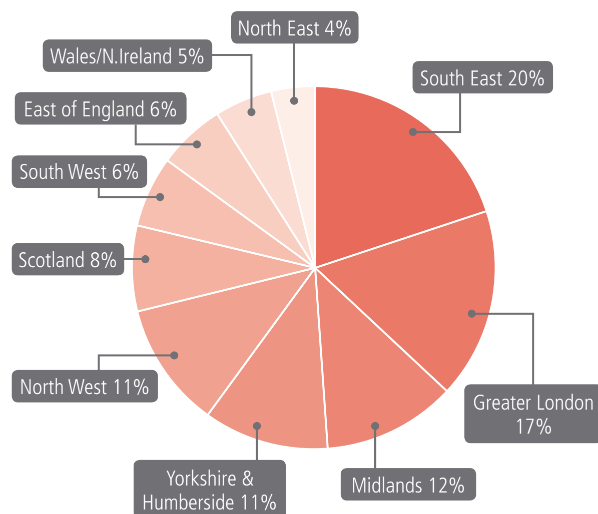
Taking these in turn:

- 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.

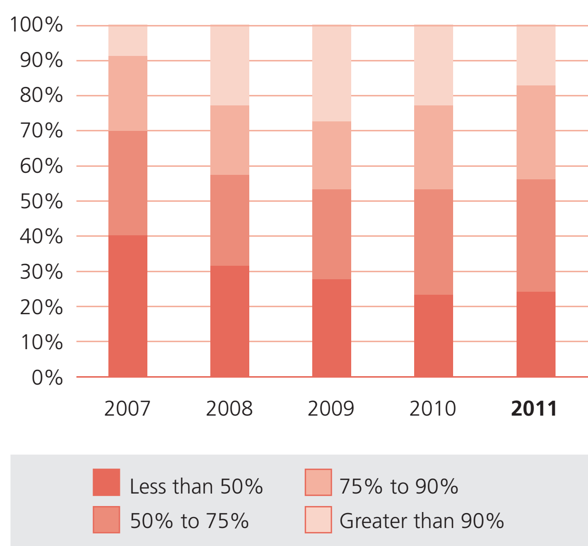
GEOGRAPHIC DISTRIBUTION

	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

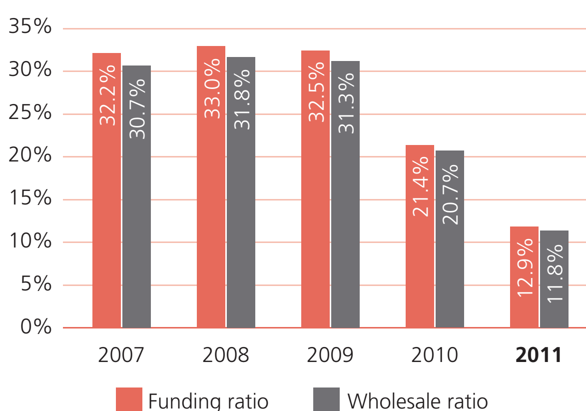
Key Performance Indicator explanation: The Board monitors the Group's relative reliance on wholesale versus retail funding through two measures:

- 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%).

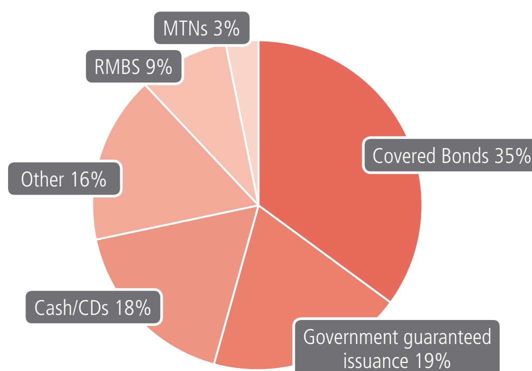
Key Performance Indicator explanation:
The Board monitors the Group's retail savings performance by tracking its net retail inflow in absolute terms, being the net amount by which its retail savings balances grow in any period. Any portfolio of retail savings products will, at any point in time, have 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:

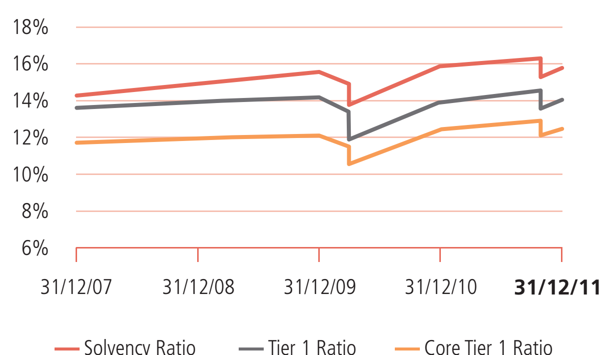
- Core Tier 1 ratio – core tier 1 capital represents the very strongest form of capital for any financial institution, and for the Group is essentially its accumulated profits built up over time. The ratio compares this to its assets weighted according to how much risk they carry - all financial institutions, 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

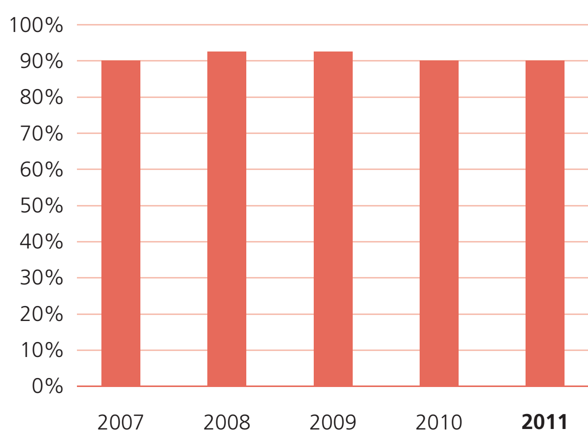
In addition to financial indicators, the Board monitors a range of measures designed to reflect how well the Group is meeting our members' and other customers' needs for high-quality products and services.

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.

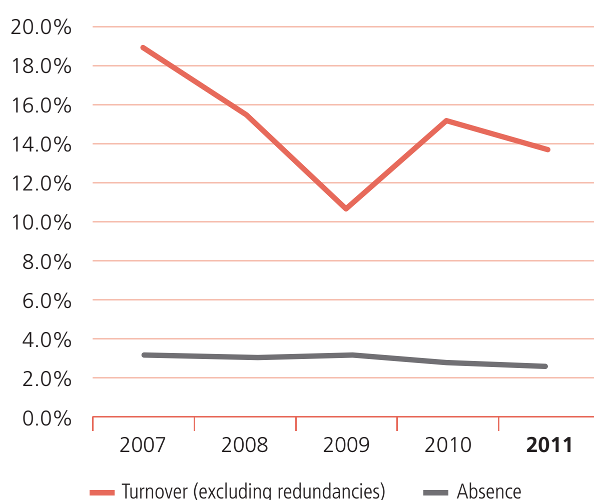
Key Performance Indicator explanation: The Group looks at two staff metrics on a monthly basis, as well as undertaking periodic detailed staff surveys:

- 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
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