Report & Accounts 2013

Yorkshire
BUILDING SOCIETY

Contents

Looking ahead to a brighter future

Our Chairman, Ed Anderson, reports another successful year as the economic upturn becomes more established

I'm delighted that during 2013 we continued to build on our success of recent years. The Group's financial performance has remained very strong, achieving excellent levels of profit while maintaining solid levels of capital and liquidity.

We are one of the UK's strongest financial institutions, because of our management approach. With trust in financial services organisations remaining low we continue to stand out amongst the crowd, because we are different, because we have customers at our heart and because we have no need to chase short-term profits or undertake risky financial activities.

We will continue to balance delivering value and service to our members with maintaining our financial strength for the long term. We view 2013 as having been another year of successful delivery.

Is the UK economy finally turning a corner?

Forecasts are more optimistic and business confidence is growing

Our lending activity has increased - whether it's residential lending to home owners, buy to let, social housing or secured lending to small and medium-sized businesses. Through safe and responsible lending, business has grown across our Yorkshire, Chelsea and Norwich & Peterborough building society brands and Accord Mortgages, our intermediary lending subsidiary.

This is despite the continued economic uncertainty that prevailed for most of 2013. As we move into 2014, there is growing evidence that the UK economy is now taking a more convincing path towards recovery. Both commentators and independent forecasters are increasingly optimistic, and business confidence is now above pre-crisis levels.

All this means that we're well placed to grow our business further. We are aware that there are still risks to the UK economy and so it makes sense for us to approach 2014 confidently but carefully.

How are things looking for savers?

Low rates are likely to be with us for some time to come

Savers continue to face low interest rates and may do so for some time. Rates are driven by the record-low Bank of England Bank Rate and the effects of the Government's Funding for Lending Scheme. Mark Carney, the new Governor of the Bank of England ('the Bank'), has indicated that the Bank Rate will not be increased until the UK recovery is well established.

Against this background, we will continue to seek to protect savers from the worst effects of low rates as far as we sensibly can.

How are you protecting savers and ensuring pricing that's sustainable in the long term?

We remain focused on delivering long-term value

We're always exploring ways to offer excellent rates through competitive products for both new and existing customers. At the same time we have to be careful not to overprice our savings products and be flooded with more money than we're able to sensibly lend to our borrowers.

As a responsible mutual building society, answerable to our members and not to external shareholders, we see simple, easy-to-understand products as key to our long-term vision.

What's the picture for home owners?

As demand picks up, we remain committed to responsible lending

2013 saw people's incomes further stretched by the rise in living costs. Inflation has been running at around 2.5% for most of 2013, but earnings have grown at less than 1%[1]. As a responsible lender, we need to make sure our borrowers can afford their mortgages not just now, but also in the future.

Assisted by improved consumer confidence, record-low interest rates and the Government's Help to Buy scheme, the mortgage market revival continues. The Bank's data[2] confirms that mortgage rates continued to fall in 2013, while demand for mortgages, and their availability increased. As the market re-energises we will maintain our focus on lending affordably and sustainably for us and our borrowers.

How are you regulated?

Two new bodies have changed the regulation landscape

In April 2013, our regulation by the Financial Services Authority (FSA) was replaced by supervision through two new bodies. At a high level, the Prudential Regulation Authority (PRA) now assesses our financial strength, while the Financial Conduct Authority (FCA) monitors how we ensure fair outcomes for our customers.

The Group achieved 3,184[3] Mortgage Best Buy mentions in 2013 – a 30% increase from 2012

During 2013, in addition to its day-to-day supervision, the PRA reviewed the Yorkshire Building Society Group in two areas. Firstly, it conducted formal 'stress tests' of our capital position to test the Board's view that it has sufficient capital. Secondly, it held a meeting with the Board to assess its effectiveness.

The FCA reviewed key areas of our business, looking at our conduct risk controls i.e. those designed to ensure that we deliver fair customer outcomes. As a Group, we've always made the way we treat customers a top priority, but we will work on continually strengthening our controls to both deliver and monitor this commitment.

How are you managing conduct risk?

Our risk framework encompasses all aspects of the Group

Our obligation is to make sure that our conduct risk framework is effective right across the Group, so that we consistently deliver fair customer outcomes.

It has become clear that some of the Group's processes and systems were not providing sufficiently robust assurance that fair outcomes were always being delivered to customers. In other words, we could not always be sure that we were delivering on our commitment. This was particularly the case in our arrears collection operation where it was felt that a lack of robustness in some processes could lead to the unnecessary charging of administration fees to some customers.

We are working to put this right in our arrears management through a programme of reimbursing previously charged administration fees and re-designing our arrears management systems and processes.

During the year we also withdrew our Protected Capital Account from sale, as a result of concerns raised by the FCA about an element of the product literature. We continue to discuss this with the FCA to ensure that fair outcomes for customers are achieved.

At the same time, we very quickly sought advice from an expert external firm to review all areas of the business and identify those where detailed reviews and changes might be needed in order to ensure that fair outcomes for customers are delivered consistently. We're now acting on that advice across a range of areas including investing in an ongoing assurance programme to ensure we maintain the high standards we have set ourselves.

How is the Group responding to regulatory changes?

We closely monitor the impact of new regulation

The Retail Distribution Review (RDR) conducted by the FSA looked at how to raise professional standards for the provision of financial advice, providing better clarity between the different types of service available and making the cost of advice clearer to customers. The resulting regulations were introduced in January 2013 and a number of providers of financial advice have since withdrawn from the high

[1] Source: Office for National Statistics - Consumer Price Inflation and Average Weekly Earnings
[2] Source: Bank of England 'Trends in Lending' January 2014
[3] Source: Presswatch Financial from Kantar Media

As a Group, we've always made the way we treat customers our top priority, but will continue to strengthen our controls to deliver and monitor this commitment

street. Many other providers are now restricting their advice to more affluent customers and reducing the number of advisers they employ. We are proud to say we continue to be committed to offering financial advice to all our customers, through our relationship with Legal & General.

April 2014 sees new Mortgage Market Review (MMR) regulations coming into force. These new regulations are designed to ensure responsible lending to new and existing borrowers. We believe that we are well placed for their introduction. For example, our branches already provide mortgage information to new and existing borrowers on an 'advised' basis through our qualified mortgage advisers – a requirement of the new regulations.

We keep a constant watch on economic and regulatory developments. As we enter 2014, we will continue to monitor the impact of MMR changes, the EU's mortgage credit directive, and the upcoming FCA review of cash savings accounts.

What were the Board's priorities in 2013?

Our main focus during the year was on:

- **Ensuring capital and liquidity ratios remain efficient**
  We have maintained capital and liquidity at levels above those that would be required in adverse conditions.
- **Managing our funding in a sustainable way**
  We have taken advantage of the Government's Funding for Lending Scheme but continue to draw the majority of our funding from members' savings.
- **Continuing to grow the business through new lending**
  Balancing borrowers' needs with our commitment to lend safely and responsibly at all times.
- **Closely managing our arrears position**
  Arrears remain well below the industry average[4], nevertheless we continue to focus on helping borrowers who are experiencing payment difficulties.
- **Effective management of conduct risks**
  Ensuring fair customer outcomes through an effective conduct risk framework right across the Group.
- **Ensuring the Group is set up to deliver our strategy and operate more effectively**
  Our new customer-focused organisational structure means we're better placed to deliver our strategy.
- **Staying close to what members need**
  We do this in various ways, including regular surveys, member Q&A sessions across the UK and branch visits. We are currently reviewing our member engagement activities, looking for new ways to make it easy for customers to tell us what they think.

How is the Board governed?

Our experienced, capable team meets the highest standards

The Board is composed of executive directors and non-executive directors who possess skills and experience at the highest level across different specialisms and industries. This means we can ably adapt to the Group's changing business needs. The Board works to ensure that the Group adopts high standards of corporate governance in line with relevant codes and regulations.

As well as their wide-ranging experience it's also vital that the Board has specialist knowledge of the financial services industry. The current members of the Board have a combined experience of around 220 years within the industry – an average of over 18 years per director.

The Corporate Governance Report on page 31 further explains the Board's principal role, composition, diversity, performance evaluation, induction and development.

[4] Source: Council of Mortgage Lenders as at December 2013

How does the Board set strategy and monitor performance?

Regular meetings and reviews ensure we are making progress against our plans

The Board holds regular monthly meetings, including two dedicated strategy sessions during the year. It works closely with the Executive Team to set, monitor and review a strategy that is appropriate for the Group and for changing market conditions.

At the same time, the Board makes sure the Group is following the agreed Corporate Plan, which sets out our strategy for the next five years. You can read more about the Plan in the Strategic Report on page 8. To do this, every month the Board reviews a Management Information pack setting out target Key Performance Indicators and the current performance against these. In particular, this enables the non-executive directors to monitor and challenge the Executive Team's performance throughout the year. You can see more detail on these measures and our performance against them in the Strategic Report.

How has the Board changed during the year?

We have strengthened your Board with new members

Guy Parsons and **Mark Pain** were appointed as non-executive directors on 1st May and 1st August 2013 respectively, bringing with them valuable experience and fresh insights. Both will be put forward for election by members at the 2014 AGM. You can learn more about what each director brings on pages 24 to 27.

> As a credible and successful building society, we continue to demonstrate we're a genuine alternative to banks

Mike Regnier has recently been appointed to the new role of Chief Commercial Officer and Executive Director to lead the Group's commercial activities, including product development and marketing. He is expected to take up his position in the spring.

Roger Burden retired after three years on the Board as a non-executive director on 17th April 2013. We thank him for his commitment and excellent contribution.

It is with great sadness that I have to report the death of Mark Jenkins, General Manager for Commercial Services, following his long battle with cancer. Mark's significant contribution to the Executive Team has helped transform our business and he will be greatly missed by all. In his memory, the money we donate from each AGM vote will be shared between the two charities that Mark supported, Macmillan Cancer Support and Guide Dogs for the Blind Association.

It's our people that make the difference

A big thank you to our team

The Group's workforce now stands at 4,333 people across our national branch network and office sites in Bradford, Cheltenham, Leeds and Peterborough.

On behalf of the Board, I wish to thank the entire team for again delivering excellent service to all our customers in 2013. It is thanks to their hard work that the Group has performed so well.

Further building trust as we celebrate 150 years

As an established building society, the interests of our members will always come first

Trust in the financial services sector as a whole continues to be low. As a building society we are owned by our members and everything we do is aimed at building on the trust you place in us to act in your long-term interests.

150 years on from the original foundations of the Yorkshire, we continue to believe in helping people have better lives. We will work hard to fulfil our vision 'to be the most trusted provider of financial services in the UK'. We will do this by providing excellent service to you, our members; earning and keeping your trust – and proving that we're different to the big banks. Our outstanding team, and our financial strength and sustainability equip us ably to do this and to face any uncertainties that lie ahead.

Ed Anderson
Chairman

25th February 2014

Delivering our vision for the future

I am delighted to introduce the Group's Strategic Report which provides a comprehensive review of our strategy and of how we have performed in 2013.

2013 has been a year of change. Changes to the way that all financial services are scrutinised and regulated; changes to our own Group structure and, for many of our people, changes to both working environments and ways of working. What has remained constant during the year is everyone's personal passion to keep customers at our heart, and our determination to build trust at every turn.

We have continued to deliver during 2013 – in our growing core businesses and our drive to continually deliver value to our customers; and in our investment and change programme which will safeguard the Group's future.

Within this Report we have set out:	Find out more on page...
Our vision is 'to be the most trusted provider of financial services in the UK'	8
We will deliver the vision through five areas of strategic priority	8
Our values drive the behaviours of our people	8
To help translate our strategy and business model into reality we have reviewed the operating model	10
In 2013 we commenced our ambitious and wide ranging investment programme	10
We measure progress towards our strategy using a comprehensive set of key performance measures	10
In 2013 we continue to deliver an award winning customer experience	13
In 2013 we laid the foundations for our transformation agenda to make things easier and simpler	15
We strive to attract and retain the best talent with a leading people experience	15
We have maintained the financial strength and sustainability of the business	17
The principal risks and uncertainties of the Group are considered in a number of categories	21

150 YEARS BUILDING TRUST

In 2014 we celebrate our 150th anniversary – with many of our brands approaching or having turned 150 years old. While things may have been very different back in 1864, the principles of helping people to achieve financial security and the dream of home ownership, are exactly the same. The fact that we're now a modern mutual, one that's been around for 150 years, and hopefully will be around for 150 years to come, is down to the hard work, passion and commitment of our people, and I would like to take this opportunity to thank them all.

Chris Pilling
Chief Executive

25th February 2014

Our strategic framework

As set out in the Group's Corporate Plan 2014-2018, our vision is "to be the most trusted provider of financial services in the UK". We aim to deliver this vision through remaining committed to our 150 year old mutual heritage and what that means today; as a mutual we are owned by our members and our fundamental purpose remains to provide a secure place for our members to save and to support as many people as possible in buying their own homes.

We aim to provide value to our members by optimising rather than maximising profits. This means that we look to price our products so that they deliver long-term value to our members and, by being attractive to them, achieve growth for the Group. At the same time products must generate sufficient profits to maintain the Group's strong capital position since retained profits are our primary source of capital. This is not always an easy balance to achieve safely in a dynamic market. To do so we believe we must deliver on our five strategic priorities:

- To deliver a market leading **customer experience** built on empathy, simplicity and trust.
- To deliver products, processes and systems for all our channels and brands that are **easy and simple** to use.
- To attract and retain the best talent, with a leading **people experience** built on our cultural foundation of mutual trust.
- To deliver **sustainable financial performance** that ensures real financial security for our customers, within our risk appetite.
- To be **locally famous** and meaningfully engaged in our communities.

At the start of 2013 all our people were involved in devising and selecting the Group's new values, building on our existing values, and reflecting both our strategic priorities and the type of organisation they wish to work for. These were introduced early in 2013 and are:

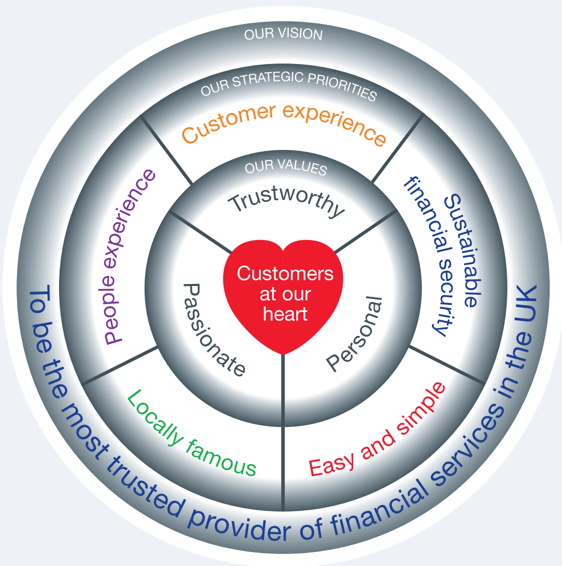
Customers at our heart
A simple but powerful principle that guides everything we do and, more importantly, one that encapsulates how we already looked to behave as an organisation.

As part of this principle, we will aim to:

Be trustworthy
Keeping our promises so customers can count on us when it counts most.

Keep it personal
Putting people first with humanity, decency, warmth and care.

Be passionate
Loving what we do today and sharing our ideas to make things better for tomorrow.



Our Vision, Strategic Priorities and Values together form our 'Circle of Trust'

Our business model

The Group's business model comprises a number of business units each of which fulfils a distinct purpose aligned to the overall Group's strategy. The units can be divided into four areas for the purpose of segmental reporting (Note 12 on page 102):

- **Primary retail business**
- **Primary non-retail business**
- **Secondary business**
- **Central functions**

The primary businesses represent the core focus of the Group in terms of customers, resources, people, leadership and management time.

These can be seen in the table opposite:

Retail Business	Strategic Purpose
Retail Funding	To provide a trusted home for members' savings.
Direct Prime Lending	To provide residential mortgages through all our high street branches and the internet.
Intermediary Prime Lending	To provide residential mortgages through trusted brokers via our Accord subsidiary.
Buy to Let Lending	To provide buy to let mortgages through trusted brokers via our Accord subsidiary.
Current Accounts	To provide a current account facility, through our Norwich and Peterborough Building Society brand (N&P).
Investments	To provide a cost effective and multi-faceted long-term financial advice service through Legal & General.
General Insurance and Protection products	To provide essential protection products to the widest range of customers through Royal Sun Alliance.
Share Plans	To provide a high quality savings service to Share Plans customers and in doing so to source stable, long-term retail funds for the Group.

Non-retail Business	Strategic Purpose
Commercial Lending	To provide mortgages to commercial customers.
Social Housing	To provide finance to housing associations and registered social landlords, consistent with the Group's purpose of assisting people's housing needs.

Between these different areas we offer, directly or through trusted partners, the following products and services (shown opposite):

Directly

Via trusted partners

Lending	Savings & Investments	Other
Residential Mortgages	Savings	Protection products
Social Housing Lending	Investments	Home Insurance
Commercial Mortgages	Current Account	Life Insurance
Buy to Let	Share Plans	Car Insurance
	Sharedealing	Credit Cards

We also have a range of businesses and loan portfolios (our secondary businesses) that do not naturally sit within the core business areas of the Group. Many arose out of our recent merger activity. These are currently in run-off or are being actively managed down. For example, as part of this process we have now sold the equity release mortgage book we inherited on the merger with the Chelsea Building Society in 2010.

All these businesses are supported by central functions, which includes the Treasury function. Our Treasury team play a key enabling role, allowing the business to function on a day-to-day basis by managing the cash-flows of the Group, as well as providing wholesale funding and management of liquidity and issued capital.

To translate our strategy and business models into operational reality, during 2013 we also looked at our Target Operating Model (the 'Model'). The objective of the Model is to create and strengthen the foundation for delivery of our strategic priorities. Its creation has driven an organisation-wide restructure which will allow the Group to work more effectively for our customers.

Within the Model similar activities across the organisation have been consolidated for efficiency. There are three groups of functions:

- **Business delivery functions** – these functions are the customer facing drivers of business.
- **Business direction functions** – these functions set the direction for the business.
- **Business enabling functions** – these functions are facilitators of the business.

The Model aligns all these constituent parts to our business strategy and will help deliver our business goals and optimise performance.

In addition, we have adopted a new title of 'Chief Officers' for the Executive Team roles. In addition to the Chief Executive position, three of the incumbent Chief Officers are also executive directors and will sit on the main Board of the Group, attending Board meetings and relevant governance committees. More information on all of the Chief Officers can be found on pages 26 to 27.

Investment programme

2013 saw the Group commence its ambitious and wide-ranging investment programme, through which we are investing heavily in our systems, networks, people and products, all aimed at further enhancing our service and product delivery. At the same time an overriding priority for the Group is doing the right thing for our customers to protect our Group's Trust vision. Therefore, key regulatory projects form part of the investment programme.

There are four main elements to the investment programme:

- **Re-engineering** – Establishing substantially more efficient, effective and cohesive processes and systems enabling the Group to deliver a customer experience which is simpler and easier, and to operate and grow at lower cost.
- **Web and Mobile** – Developing the Group's internet and mobile channel capabilities and delivering improvements to security, customer experience and commercial performance. This includes the introduction of appointment booking across all channels and enhanced web-chat capabilities.
- **Insight** – Enhancing our management information systems and processes to facilitate more efficient and effective decision making across the Group, including enhancements to our capital management processes.
- **Branch, Property and Brand** – A number of initiatives that will deliver across all of our branches, brands and other properties to enhance the customer experience and improve environments for our customers and our people.

The overall cost (before any benefits) of the programme is around £273m over the next five years, and we firmly believe that it is in the interests of our customers to move the Group forward in this way. Some projects deliver a direct financial benefit, whilst others represent an investment in our infrastructure with less direct benefit. Overall the programme is projected to deliver a positive financial return as well as enhancing what we deliver to our customers.

Key Performance Indicators (KPIs)

We measure progress towards our strategy and against shorter term plans using a set of performance indicators that are reported to the Board monthly. The following indicators are key to the Board's monitoring of the Group's performance and to its decision making. More information on our performance against these measures follows on pages 13 to 21.

Brand Perception/ Customer Experience

The Board looks at a range of customer metrics of which the **Net Promoter Score®** (NPS) is key. This shows the percentage of our customers who are strongly prepared to recommend our products and services to others less the proportion who are not prepared to do so. Crucially, it excludes those who are neutral towards us.

A range of complaints data is monitored including the number and type received, the speed with which they are resolved and the proportion that are accepted or rejected. A key measure derives from those complaints referred by the customer to the Financial Ombudsman Service (FOS) and how many of those are found in our or the customer's favour. The **FOS overturn rate** measures the proportion of referrals where the FOS disagrees with our original treatment of the complaint, providing an indication of our complaint handling fairness and effectiveness.

Operational Effectiveness

The Group maintains a wide range of operational management information that measures our performance against pre-set targets. These measures, which are set for our different operational units, include, for example, how quickly we answer telephone calls, how many are abandoned because we fail to answer quickly enough, how long it takes us to respond to a customer's query, how long it takes to process a mortgage application and how quickly our internet pages are loading. There are many more. We are clear that we cannot get everything right 100% of the time and so we set target performance levels. For example we aim to answer a set percentage of telephone calls within a target time.

Measures are aggregated for individual business areas, and then further aggregated for an overall Group view. These aggregated views are assessed on a "Red, Amber, Green" basis. Red means there are potentially high impact issues or issues for which there is no clear and immediate resolution, amber is highlighting issues, or potential issues, for which actions to resolve are being taken, and green indicates the absence of any such issues.

Corporate Social Responsibility (CSR)

The management of CSR activity, including the relevant KPIs used, is covered within the separate CSR report on pages 22 to 23.

People Experience

Colleague Engagement – We have introduced a new approach to our colleague survey in 2013 enabling a more robust comparison with the external market. We measure three areas of Say (advocacy), Stay (commitment) and Strive (discretionary effort) which combine to form an overall **Employee Engagement Index** that is directly comparable to other organisations.

People Capability – We measure our ability to meet the requirements of the organisation for people and skills by looking at our latest headcount position against forecast, and at our **internal hire ratio** (which indicates our success in attracting, retaining and developing the right calibre people).

Colleague Turnover and absenteeism – We measure the number of people voluntarily leaving the business through resignation, and also turnover in our higher and lower performers. This is to ensure we are retaining valued performers and effectively managing lower performers. Absenteeism 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.

Trading Performance

Profit before tax – Using statutory profit, this is the most commonly used comparative definition of profit, and is a key contributor to our capital.

Core Operating Profit – Statutory profit includes a number of items that the Board believes do not reflect longer-term, sustainable business performance because they are, for example, one-off in nature or are timing differences that reverse over time. The Board therefore uses core operating profit, which excludes these items, to assess the underlying Group financial performance.

A reconciliation between statutory profit before tax and core operating profit is provided on page 17.

Net Interest Margin – Net interest margin expresses net interest income as a percentage of mean assets and reflects how effectively an institution manages the income from its assets and the interest paid for its funding. The majority of our assets and liabilities are in the form of mortgage loans to, and savings deposited by, our customers. The Board's policy is to optimise rather than maximise net interest margin since the interest rates are our key mechanism for delivering value to our members.

Cost:Income Ratio – This ratio looks at the relationship between income generation and our costs. The lower the ratio the less an institution is spending to generate every one pound of income. 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 Board regards the long-term trend as important, as the ratio will be higher in individual years where an organisation is investing for the future as the Group is currently doing. In addition we would not seek to minimise costs at the expense of delivering an exceptional customer experience.

Net Lending – The Board monitors the Group's mortgage lending performance in a number of ways. A key measure is net lending (gross advances less repayments of principal), which covers all portfolios and channels, and measures our effectiveness in both new mortgage lending and in retaining borrowers. It provides an indication of how well we are performing, both in terms of offering the type of competitive mortgage products that our customers want and in meeting our growth aspirations.

Retail flows – The Board monitors the Group's retail savings performance by tracking the net amount by which retail savings balances grow in any period – the "net retail inflow". 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 reduce product rates to de minimis levels once the introductory period has passed. 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.

Arrears – The Board monitors the Group's arrears performance using a range of measures because current arrears and the underlying trend indicate how well borrowers are coping with current economic conditions and therefore how exposed the Group may be to defaults and hence future loan losses. A range of arrears measures are used because they each provide a slightly different perspective on current and prospective conditions. The key measure used by the Board to monitor our performance is the percentage of outstanding mortgage balances (including repossessions) in arrears by three months or more.

Change/Project Delivery

The Board reviews a range of measures that look at:

Project delivery – how well are our portfolio of projects being delivered in terms of scope, timing, cost and benefits?

Project capability – are we satisfied that we can continue to deliver the level of change we have planned, or are signs of stress showing?

Portfolio volatility – is our portfolio of projects stable, or are we adding/cancelling projects in such a way as to suggest a lack of control?

Change capacity – do we have the resources to deliver our portfolio and how much pent up demand exists that is yet to be delivered?

These measures are aggregated and assessed on a "Red, Amber, Green" basis (explained under Operational Effectiveness on page 11).

Sustainability

Sustainability KPIs measure the ongoing strength of the Group. In addition to trading performance metrics, such as profit before tax, sustainability measures include:

Liquidity Ratio – One of the key measures that we are required to report to the Prudential Regulation Authority (PRA) is the liquidity ratio. This expresses the total cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets as a percentage of our shares and borrowings. It is inefficient to hold significantly more liquidity than is needed as excess liquidity earns less than it costs to raise. Therefore the Board focuses on whether we have (or have access to) sufficient liquidity rather than on maximising the absolute liquidity levels.

As the liquidity ratio measures actual holdings (as distinct from liquidity available through, for example, the Funding for Lending Scheme (FLS)), the Board monitors the Group's liquidity position in a number of ways. This includes regularly running potential stress scenarios against our current balance sheet to test that adequate liquidity is in place, and by monitoring the make-up of our funding and liquidity portfolios.

Core Tier 1 Capital Ratio – Core tier 1 capital represents the very strongest form of capital for any financial institution, and for the Group it is essentially our accumulated profits built up over time. The ratio compares this to the Group's assets, weighted according to how much risk they carry, as all financial institutions, by their very nature, take some degree of risk in investing their assets, but differing assets carry differing degrees of risk.

Risk Appetite

The Group monitors its risk positions in a wide range of ways in both absolute terms and, as described in the Risk Management Report on page 45, against a Risk Appetite set annually by the Group Risk Committee. At a Group KPI level, this range of measures is reviewed by the Group Risk function, and separately in our front-line delivery functions, and overall ratings reported for Prudential and Conduct risk. These aggregated views are assessed on a "Red, Amber, Green" basis (explained under Operational Effectiveness on page 11).

Review of 2013

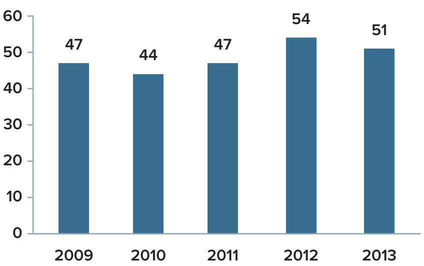
Award Winning Customer Experience

It has been another tough year for savers, with rates falling further (partly as a consequence of the Government's Funding for Lending scheme) and the record-low Bank of England Bank Rate which looks set to continue for some time to come. Against this background our savings rates have remained competitive. For example, at October 2013 the overall average interest rate on our savings products was 2.00%, compared to the rest of the market[1] at 1.72%. In particular the Yorkshire Building Society (YBS) Regular Saver account remains popular and in 2013 we have seen over 22,000 new accounts opened – this is almost three times more than the same period last year. Across all our brands our range of savings products has received 1,232 Best Buy mentions[2] throughout 2013.

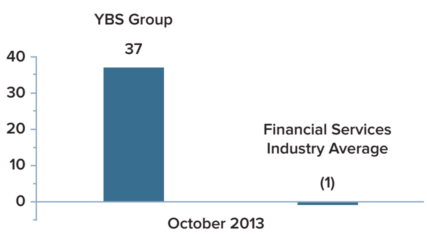
As the housing market starts to recover we have seen record levels of mortgage completions. We chose not to participate in the Government's Help to Buy scheme but instead confirmed our commitment to first time buyers by reintroducing 5% deposit mortgages. The Yorkshire launched the lowest five year fixed rate ever[3] and received 3,184 Best Buy mentions[2] across our brands. All of this led to gross lending for the year of £6.8bn.

We are proud to consistently receive positive **Net Promoter Scores®** (NPS) across all our high street brands. We have reported our Brand NPS for several years. This is generated from a postal survey sent to around 6,500 customers who have a relationship with one of our brands, but it does not include our Barnsley customers or customers with an online relationship. The Group average for the Brand NPS fell slightly in 2013 largely due to the savings rate cuts we had to make during the year; however at 51% it remains extremely strong. We also report an Experience NPS, which is a monthly, independently conducted survey of customers from across the whole Group who have transacted with us in the previous month. With an annual sample size of around 30,000 customers, this provides a robust, real-time measure of our customers' experience and at 37% is well ahead of the industry average of -1%[4].

% Brand Net Promoter Score



% Experience Net Promoter Score



During 2013 our **Operational Effectiveness KPIs** were rated green at a Group level. Clearly, within this there were a number of individual measures that were graded as amber at times, and some red rated issues. However, at an overall level we were satisfied with our operational performance, and with how we managed and resolved issues identified by red and amber KPIs.

We are investing heavily in our web and mobile offering and have already delivered significant improvements to our website processes, making it easier than ever for our customers to search and apply for products. We have also launched a new mobile and tablet-friendly version of our website which includes an improved Yorkshire Building Society branch finder helping our customers locate us on the move.

This investment does not detract from our commitment to our branch network. Whilst some other high street banks and building societies continue to close branches we have opened three new YBS branches at Ripon, Wetherby and Yeadon, as well as successfully delivering a refurbished concept branch in Harrogate, the design of which was based on customer feedback. We have also expanded our wider network, opening eight new agencies across the country.

Despite many banks choosing to withdraw from the high-street financial advice market, the Group remains committed to offering both new and existing customers access to a fully qualified financial consultant through its relationship with Legal & General. By creating a personalised financial plan and an enduring relationship, we will continue to support our members to achieve their long-term financial goals.

[1] Source: Average rates based on Savings stock from CACI's Current Account and Savings Database (CSDB), currently covering 86% of the retail savings market. Data as at the last working day of October 2013.

[2] Source: Presswatch Financial from Kantar Media.

[3] Source: Moneyfacts March 2013.

[4] Source: Nunwood Customer Excellence 2013 rankings – a national survey of 7,500 UK consumers conducted in October 2013.

We introduced changes to the branch staff reward scheme and the branch retail behavioural framework principally to remove incentives linked to sales targets. These changes will continue to ensure we build trust with our customers by more clearly helping them make an informed choice confidently for themselves.

As in previous years we continue to be proud of the number of industry awards for which we are nominated. In the current environment it is particularly pleasing that Yorkshire Building Society was awarded **Most Trusted Financial Provider at the Moneywise Awards 2013** – a fantastic achievement that is absolutely in line with our vision **'to be the most trusted provider of financial services in the UK'**. With almost 20,000 people voting this is by far the largest customer service survey about financial services providers carried out in the UK. Other awards and accolades received by the Group in 2013 include:

- **UK's Best Building Society** (Personal Finance Awards)
- **Most Trusted Savings Provider** (Moneywise Customer Service Awards 2013)
- **Best Lender for Fixed Rate Mortgages** (Moneywise Mortgage Awards 2013)
- **Best Short Term Fixed Rate Mortgage Provider** (Moneyfacts Awards 2013)
- **Best Building Society Mortgage Provider** (Moneyfacts Awards 2013)
- **Best High Street Savings Provider 2013** (Consumer Moneyfacts 2013)
- **Winner of Lenders' Customer Service/Treating Customers Fairly category** (Mortgage Finance Gazette)
- **Winner of Best Overall Mortgage Provider** (Moneynet Awards 2013)
- **Winner of Best Offset Mortgage Provider** (Moneynet Awards 2013)
- **Winner of Best Debit Card for Use Abroad** (Moneynet Awards 2013)
- **Winner of Best National Building Society** (What Mortgage Awards)
- **Winner of Large Lenders Community Services prize** (Mortgage Finance Gazette)
- **Winner of Customer Service/ TCF – Lenders** (Mortgage Finance Gazette Awards)

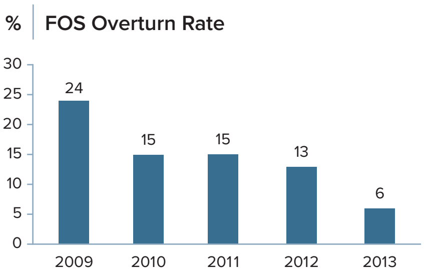
While celebrating these successes we are aware that we don't always get it right for our customers. It has become clear that a number of the Group's processes and systems were not always providing sufficiently robust assurance that fair outcomes were always being delivered to customers. This became especially clear in our arrears collection operation where it was felt that a lack of robustness in some processes could lead to the unnecessary charging of administration fees. In addition to working to put that right through both reimbursing fees and re-designing our systems and processes, the Group acted very quickly and sought advice from an expert external firm to identify areas where detailed reviews and changes might be needed. That advice is being acted upon within our investment programme whilst an ongoing assurance programme will ensure that the new higher standards are maintained. This investment is evidence of how important the delivery of fair outcomes and maintenance of trust is, and will always remain, to the Group.

Similarly, we have withdrawn our Protected Capital Account from sale. This product, which has historically been offered through Credit Suisse, provided the opportunity for customers to invest in a product with returns linked to the performance of the FTSE but protected from any capital losses. The withdrawal arose from a review that was deemed necessary as a result of a concern raised by the FCA about an element of the product literature. We are continuing to work through this issue with the FCA.

Complaints provide a crucial moment when we can restore and strengthen our customers' trust in the Group. Put simply we can look to put things right where we have got them wrong and learn how to improve what we do for the future. In line with best practice, we have enhanced our complaints process to include all instances where a customer displays any form of dissatisfaction – even if it is resolved immediately or where the customer does not explicitly lodge a complaint. While this has increased the number of general complaints logged this year by 43%, it provides us with the opportunity to learn and therefore improve the customer experience. Our handling and resolution of complaints continues, we believe, to be excellent.

The best guide to this is when cases are referred to the Financial Ombudsman Service (FOS) because the customer is not happy with our decision. Of the complaints that were handled by the FOS in the first half of 2013 only 6% were upheld in the customers' favour compared to the industry average uphold rate of 64%[5]. In other words FOS believed we got it right 94% of the time. Unfortunately regardless of whether the complaint is upheld or not there is a cost to the Group of at least £550 per case. In 2013 we had to pay a total of £1.7m in fees to the FOS.

[5] Source: Financial Ombudsman Service complaints data 1 January - 30 June 2013 resolved cases.



We pro-actively seek our members' feedback through regular surveys sent to our Member Panel who provide input into products and services. During 2013 we also ran several Member Question Time events where members of the Board and senior leadership team went to York, Norwich and Poole to listen to what matters to our members.

Making It Easy and Simple

2013 saw us laying the foundations of our transformation agenda, and we focused on the development of our people to ensure they have the required skills and competencies to drive the change agenda, as well as bringing on board external expertise where required. We started to streamline our organisational structure, identifying efficiencies and improving processes to ensure we make things easy and simple for our people, and ultimately our customers.

A major success for 2013 was the completion of the first stage of a major upgrade to our arrears management system which allows us to provide greater assistance and information to borrowers who find themselves in financial difficulties. This will be followed by a second phase in 2014.

Following the merger with N&P in 2012, further work has been done on consolidating systems. Full integration is not yet complete and this will require further work in 2014 and beyond to ensure that we deliver it alongside the transformation programme.

In addition major progress has been made on a range of projects including:

- Delivering changes required to comply with Mortgage Market Review (MMR) regulations
- Building a new data warehouse to enhance our management information processes
- Replacing our old margin and cost management systems and upgrading our capital management models
- Significantly investing in our web and mobile capabilities
- Re-engineering our complaints handling processes and systems
- Re-designing our multiple core mortgage and savings systems to operate on a single platform.

In 2014 we will be focussing on a range of projects including:

- Completing our MMR compliance investment, and investment in our wider compliance and conduct processes
- Continuing our investment in capital, margin, cost and management information systems
- Re-engineering our mortgage processes and systems across the Group
- Migrating our portfolios onto a new single multi brand platform
- Undertaking material investment in our Share Plan businesses
- Continuing our refurbishment of our Bradford office and of branches across the network.

During 2013 our Project KPIs showed a range of gradings as we progressed through the process of reviewing, re-prioritising and re-phasing the overall portfolio, and managing the need to address new issues that arose during the year e.g. new regulatory requirements. This is to be expected, especially when we are undertaking so much. A number of individual projects were viewed at times as being red (as defined under Operational Effectiveness on page 11) but our processes fulfilled their role since these warnings led us to re-plan and to successfully deliver the projects as required.

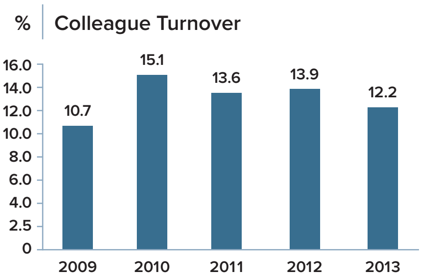
A full review of priorities and the costs and benefits associated with each project has taken place and has been approved by the Board. We believe the level of investment is right for the Group and will deliver sustainable benefits for our people and our customers.

A Leading People Experience

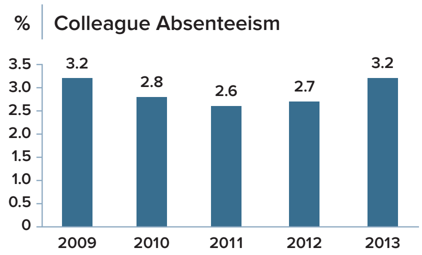
We strive to attract and retain the best talent with a leading people experience. This is important because, quite simply, without great people who enjoy what they do we cannot hope to deliver an outstanding experience for our customers. As we grow and expand the business, having a clear focus on our people is vital and this year we have further developed and revised our People Strategy.

In 2013 the total number of people employed increased by 222 with the increase being needed to support the Group's transformation agenda and to run our new branches. As well as recruiting externally to bring in fresh perspectives and new talent to the organisation we are continually developing our people and we have an **internal hire ratio** of 35% across all our roles.

Of course, people have also left us throughout the year and the Group's annual **turnover rate** is 12% excluding redundancies. The Board regards this as an acceptable level, as a much higher number might indicate underlying people issues and too low a number might suggest an element of stagnation.



2013 saw the overall Group sickness **absence rate** increase to 3.2%, from 2.7% in 2012. This increase is neither unexpected (given the level of change taking place across the Group) nor is it out of line with external market trends (with increased absence levels reported[6] across the private sector).



The growth in colleague numbers has led to the need for larger premises. Towards the end of 2013 we re-located almost 800 people to new offices in the centre of Leeds and we have started to refurbish our principal office in Bradford so that it can act more effectively as our operational hub which will accommodate over 1,000 colleagues. A "pride in our space" programme has been designed to support our strategy of providing a leading People Experience to our employees, and critically is designed to deliver a modern working environment that promotes collaborative working and a healthy productive work life. The move to Leeds was not without its challenges as it involved a huge logistical and communications exercise. The use of colleague engagement helped shape many key decisions about the move, and 89% of our people said that their moving-in experience was a positive one.

In line with our vision, we aim to be a trusted employer. Building on this trust we have introduced 'Smart' working practices in our Head Office teams to ensure our people benefit from a work-life balance that is right for them.

Smart working is one component of our overall approach to flexible working practices, and it involves our colleagues taking more control around their working day based on a foundation of trust and consistent output.

Research shows that there is a strong correlation between high levels of engagement and performance. This year, we have reached **engagement levels** of 76% compared to the Financial Services industry average of 73%[7]. The Group is continuously developing its colleague engagement and communication channels to ensure that our people understand our vision, our strategy and the role they play in putting the strategy into action. We do this not as an end in itself but so that we can deliver a great service to our customers.

The Group is committed to creating a leading People Experience for its colleagues through ensuring equality, diversity and inclusion for all.

The current gender split across the Group is as follows:

	Male	Female
Board	83%	17%
All colleagues[8]	34%	66%

Further details can be found in the Corporate Governance Report on page 34.

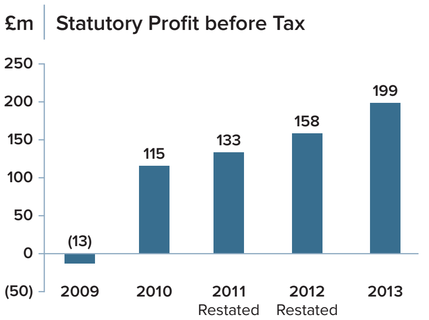
The Group operates exclusively in the UK and, as such, is subject to the European Convention on Human Rights and the UK Human Rights Act 1998.

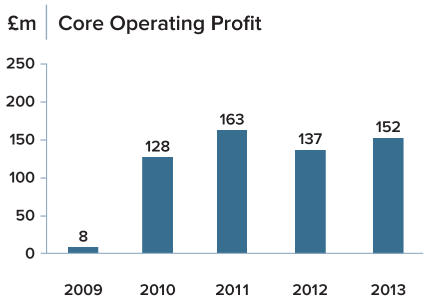
The Group respects all human rights and in conducting its business the Group regards those rights relating to non-discrimination, fair treatment and respect for privacy to be the most relevant and to have the greatest potential impact on its key stakeholder groups of customers, colleagues and suppliers.

[6] The CIPD's 2013 annual survey report "Absence Management" October 2013
[7] Source: ORC International YBS Group Colleague Survey 2013
[8] All colleagues includes the Executive Directors on the Board, but not the Non-executive Directors

Sustainable Financial Performance

All of the above has been achieved whilst maintaining the financial strength and sustainability of the business.

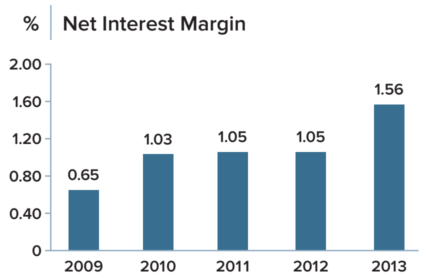




£m	2009	2010	2011	2012	**2013**
Statutory profit/(loss) before tax	(13)	115	133[9]	158[9]	**199**
Add back:					
FSCS levy	3	4	3	5	**12**
Non-core investments	(7)	10	5	(1)	**(14)**
Timing differences - fair value volatility	18	6	5	13	**(2)**
Mergers - adjustments to balances acquired	–	–	–	6	**(94)**
Mergers and acquisitions - costs	7	10	20	16	**2**
Mergers - goodwill	–	(17)	(6)	–	**–**
Mortgage book disposal	–	–	–	–	**13**
Balance sheet structured debt buy back	–	–	–	(62)	**30**
Other non-core items	–	–	3	2	**6**
Core operating profit	8	128	163	137	**152**

In 2013 the Group recorded another year of strong financial performance, with robust profits, continued capital strength and healthy liquidity. Core Operating Profit, which measures longer-term underlying performance, was also very strong.

The increase in profitability in 2013 was driven primarily by a strong margin performance (1.56% vs. 1.05% in 2012).



The increase in margin resulted from a number of factors, including:

- Most materially, the release of Fair Value Adjustments made against the assets and liabilities taken on during the mergers with Chelsea Building Society in 2010 and Norwich & Peterborough Building Society in 2011. One category of adjustments reflects the difference between current product rates and those that would have been available at the time of the merger. These adjustments are released through the Net Interest Margin as the acquired balances run off, either through maturity or early redemption. Another set of adjustments were made against future potential credit losses which are released as and when it becomes clear that the actual losses are likely to be less than originally anticipated. At the year-end we undertook an exercise to review these credit risk related adjustments in the light of changing market conditions. Even whilst still taking a conservative view of future house prices and other economic factors, our underlying credit losses now look likely to be significantly lower than we originally estimated. This reflects both improved economic conditions and the actual performance of the underlying loans.

  In some instances adjustments can now be released because previously identified risks have not materialised (e.g. where we made provisions against possible fraud within the Chelsea Building Society portfolio).

  The impact on the margin in 2013 of these releases was a charge of £19m for product rate related adjustments (compared to £23m in 2012) and an additional credit of £78m in relation to the reassessment of future credit losses against the acquired books and other miscellaneous items. Without this latter additional item our margin would have been 1.34%.

- The relatively low cost to the Group of retail funding where savings rates have been suppressed by a number of external factors including the impact on funding costs of the Government's FLS scheme. Whilst we strive to protect our customers from the impact of low rates there is a limit to how far we are able to do this. If we offer rates substantially higher than the market then we quickly attract more money than we can sensibly, and safely, lend. Every £1bn of excess liquidity costs us over £15m a year without providing any benefit to our members. Therefore, whilst we continually manage our liquidity to optimise the position for our savers

[9] Restated. See page 85

(and indeed we were one of the last savings institutions to cut savers' rates in 2013) we can only do this within certain limits.

- Another contributor to the improved margin in 2013 has been the impact of our continued efforts to manage liquidity ever more efficiently. We started the year with excess liquidity as a result of protecting savers during the last quarter of 2012 as market rates fell sharply on the launch of the FLS scheme. We therefore attracted more funds than we could sensibly lend on as mortgages. Having delayed savings rate cuts as long as was felt to be safe we gradually managed down the positions, reduced our liquidity levels whilst still remaining well above our regulatory requirements throughout the year. This led to an improvement in the net interest margin.

Another contributor to the increased profits has been the fall in the charge made for impairment provisions which were £23m compared to £39m in 2012. This reflects our continual efforts to maintain the quality of our loan books.

Set against this have been a number of areas where profit has been suppressed in 2013. In terms of one-off items, two of the most material transactions relate to certain items inherited with, or created by, the merger with Chelsea Building Society. Whilst each generated a loss in 2013 they will, in different ways, protect the Group's future profitability.

- During December 2013, the Group completed a capital buy back by re-purchasing £75m of the £100m of Convertible Capital Notes which were issued at the time of the merger with Chelsea Building Society to investors who had previously held Chelsea's subordinated debt. This generated a £30m loss in the year, made up of a £40m loss on the nominal value of the notes offset by a £10m profit on the unwinding of the associated hedging instrument. The loss represents the increase in the market value of the bonds since their issue date (over and above the face value of the debt) plus the premium paid to investors who chose to participate in the transaction. As the debt was paying interest at 13.5%, the Group will save significant interest costs in future years.

  This deal therefore benefits the Group in two ways. Firstly it retires capital which, given the current regulatory regime, would gradually cease to be recognised as capital for regulatory purposes in the final five years of the bond issue. Secondly, it represents a net gain to the Group when the future savings in the net interest margin are taken into account. This transaction will therefore add to our core capital position and further demonstrates our capital strength.

  Last year the Group made a combined profit of £62m on the buy-back of Subordinated Debt and Permanent Interest Bearing Shares, retiring lower grade capital at a time when it was priced at less than its face value. The two deals therefore ultimately achieve the same end but in different timescales.

- The disposal of a £200m equity release mortgage book inherited through the Chelsea merger. This generated a £13m loss in the year. The loss is the net result of the sale proceeds, the carrying value of the book and the settlement of the associated derivatives position. The principal benefit to the Group of this transaction is that it removes the uncertainties around the future profitability of the book. For example, any increase in the life expectancy of the borrowers beyond that assumed at the time of the merger could generate losses for the Group as the loans would accrue interest for longer than anticipated and so might exceed the underlying value of the associated properties.

  This book was not seen as a core activity for the Group in that it was not a business area we had actively decided to enter into and its sale, albeit at a loss, was seen as a sensible move by the Board in removing risk to our future profitability.

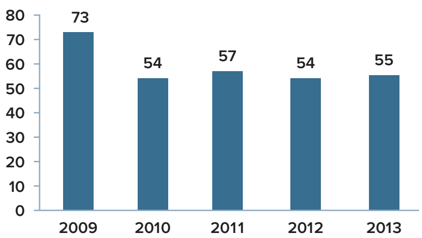
At the same time we saw a significant fall in other income mainly because of the Board's decision to withdraw our Protected Capital Account product from sale (discussed earlier on page 14).

As expected, and highlighted last year, management expenses were higher than in 2012 by £50m, although the increase is nearer to £59m when we adjust for the one-off impacts of 2012's merger and integration costs and 2013's property write-down. The latter arose following our opening of an office in Leeds (see page 16) which enabled us to release significant space in our principal office in Bradford, initially for refurbishment and then consolidation by reducing the number of inefficient satellite locations in the city.

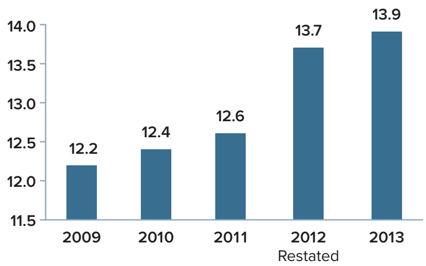
The increase in our cost base, which was discussed in our 2012 Business Review, is driven mainly by the planned programme of investment discussed earlier.

Another area which has driven costs upwards is regulation, both in the form of annual fees (c. £5m in 2013) and the internal administrative costs of dealing with the new regulatory framework. Although we are currently seeing an exceptional level of spend as the financial services industry adapts to these new regulatory structures and norms, we do expect a permanent increase in our cost base as a result.

% Cost:Income Ratio



% Core Tier 1 Capital Ratio



Despite the fact that the underlying reasons for the cost increases are well-known, the Board is determined to maintain a balance between investing for the future and ensuring that our costs are contained at an appropriate level. As a result, the Board will review our underlying cost base during 2014 to ensure we remain efficient without compromising customer service. Nevertheless we believe that our cost:income ratio compares very favourably with the high street banks.

There were also some costs in 2013 which resulted from failing to live up to our own high standards. Our intention is always to put the customer at the heart of everything we do and our people always try to put the best interests of our customers first. However, there are occasions where either we fail to deliver the best outcome for the customer, or our systems and processes are not sufficiently detailed to prove, to ourselves and our regulator, that we have delivered the best outcome.

A total provision of £21m has been made to cover costs connected with the conduct issues discussed earlier in this document relating to arrears administration and the withdrawal of the Protected Capital Account product.

Balance Sheet Strength

We have maintained the Group's strong capital position.

Our key capital metric is the **Core Tier 1 ratio** which divides our highest quality capital by a measure of our assets which reflects the risk inherent in each.

The Core Tier 1 ratio has risen to 13.9%, even after the additional capital backing required to underpin our growing mortgage book. Following the capital buy-back transactions in 2012 and 2013, our Solvency Ratio, which includes all forms of capital, is now virtually the same as the Core Tier 1 ratio (just 0.4% different) reflecting that almost all our capital is of the highest quality.

Another measure of capital strength is the **leverage ratio** which measures Tier 1 capital against assets. Whilst this measure removes the risk weighting used in the Core Tier 1 ratio, it also adds in a measure of off-balance sheet exposures to the asset side of the equation, requiring capital to be held against features such as mortgage offers that have yet to complete. The new European Capital Requirements Directive introduces leverage ratio limits for financial institutions, with a widely-held view being that a minimum of 3% is a likely target. At the end of 2013, our leverage ratio was 4.6% which we believe compares favourably with most high street banks and our peers in the mutual sector.

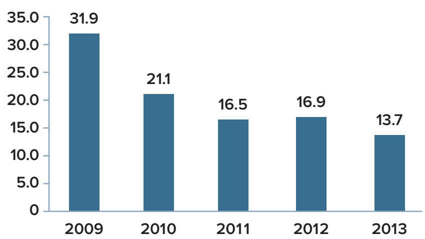
It is critical that the Group continues to have access to sufficient liquid funds to operate the business - to lend in the form of loans, for customers wanting to access their savings and to meet other obligations that fall due. The quality of this liquidity is equally important. Throughout the year, in excess of 80% of our liquidity was deposited with the Bank of England or held in the form of UK Government gilts, and at the end of 2013, 93% of our total liquidity, £4.1bn, was eligible for inclusion in our regulatory liquid assets buffer.

As well as liquid assets on the balance sheet, liquidity is available to the Group in the form of the FLS. The FLS requires institutions to have mortgage assets of sufficient value and quality to be available as security against which the Bank of England lends Treasury Bills. These Treasury Bills can be readily converted into liquidity. Funds which are available through the FLS scheme do not show on the balance sheet until they are drawn. This means that it is not possible to judge an institution's liquidity position from the balance sheet alone.

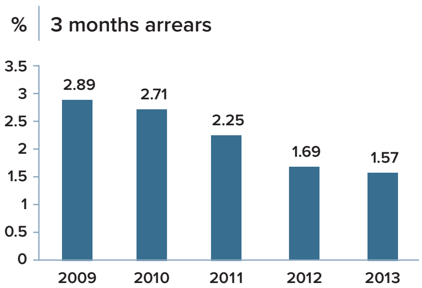
Set against the requirement to have sufficient liquidity available at all times is the fact that holding excess liquidity carries a cost in that it earns, typically, around 0.5% compared to the cost of raising funds (which can be around 2% depending on the source).

These conflicting drivers mean that we constantly and actively forecast and manage liquidity. During 2013 the Group both stayed well above the liquidity requirements set by our regulator but still managed to reduce liquidity levels (see page 18) thereby contributing to the year-on-year improvement in the net interest margin described above.

% Liquidity Ratio



The quality of our mortgage books is another critical element of our balance sheet strength. The percentage of our outstanding retail mortgage balances in arrears by three months or more (including repossessions) continues to improve and in 2013 fell to 1.57% from 1.69%.



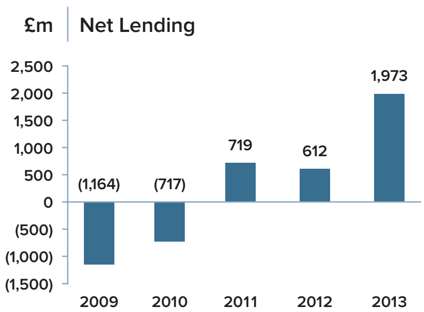
The industry average for mortgage arrears is measured as the number of accounts three months or more in arrears (including repossessions) – and at 1.45%, our performance remains healthily below the industry average of 1.76%.[10]

In terms of the exposure to the Group from losses in a changing economic environment, the books' resilience is reflected in the Loan-To-Value (LTV) ratio which compares the value of the outstanding loan with the underlying collateral. This position has remained strong throughout the year and at the end of the year, over 75% of the residential mortgage book had an LTV of less than 80%.

As we have re-entered the 95% LTV market, to assist first time buyers with small deposits, there will inevitably be some upward pressure on our LTV ratios. However these products are a relatively small proportion of our new lending and we are confident in our processes for assessing and managing risk in this area.

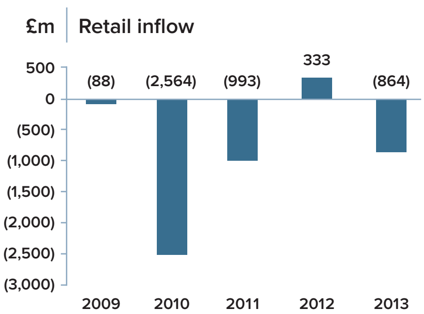
Business Volumes

In 2013 mortgage lending returned to levels not seen for several years with net lending of £2.0bn (compared to £0.6bn in 2012) and gross lending of £6.8bn, up from £4.6bn.



This performance represents a market share of gross lending of 3.8% (2012: 3.2%)[11] and demonstrates our commitment and ability to deliver competitive products in a changing market. The recovery in the mortgage market also meant that we experienced higher volumes of redemptions as can be seen from the wider gap between gross and net lending.

2013 saw a net outflow of retail funding of £864m, with a number of factors behind this outflow.



We closed 2012 with approximately £1bn of excess liquidity due to high retail inflows following our decision to protect our existing customers from falling rates for as long as possible. Whilst delaying and minimising rate reductions protected our savers it also meant we attracted more funds than we could lend which came at a financial cost. During 2013 we managed down this excess liquidity and drew on the cheaper funds available through the FLS scheme so that we were able to fund mortgage growth despite lower retail deposit balances.

Risk Appetite

In addition to financial performance and balance sheet strength, a key element of Sustainable Financial Performance is our Risk Appetite. As described on page 12 we monitor our Risk Appetite adherence in two sections – Prudential Risk and Conduct Risk. In terms of Prudential Risk Appetite, our performance was graded as Green throughout the year. Whilst there were a limited number of individual, underlying measures that were graded as amber at some point during the year, the overall Group position remained healthy.

Given that Conduct Risk is an area that is the subject of development work within the Group, and that some issues and remedial actions have been identified, we have rated ourselves red to reflect the issues that we are addressing. It is likely to remain so until the Board is more satisfied that progress is clear on the issues that we are addressing. If it were rated on just the actual fairness of outcomes for customers it would be graded more favourably by both our Group Risk function and our front line functions.

[10] Source: Council of Mortgage Lenders, as at December 2013

[11] Source: Council of Mortgage Lenders - Lending secured on dwellings 2013

Being Locally Famous

It is important to us that our people across the branch network and within our Head Offices connect with their local communities. During 2013 we rolled out a branch revitalisation programme across the Yorkshire and Chelsea networks that put our branches even more at the heart of their communities. This includes our Charity Choices programme where members of the community elect which local charities their branch will support. Revitalisation of the N&P network will commence in 2014. In addition more than 9,000 employee hours were spent supporting local community projects.

In 2013 the Group donated £1.2m to charities, good causes and community groups across the UK, approximately £540,000 of which was from the Yorkshire Building Society Charitable Foundation. In addition our Charity partnership with the Royal National Lifeboat Institution (RNLI) continued for a second year, raising £154,000 in 2013. We were honoured to be made the RNLI's Corporate Supporter of the Year.

Our activities in these areas led to the Group's Societies Together community programme winning Gold in the community category of the International CSR Excellence Award.

Principal Risks and Uncertainties

The principal risks and uncertainties relating to the achievement of the Group's objectives can be considered in a number of categories. The Group has constructed its systems of monitoring and control around these categories, and details about the risk management infrastructure are included in the Risk Management Report (see pages 45 to 51).

At the end of 2013 and the beginning of 2014, the principal risks and uncertainties faced by the Group can be broadly summarised as follows:

- The economic recovery appears to be becoming more firmly established although a variety of significant threats persist, especially around the Eurozone. In the UK, a continuing low interest rate environment is expected with the Bank of England using other macro-prudential measures to influence the banking sector in general and mortgage lending in particular.
- Structural change in UK financial services regulation, with the replacement of the Financial Services Authority with the PRA and FCA in April 2013, is bedding in at the same time as we are seeing significant changes in the underlying regulation itself. This includes revised capital and liquidity requirements, and the introduction of formal recovery and resolution plans.
- The implementation of the 2013 European Capital Requirements Directive introduces revised capital requirements and new regulatory measures such as the leverage ratio and the liquidity coverage ratio which require changes to institutions' capital and liquidity management systems and structures, with which we are well advanced.
- Recent headline fines for major financial institutions also demonstrate that financial regulation is increasingly rigorous from both a prudential and a conduct perspective.
- The Group has embarked upon a significant change programme to achieve its ambitious strategic vision. Whilst confident of our ability to become the most trusted provider of financial services in the UK, the Board recognises that the successful management of risks and uncertainties in the delivery of significant change is a critical element of the programme.

These risks and uncertainties are closely monitored and were taken into account when setting our Corporate Plan for 2014-2018. We are confident that with our financial strength, passion for customers and our mutual heartbeat, along with investment in the business and focus on our strategic priorities, we are well placed to continue to succeed and be the most trusted provider of financial services in the UK.

Outlook for 2014

Our strategic framework, business model and priorities are explained in the opening sections of this report.

2014 will see a continuation of our focus on delivering the investment programme we commenced in 2013 to underpin our strategic priorities. As outlined elsewhere in this report, this is a significant investment and will continue to put pressure on our costs until we start to realise some of the financial benefits. However, customers and colleagues should start to see the benefits of our investment in terms of their experience of interacting with us and using our processes and systems.

We expect 2014 to offer real opportunities for us to increase the scale of our mortgage lending, within our agreed risk appetite, bringing the benefits of our award winning mortgages to a growing number of customers.

Robin Churchouse
Chief Operating Officer
& Finance Director

25th February 2014

Societies Together

Our contribution to society goes beyond providing great customer service and simple, straightforward products. Through our Societies Together programme we're also proud to play a key role in the local communities we're part of, supporting causes close to your hearts.

£1.2m
in donations to charities, community projects and local activities

2,800
good causes supported across the UK

Yorkshire Building Society Charitable Foundation

The Yorkshire Building Society Charitable Foundation supports registered charities helping those people who are more vulnerable, particularly the elderly, children and people with disabilities. 80% of causes are nominated by members.

Small Change, Big Difference™[1]

Our innovative scheme allows members to donate to the Charitable Foundation. This is done through donating the pennies of interest from their account(s) each year. The average donation is less than 50p per year and the maximum is just 99p. Each small amount given adds together to make a difference to the lives of others local to you in your area.

- **Currently there are over 800,000 participating accounts.**
- **The scheme has raised almost £3m since launch in 2000.**
- **Our aim is to have one million accounts signed up to the scheme.**

[1] Small Change, Big Difference™ is a registered trademark of Yorkshire Building Society

£154k
raised for **RNLI** Charity of the Year partner in 2013

9,016
volunteering hours completed through our Actionteering programme

Charity of the Year – RNLI

Our partnership with the Royal National Lifeboat Institution (RNLI) in 2012 was so successful we extended the relationship for 2013 across the whole Group – launching for the first time with our Norwich & Peterborough colleagues in March 2013.

Involving our employees

We encourage all our people to share their skills and experience through volunteering activity to make a positive impact and build longer-term relationships in their communities.

Environment

As our business grows we have more of an impact upon the environment, however we are committed to ensuring our footprint on the planet is as low as possible. Our approach encompasses all areas of our operations including:

- **Design and procurement –** we embed environmental considerations into our decision making.
- **Travel choices –** we ensure company vehicles have low carbon emissions and support colleagues to choose green ways to travel to work.
- **Waste –** we continuously strive to reduce our usage of paper and electricity through avoidance, reduction and recycling.
- **Energy –** Efficient boilers, insulation and efficient lighting is installed across our estate as we refurbish and upgrade.
- **Reducing Carbon Footprint –** we are committed to the Government's Carbon Reduction Commitment Energy Efficiency Scheme, which requires us to purchase allowances for every ton of energy related CO^2 we emit.

Making a difference into the future

In 2014 we'll focus on continuing to review our programmes to ensure we're making a real and lasting difference in our communities. This is integral to our vision of being the most trusted financial service provider. We'll also make sure we manage our impacts on society and the environment in a sustainable way.

Non-Executive Directors

Ed Anderson | Kate Barker | Lynne Charlesworth | Philip Johnson

Ed Anderson, BSc, CPFA (age 63)
Chairman

Ed joined the Board in 2003 and was appointed Chairman on 1st January 2007. He also chairs the Board Governance and Nominations Committee.

He 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 Pro Chancellor of Leeds Trinity University. He is also involved in various other local organisations and charities.

Kate Barker, CBE (age 56)
Non-executive Director

Kate joined the Board in November 2010 and is a member of the Group Risk Committee and the Board Governance and Nominations Committee. She holds the Society's 'Conduct Risk' oversight role on behalf of the Board and is also a trustee of the N&P Building Society Pension Scheme (until the Scheme merges with the Yorkshire Building Society Scheme at the end of February 2014).

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.

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 Private Equity Plc and Taylor Wimpey Plc and a senior adviser to Credit Suisse.

Lynne Charlesworth, BA, MBA (age 57)
Vice Chairman

Lynne joined the Board in 2006 and was appointed Vice Chairman of the Society on 18th April 2012. She is Chairman of the Group Risk Committee and a member of the Board Governance and Nominations Committee, as well as a trustee of the Society's Pension Scheme.

Lynne has a background in risk management, particularly within the financial services and property sectors. She also has experience within the building society industry, becoming Group Risk Manager of Abbey National Plc when it acquired 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.

Philip Johnson, FCA (age 67)
Non-executive Director

Philip joined the Board in 2007 and is Chairman of the Audit Committee. He 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 Deloitte partner, Philip specialised in providing advisory and assurance services to large corporate clients. He has considerable experience of financial services, having led major investigations in the sector. Philip is a member of the Audit Committee of the Wellcome Trust and, until December 2012 was President of the Federation of European Accountants. In January 2014 he was appointed a member of the Standing Advisory Group of the Public Company Accounting Oversight Board in the USA. He is also a non-executive director of Lakeland Ltd.

David Paige

Mark Pain

Guy Parsons

Simon Turner

David Paige, BSc, FCA (age 62)
Non-executive Director

David 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 is a chartered accountant and has considerable 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 Willis Ltd and the IFG Group Plc.

Mark Pain, BSc, FCA (age 52)
Non-executive Director

Mark joined the Board in August 2013 and is a member of the Audit and Group Risk Committees. Mark has 15 years' experience at director-level roles within FTSE 100 companies across the financial services and residential properties sectors. He spent 16 years with the Abbey National Group, including seven years as Group Finance Director, Chief Executive of Abbey National Treasury Services, and Customer Sales Director. He was then appointed Group Finance Director at Barrett Developments Plc where he worked until 2009.

Mark holds a number of other directorships; he is a non-executive director of Aviva UK and the Spirit Pub Company and the Senior Independent Director at Johnston Press.

Guy Parsons, BA (age 50)
Non-executive Director

Guy joined the Board in May 2013 and is a member of the Remuneration Committee. He also holds the 'People' oversight role on behalf of the Board.

Guy has more than 20 years' experience of director-level roles with major UK companies, including eight years with Travelodge where he became Chief Executive. Prior to joining Travelodge, he held a number of senior positions with Whitbread Plc, including Managing Director of the restaurant chain, TGI Fridays.

Guy holds a number of other directorships; he is a non-executive director of the official London promotion organisation; London and Partners, and heating manufacturer; Warmup Plc. He is also the Chairman of the North East Surrey College of Technology.

Simon Turner, BSc (age 62)
Non-executive Director

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

Simon has extensive experience in marketing, sales and general management. This includes a variety of roles in the electrical and publishing markets. He was Managing Director of Philips in the UK and Ireland until 1999. After that 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 Group's service business. He also chaired DSG's pan-european internet business before his retirement at the end of 2008. Since then Simon has taken on a variety of roles in the electronic industry and is now a senior executive within the European Division of the Acer Group.

Simon is to retire from the Board immediately following the Annual General Meeting on 15th April 2014.

Executive Directors

Chris Pilling | Ian Bullock | Andy Caton | Robin Churchouse

Chris Pilling, MA (Age 48)
Chief Executive

Chris joined the Society on 31st 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 included Chief Executive of First Direct; 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 53)
Chief Customer Officer and Executive Director

Ian 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, becoming an Executive Director responsible for sales and marketing in April 2007.

Ian currently has responsibility for product development, marketing, the Society's distribution network including our branches, agencies and online business, and the customer operations and customer relations functions. He is also Chairman of Accord Mortgages Ltd, the Society's intermediary lending subsidiary.

Andy Caton, BA (age 50)
Chief Corporate Affairs and Treasury Officer
and Executive Director

Andy 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 and corporate affairs functions.

Andy is a trustee of Yorkshire Building Society Charitable Foundation and a trustee of the N&P Building Society Pension Scheme (until the Scheme merges with the Yorkshire scheme at the end of February 2014). He is also Vice President of the Bradford Chamber of Commerce and Industry.

Robin Churchouse, MA, ACA (age 48)
Chief Operating Officer and Finance Director

Robin joined the Society in 2004 as Head of Finance. He was promoted to the General Management team in June 2006 and appointed Finance Director in June 2010. He now has responsibility for the corporate planning, finance, property and shared services 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.

Other Chief Officers

Jane Hanson | David Henderson | Richard Wells

Jane Hanson, BA, MBA, MCIPD (age 41)
Chief People Officer

Jane joined the Society in March 2013 to lead our human resources (HR) and internal communications functions. She has almost 20 years' experience within HR and financial services, having worked with Alliance & Leicester, HSBC and First Direct - which regularly featured in the Sunday Times 'Top 100 Employers' list under her tenure as Head of HR.

David Henderson, BSc (age 53)
Chief Information and Change Officer

David joined the Society in 2007 as Chief Information Officer and now has responsibility for the Group's IT, information security and change management functions. He is leading our business transformation programmes as part of our strategic plans to invest substantially in improved business processes and technology. He is also Chairman of Yorkshire Key Services, which provides IT services externally. David started his career in the building society sector and, prior to joining the Yorkshire, held a range of senior IT positions within a major UK banking group.

Richard Wells, FCIB (age 50)
Chief Risk Officer

Richard joined the Society in 2010 as General Manager, Risk and 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. He is also responsible for the legal & secretarial function.

Directors' Report

The directors have pleasure in presenting their annual report, together with the Group Accounts and Annual Business Statement, for the year ended 31st December 2013.

Business objectives and activities

The Group's vision is 'to be the most trusted provider of financial services in the UK'.

Further information on the Group's vision and strategy is given in the Strategic Report on pages 8 to 21.

Principal risks, uncertainties and going concern

The principal risks and uncertainties faced by the Group are set out in the Strategic Report on pages 8 to 21 and our approach to managing them is set out in the Risk Management Report on pages 45 to 51.

As set out on page 73, 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 uses all available information about future risks and uncertainties.

The future risks considered in the latest review, performed in January 2014, included:

- The impacts of external events and pressures on the financial services sector.
- Further changes to the regulatory framework.
- Continuing economic uncertainty and volatility.
- The outlook for interest rates and house prices.
- Risks associated with the Group's major projects, further details of which are shown on page 21 of the Strategic Report.

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 is used to assess the Group's ability to withstand a variety of extreme circumstances and conditions.

As a result of the detailed assessment performed in January 2014 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.

Business review and future developments

Key developments and the future outlook are reviewed by the Chairman on pages 2 to 5 and in the Strategic Report on pages 8 to 21. The Strategic Report identifies and explains the Group's Key Performance Indicators and sets out how the Group has performed against each during 2013.

Profit and capital

Profit before tax for the year was £199.3m (2012 restated – £158.1m) and after tax the amount transferred to Group general reserves was £148.1m (2012 restated – £123.9m).

Total Group reserves at 31st December 2013 were £1,809.4m (2012 restated – £1,641.5m). Details of reserves movements are given in the Statements of Changes in Members' Interest on pages 82 to 83.

Gross capital at 31st December 2013 was £1,864.9m (2012 restated – £1,771.6m) including £48.7m (2012 – £122.8m) of subordinated liabilities and £6.8m (2012 – £7.3m) of subscribed capital. Expressed as a ratio to shares and deposits gross capital was 5.79% (2012 restated – 5.69%) and free capital was 5.27% (2012 restated – 5.18%). These ratios are explained on page 148.

Further information about the Group's capital strength is outlined in the Strategic Report on page 19.

Mortgage arrears

Details of the Group's mortgage accounts which were 12 months or more in arrears at 31st December 2013 were as follows:

	2013	2012	2013 % of mortgage accounts/balances	2012
Number of accounts	**435**	593	**0.17**	0.23
Balances outstanding on accounts	**£62.4m**	£84.0m	**0.21**	0.31
Amount of arrears included in balances	**£7.3m**	£9.4m	**0.03**	0.03

Further details of the Group's arrears position and the various provisions made against potential losses are set out in the Strategic Report on pages 8 to 21. Note 39 on page 141 describes the various forbearance measures offered by the Group to borrowers experiencing difficulties in meeting their repayments.

Colleagues

Our colleagues are key to our operations.

The Group's management meet colleague representatives regularly to discuss a wide range of topics. Communication with and between all colleagues is subject to regular review and includes regular colleague 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 colleagues 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 colleagues 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 31 to 38.

At the 2014 Annual General Meeting (AGM), Mark Pain and Guy Parsons will be put forward for election by the members. At the same meeting, Ed Anderson, Kate Barker, Andy Caton and Robin Churchouse will retire as directors and, being eligible, offer themselves for re-election. Biographical details of all directors are outlined on pages 24 to 26.

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.

Auditor

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

On behalf of the Board

Ed Anderson
Chairman
25th February 2014

Corporate Governance Report

Chairman's statement

In my Chairman's Report on pages 2 to 5, I comment on the main areas that the Board focused on in 2013, the impact of the new regulatory regime and other regulatory developments and how we have protected our savers and borrowers. I also refer to how the Board is governed. Good corporate governance, which provides a framework of how the Board (and the rest of the Yorkshire Building Society Group) operates, is also vital in providing effective leadership and in assisting the Society to continue as a successful organisation run for the benefit of its current and future members in a legal, ethical and transparent manner.

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, including all our customers, colleagues and the communities in which we operate, are also taken into account.
- That the Society should be managed in a prudent and efficient 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 Group.

The approach is based on the principles and provisions of the most recent version of the UK Corporate Governance Code (the Code) published by the Financial Reporting Council (FRC) in October 2012, 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 interests of transparency, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) also encourage each building society to explain in its Annual Report and Accounts whether, and to what extent, it adheres to the Code.

This Report sets out how the Board operates and whether it complies with the Code and, where it does not comply, an explanation as to the reasons why.

Ed Anderson
Chairman

1. Does the Society comply with the Code?

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 to depart from the Code then it will do so, the key consideration being that such a departure is believed to be in the best interests of members and that the governance of the Society is not compromised.

The Board considers that in 2013, the Society complied with the guidance issued by the Building Societies Association on the Code with the exception of the following Code provisions:

- That all directors should be subject to annual election by shareholders (that is the Society's members).
- That evaluation of the Board should be externally facilitated at least every three years.

The reasons for non-compliance with the above two Code provisions are set out below.

Annual election of all directors

This would take place at the Society's Annual General Meeting (AGM). As reported in the 2012 Corporate Governance Report, the Board considered this provision in respect of the Society's AGMs held in 2011 to 2013 and agreed that it 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 given careful consideration to the adoption of this provision at the 2014 AGM, being mindful of the Board's stated commitment to comply with best practice in corporate governance and its duty to act in the best interests of its members. The Board has concluded that the current policy should continue and, as a result, not all the directors should be put forward for re-election at the AGM to be held in April 2014.

The Society's Rules, which set out the constitution of the Society, state that only those directors who are due for election or have not been re-elected in the previous three years should be put forward for election/re-election by members. However, the Board continues to adopt a policy that if annual elections of all directors are not adopted then members should be able to vote on at least one third of the directors, including at least one executive director, with re-elections being brought forward if necessary. This is permitted under the Society's Rules.

At the 2014 AGM, there will be four directors due for re-election (including two executive directors) as a result of the above mentioned three year cycle and two directors due for election. They are:

For re-election:

- Ed Anderson, Chairman
- Kate Barker, Non-executive Director
- Andy Caton, Chief Corporate Affairs & Treasury Officer & Executive Director
- Robin Churchouse, Chief Operating Officer & Finance Director

For election:

- Mark Pain, Non-executive Director
- Guy Parsons, Non-executive Director

This will mean that out of 11 directors on the Board immediately after the 2014 AGM (or 12 directors if the new Chief Commercial Officer and Executive Director takes up his position on or before the date of the AGM), members will have had the opportunity to vote on six of them. No director has been brought forward for early re-election. The Board has considered (in the absence of each relevant director) that the performance of those directors to be voted upon at the AGM continues to be effective and they demonstrate the necessary commitment to the role.

External Board Evaluation

The Society undertook an externally facilitated process at the end of 2010 which was completed in early 2011. In 2013 the Board considered the approach to be adopted for the annual Board evaluation review in 2013. On the recommendation of the Board Governance and Nominations Committee, the Board agreed that consideration of an externally facilitated Board evaluation process should be deferred for one year. The reason for this was that the Board was in the middle of a transition phase in respect of non-executive director recruitment and deferral of the review would enable the new directors to have time to gain a greater understanding of how the Board operates and thereby contribute more fully to such a review. In addition, external reviews do require a considerable amount of participation by the directors and it was felt that it could be a distraction for the executive directors during a period of intensive focus on our investment programme (as referred to on page 10). The timing of the next external review will be considered by the Board Governance and Nominations Committee in the first half of 2014 which will then make a recommendation to the Board. The external review referred to above had not highlighted any major issues and confirmed that the Board was highly effective and well placed on all key aspects of Board performance. Please refer to section 7 of this Report on the 2013 internal review process.

2. The role of the Board

The Board's principal role is to:

- Safeguard the interests of members, ensuring the long-term success of the Group.
- Focus on the Group's strategy.
- Ensure that the necessary resources are in place for the Group to meet its objectives.
- Ensure that financial and internal controls and systems of risk management are robust.
- Provide general direction to the organisation.
- Monitor the performance of the senior management team.

3. Reserved matters to the Board

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 the 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 Chief Officers (collectively known as the Executive Team). Other matters are delegated to the Executive Team or to other specified colleagues or committees, including the Board committees referred to on page 35. Details of all the directors and other members of the Executive Team are set out on pages 24 to 27.

4. Composition of the Board

As at the date of this Report, the total number of directors on the Board is 12, consisting of four executive directors and eight non-executive directors. Their details are set out on pages 24 to 26. 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 gaps, either due to changes in the Group's business activities or as part of succession planning and recruitment. 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 Board Governance and 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.

5. Appointments to the Board in 2013

The appointment of new directors is initially considered by the Board Governance and Nominations Committee which is made up of Ed Anderson (Chairman), Lynne Charlesworth (Vice Chairman) and Kate Barker (Non-executive Director). The committee is responsible for considering matters relating to the composition of the Board, including nominating candidates for the position of director, taking into account the balance of skills, knowledge and experience of directors, and making recommendations to the Board as appropriate.

Non-executive Director Appointments

A review of the succession planning for non-executive directors was agreed by the Board in 2012 and was shared with the regulator which at the time was the Financial Services Authority (the FSA). This succession plan takes into account a phased recruitment to ensure that there continues to be relevant skills and experience on the Board during the period of change to the Board membership. The Corporate Governance Report for 2012 set out the recruitment process for the replacement of Simon Turner, Non-executive Director, who will retire immediately after the 2014 AGM with the aim of allowing a considerable period of overlap with his successor. This resulted in the appointment of Guy Parsons as a non-executive director on 1st May 2013.

In January 2013 a search commenced for a further non-executive director to replace Roger Burden who retired immediately after the AGM on 17th April 2013. An independent external search agency, The Zygos Partnership, was engaged to assist in the candidate search and administration of the recruitment process and the position was advertised on the Group's websites. A 'long' list of candidates was considered by the Board Governance and Nominations Committee who then conducted interviews with the selected shortlist of candidates. The committee made a recommendation to the Board which resulted in the appointment of Mark Pain as a non-executive director on 1st August 2013. Zygos was also engaged in the recruitment of the replacement for Simon Turner (as referred to above). The agency has no other connection with the Society.

Under the Society's current 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 Society's Regulators, the FCA and the PRA, as Approved Persons in order to fulfil their controlled function as a director. The two new non-executive directors referred to above will be put forward for election by members at the 2014 AGM. Details on each of them can be found on page 25.

In late 2013 the Board appointed Egon Zehnder to assist in the search for candidates for two new non-executive director appointments as part of the ongoing non-executive director succession planning process. Further announcements on this recruitment will be made later in the year. Egon Zehnder has no other connection with the Society.

Executive Director Appointment

In 2013 a review of the organisational structure of the Group was undertaken and approved by the Board to ensure that it remained appropriate for the business, taking into account the evolving business priorities and strategy of the Group. This resulted in a number of changes in the senior management structure, including a change of responsibilities in some areas, and also the recruitment of a new Chief Commercial Officer and Executive Director to lead the Group's commercial activities, including our product development and marketing activities. The Board approved the appointment of Mike Regnier in 2013 to fulfil this executive director role. Mr Regnier is expected to take up his position in the Spring.

6. Diversity

The Board gives consideration to all aspects of diversity, including gender, on the Board although it continues to adopt the principle that all appointments should be based on merit and the skills and experience that the individual can bring and it also takes into account the composite make-up, skills and experience on the Board. In November 2013 the Board approved a recommendation of the Board Governance and Nominations Committee that there should be an aspirational target to have 25% female directors by the end of 2015. The Group will work closely with external recruitment partners to try and achieve this.

The Society takes into account diversity at all levels of recruitment and supports colleagues through various initiatives, including taking on voluntary roles such as trusteeship and non-executive roles in local voluntary organisations, to enable colleagues to gain experience of Board roles.

The percentage of females on the Society's Board at the date of this report is 17%. The equivalent percentage for all colleagues is 66%. As an additional disclosure in keeping with the Society's focus on diversity, 33% of the Executive Team (excluding executive directors) and 31% of the next level of senior managers (i.e. those managers who report directly to a member of the Executive Team, excluding any vacant roles) are female at the date of this Report.

The Group is committed to creating a leading People Experience for its colleagues through ensuring equality, diversity and inclusion for all.

7. Performance evaluation

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. In the latter part of 2013 an internal Board evaluation was undertaken through the means of a questionnaire. The results were reviewed by the Board at its meeting in November 2013. Overall, these results were once again very positive but a number of actions were agreed. This included recommendations in relation to the content and distribution of Board and Board Committee papers (which is undertaken electronically), improvements in the reporting process to the Board from Board committees and non-executive director 'oversight roles', long-term non-executive director succession planning and Board strategy sessions.

As stated in section 1 of this Report, an external performance evaluation of the Board was undertaken between November 2010 and January 2011. Consideration will be given during 2014 as to when the next external review should take place.

In 2013 internal performance evaluations of the Audit, Group Risk and Remuneration Committees 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.

In the latter part of 2013 individual evaluation of directors was undertaken through the completion of internal questionnaires which concluded that all directors continued to perform effectively. Each non-executive director was reviewed by all other directors and Chief Officers. The written results were given to each such director by the Chairman in a 1:1 appraisal meeting held in January 2014 which included a discussion on any training requirements. The Vice Chairman conducted the 1:1 meeting with the Chairman.

The non-executive directors reviewed the performance of each executive director (and also the other members of the Executive Team) through the completion of an internal questionnaire, the results of which were discussed in meetings with the Chairman. They were also used as part of the year end performance appraisal meetings with the Chief Executive. The Chief Executive's appraisal meeting was conducted by the Chairman.

8. Board meetings

The Board held 11 meetings in 2013. The attendance record of each director at these meetings and at relevant Board committee meetings is set out on page 38. 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 Board generally meets in West Yorkshire but at least one meeting each year is held in a location outside of West Yorkshire where the Group has an administration office or a branch which gives the non-executive directors an opportunity to meet local management and colleagues. In January 2013 the Board meeting was held at our offices in Cheltenham and in October 2013 the meeting was held at offices in Peterborough (which was the head office of the former Norwich & Peterborough Building Society).

At each Board meeting, the Board receives a comprehensive management information pack covering financial and non-financial information (including customer service and people metrics) with risk being an integral part of each reporting item. The relevant executive director or Chief Officer highlights appropriate matters including the performance of particular aspects of the business against targets. In addition, the agenda includes the following:

- 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.
- A report from the Chief Executive (CEO) which highlights the current trading and financial performance and any other relevant matters considered by the Executive Team since the previous Board meeting.
- Minutes of the monthly Executive Management meeting and those of the Financial Management Committee (which is a management committee).
- Items for decision and key matters which need to be debated. For example, in 2013 the Board considered the head office accommodation strategy, the new values for the Group, the management of conduct risk including regulatory dialogue and correspondence, the IT strategy, the internal executive committee structure, the Mortgage Market Review, investment in the Strategic Initiatives, results of the Colleague survey, a capital buyback exercise, the disposal of an equity release mortgage book and a revised corporate plan covering the next five years. If a major item will require more detailed consideration then the Board may delegate this to be considered by the Chairman's Committee.

9. Board committees

Certain matters are referred to Board committees in order that they can be considered in more detail by those directors with the most relevant skills and expertise. The committees are:

- The Audit Committee – details are contained in the Audit Committee Report on pages 39 to 44.
- The Board Governance and Nominations Committee – details are contained in the section on 'Appointments to the Board' on pages 33 to 34 of this Report.
- The Group Risk Committee – details are contained in the Risk Management Report on pages 45 to 51.
- The Remuneration Committee – details are contained in the Directors' Remuneration Report on pages 52 to 72 which also includes the Society's policy for voting on Directors' remuneration at the 2014 AGM.

Members of these committees are set out in the table on page 38. The Terms of Reference of the committees are available on request from the Group Secretary or on the Society's website at www.ybs.co.uk/your-society/inside-your-society/corporate-governance/committees.html. 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 specifically delegated to it.

Two of the non-executive directors also each undertake a Board oversight role to cover Conduct Risk (Kate Barker) and the Group's People strategy (Guy Parsons). These roles were created in 2012 and are to ensure that there is a continuous in-depth and independent review of these two important areas. However, overall responsibility for Conduct Risk and the Group's People strategy remains with the whole Board.

The Board and senior executive Committee Structure is set out in the Risk Management Report on page 48.

10. Non-executive Directors

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 Executive Team.

The non-executive directors meet, without the executive directors present, at least four times a year to discuss relevant matters including succession planning and the overall performance of the Executive 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 him. She would also act, if required, as an intermediary for the other directors. As Senior Independent Director, the Vice Chairman 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.

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.

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 all of the non-executive directors are independent. At the 2014 AGM Mr Anderson, the Chairman, will have served ten years as a non-executive director since his first election by members. However, the Board is unanimously of the view that the independence of his judgement will not be prejudiced by his continuation as a director. As referred to on page 32, Mr Anderson will be put forward for annual re-election at the 2014 AGM which is in line with the Code.

11. Induction and development

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 which are referred to on page 37. For example, in 2013 the non-executive directors continued to participate in a series of Treasury workshops. These were conducted by an external trainer and were specifically tailored for the Society's non-executive directors. In November 2013, Deloitte presented their annual update on regulatory and other topical issues to the Board which was forward looking. Individual training requirements for non-executive directors are discussed as part of the performance evaluation process 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 Executive Team to discuss any queries that they may have and to undertake branch and department visits on an ad hoc basis.

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.

12. The roles of the Chairman and the Chief Executive

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 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 Board review process.

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 Executive Team and through a suite of management and risk committees.

13. Member engagement

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 which give members the opportunity to meet and ask questions of the Chief Executive, other members of the Executive Team and local branch colleagues. 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 over 9,000 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 form a key performance indicator which is monitored by the Board on a monthly basis.

The Society's member engagement process is currently under review to ensure that it remains relevant and to make it as easy as possible for the Board and Executive Team to listen to our members and better meet their needs.

14. The AGM

At the AGM, the Chairman, Chief Executive and Finance Director give presentations on the previous year's financial performance and on future plans. The Chairman of the Remuneration Committee also gives a presentation on the directors' remuneration. 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.

15. Relations with other investors

The Society also places great importance in maintaining a frequent dialogue with its providers of external capital and funding. As part of the annual results publication process, the Society conducts a series of investor meetings to provide a detailed briefing on its financial performance. These briefings are held with a wide range of institutional investors and analysts and are not restricted to existing providers of wholesale funds or capital. The presentation materials are available throughout the year on the Society's website. In addition, representatives of the Society's treasury team conduct regular face-to-face meetings with external stakeholders throughout the year in order to provide updates on the Society's performance and respond to market queries.

16. Board and committee attendance record 2013

Set out below are details of the directors during 2013 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 2013.

Director	Board Meetings	Board Committees				
		Audit	Chairman's	Nominations	Remuneration	Risk
Ed Anderson Chairman	11(11)	–	4(4)	3(3)	–	3(3)
Kate Barker Non-executive Director	11(11)	–	–	3(3)	–	4(4)
Ian Bullock Chief Customer Officer & Executive Director	11(11)	–	–	–	–	2(3)
Roger Burden Non-executive Director (retired 17.04.2013)	4(4)	–	–	–	3(3)	–
Andy Caton Chief Corporate Affairs & Treasury Officer & Executive Director	11(11)	–	1(1)	–	–	3(3)
Lynne Charlesworth Vice Chairman	11(11)	–	4(4)	3(3)	–	4(4)
Robin Churchouse Chief Operating Officer & Finance Director	11(11)	–	1(1)	–	–	3(3)
Philip Johnson Non-executive Director	11(11)	7(7)	–	–	–	–
Guy Parsons Non-executive Director (appointed 01.05.2013)	7(7)	–	–	–	4(4)	–
David Paige Non-executive Director	10(11)	7(7)	–	–	6(7)	4(4)
Mark Pain Non-executive Director (appointed 01.08.2013)	4(4)	1(2)	–	–	–	1(1)
Chris Pilling Chief Executive	11(11)	–	2(2)	3(3)	–	3(3)
Simon Turner Non-executive Director	10(11)	7(7)	–	–	7(7)	–

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

On behalf of the Board

Ed Anderson
Chairman
25th February 2014

Audit Committee Report

Membership and attendees

The Audit Committee is appointed by the Board and is made up of four non-executive directors. Membership and attendance at meetings during 2013 is shown on page 38. David Paige, Mark Pain and I are the members with recent, relevant financial experience. All three meet this statement through either current or previous roles, other current non-executive directorships and our relevant qualifications. More information on the skills and experience of the members can be found in the Directors' Biographies on pages 24 to 26.

The committee invites the Chairman, Chief Executive, Finance Director, Head of Internal Audit and the external auditor to attend meetings. Further invitations are extended, as necessary, to other directors and senior managers.

Private meetings are regularly held with the external auditor and, separately, with the Head of Internal Audit with no members of management present. The chairman of the committee has regular meetings with the Head of Internal Audit.

Roles and responsibilities

The roles and responsibilities of the committee are in line with the provisions of the Financial Reporting Council (FRC) Guidance on Audit Committees (the 'Smith Guidance') which was updated in September 2012 and applied for financial years beginning on or after 1st October 2012. We chose to adopt some of its recommendations early in our 2012 year end accounts and have fully complied this year.

The main function of the committee is to assist the Board in fulfilling its oversight responsibilities in relation to:

- The integrity of the annual financial statements and interim results and any formal announcements relating to financial performance.
- The significant financial reporting judgements contained within the financial statements.
- The adoption and implementation of appropriate accounting policies and practices.
- Along with the Risk Committee, the effectiveness of the system of internal control and risk management systems.
- The management of the Group Internal Audit function and the approval of its terms of reference and audit plan.
- The appointment, re-appointment and removal of the external auditor and the review of their performance, independence and effectiveness.
- The policy on the use of the external auditor for non-audit work.
- The oversight of the whistleblowing provisions of the Group and to ensure they are operating effectively.

The committee's full Terms of Reference are available from the Corporate Governance section of our website (www.ybs.co.uk/your-society/inside-your-society/corporate-governance/committees.html).

The committee has undertaken work in all these areas in order to fulfil these obligations.

Areas of focus in 2013

Financial reporting issues and judgements

Our role in monitoring financial reporting issues is key to ensuring that all our stakeholders maintain their trust in our activities and reporting. We utilise our external auditor, Deloitte LLP (Deloitte), to help ensure that suitable accounting policies have been implemented and appropriate judgements have been made by management.

The main issues which we considered during 2013 were as follows:

- Loan loss provisioning – retail. The Group estimates the level of provisions required in the retail mortgage books using historical default and loss experience and applying judgment to predict future economic conditions. The most critical of these judgments relates to forecasts of house price movements. The committee reviewed the approach to calculating provisions and confirmed that the assumptions made are appropriate. The committee was satisfied with the overall calculation of the impairment provision. The impact of forbearance in the portfolio has been considered and appropriate disclosures made in the financial statements.

- Loan loss provisioning – commercial. The Group has two separate portfolios both of which were acquired following mergers with other Societies. The loan book acquired on the merger with Chelsea Building Society ('the Chelsea') is being held to maturity with no further loans being advanced. Sufficient fair value adjustments were made against this portfolio on the merger. The Society also made fair value adjustments against the loan book acquired on the merger with Norwich & Peterborough Building Society (N&P). This portfolio has grown since the merger and management developed a specific provisioning model in 2013 which considers, for loans in arrears, the likelihood of the underlying security having to be realised and the likely discount that may have to be applied in the event of the sale. The committee considered the approach adopted in the calculation of the provision and is comfortable with the overall level of provision made.
- Run-off of fair values associated with acquired books including revenue recognition. The Group has significant mortgage books which were acquired following the mergers with the Chelsea and N&P where the fair value of these books on acquisition was estimated by management. As these acquired assets run off over time, any adjustments to their fair values are recognised as revenues in the income statement. Management have undertaken a complete review of all our fair value adjustments and considered the underlying economic assumptions that are pertinent to each of the categories. We reviewed all the judgments made in this regard and discussed these at length with management and the external auditors. As a consequence, we are comfortable that a cautious approach has continued to be taken. The work has shown a need to release some of these provisions to the income statement this year and the committee believe it is an appropriate amount under the circumstances.
- Provisions for customer remediation – financial advice. Prior to the merger with N&P, it was identified that their financial advice business had mis-sold certain products to customers. Following the merger, we undertook a past business review of sales which involved contacting customers and remedying the effect on them of any mis-selling. As this event occurred prior to the merger, the provisions established are held as a fair value adjustment. This review is now close to completion. The committee has paid attention to the progress of the review to understand how actual experience of the proportion of customers who were mis-sold products and the value required to compensate them has compared to the initial estimates made in the fair value calculation. The number of claims and average redress paid to date has been less than originally estimated but the costs required to undertake the past business review have exceeded estimates. The committee is comfortable that the overall level of provision still held remains reasonable.
- Provisions for customer remediation – payment protection. The Society holds provisions in respect of claims made for mis-selling of payment protection products. The committee considered the approach adopted by management to review the calculation of these provisions. A range of estimates are used including claim success rates, costs and likely future volumes. The committee considered the overall level of provision to be reasonable.
- Provisions for conduct related issues – other. During 2013 the Board commissioned both internal and external reviews to determine whether our policies and procedures are sufficiently robust to ensure fair customer outcomes and to identify any instances where such outcomes may not have been delivered. Where customer detriment has been identified, an approach to remediation has been proposed. The committee considered the calculation of the estimated cost related to arrears administration and Protected Capital Account issues, and believes that appropriate provisions are being held in the financial statements. We reviewed the disclosures made in respect of on-going investigations by the FCA in respect of past practices and believe that the disclosures and associated provisions are appropriate.
- Financial Services Compensation Scheme (FSCS). The Group holds a provision for levies raised by the FSCS to fund the cost of loans from HM Treasury as a consequence of the default of a number of deposit-taking institutions. The International Financial Reporting Interpretations Committee (IFRIC) issued an interpretation of how to account for government levies such as the FSCS levy (IFRIC 21). This required a change to our accounting policy for the levy and results in a prior year adjustment and the inclusion of a third balance sheet. These changes impact many other organisations which are also subject to the levy. The committee reviewed the basis of recalculation of the levy using IFRIC 21 as well as the resultant restatements in the financial statements and believe that adequate disclosures have been made.
- Capitalisation of costs. The Group is implementing a major strategic change programme including the development of new systems. Certain of the costs associated with this programme met the recognition criteria of IAS 38 Intangible Assets and were capitalised by management. Management presented the rationale for capitalised items and demonstrated how they met the criteria set out in the accounting standard. The committee reviewed these proposals and believes that the recognition and calculation of capitalised costs is appropriate.
- Hedge accounting. The Group holds derivative financial instruments in order to mitigate various risks as set out in Note 34 on pages 124 to 126. International Financial Reporting Standards require changes in the value of these instruments to be recognised in the Income Statement unless it can be proven that they are offset by the fair value of the underlying items being hedged. The committee has overseen management's control activities in this area and is confident that amounts recognised in the Income Statement are accurate and that appropriate disclosures have been made.

- Valuation of treasury instruments. The Group continues to hold a relatively small portfolio of structured investment products which are legacy investments from before the financial crisis. It also holds certain instruments as part of its liquidity portfolio. The valuation of the structured investment portfolio has been difficult in the past due to market conditions but market values have been secured by management where possible. The committee considered the valuation made by management compared to Deloitte's independent views and is satisfied that carrying values are not materially misstated.
- Deferred tax. The Group holds a deferred tax asset on its balance sheet. The recoverability of this asset is largely dependent upon future profits being recorded. The committee considered forecasts included with the Group's corporate plan and is confident that the deferred tax asset is capable of being realised in the future.

The committee considered these issues and the other critical areas of judgement (as identified in Note 2 on pages 92 to 93) and confirmed that they are appropriate. We adopt the same disciplines and approaches when compiling the interim results.

The Group's Annual Report and Accounts are required to be fair, balanced and understandable as well as providing the necessary information for members to assess the Group's performance, business model and strategy. At the request of the Board, we considered whether these requirements were met. The process to draft and review the Annual Report and Accounts is undertaken to a challenging timetable which runs alongside the external audit undertaken by Deloitte. Key elements of our process include:

- Guidance is issued to colleagues involved in the process.
- Development of the Annual Report and Accounts is overseen by a steering group which considers disclosures made.
- Verification takes place to ensure there is appropriate supporting evidence of the content of the Annual Report and Accounts.
- A range of reviews of drafts of the Annual Report and Accounts takes place to ensure consistency of disclosures and an appropriate level of balance.
- Formal oversight and sign off by the Executive Team.

The committee was satisfied that, taken as a whole, the Annual Report and Accounts is fair, balanced and understandable.

Internal controls

Our role in reviewing the effectiveness of the system of internal controls is particularly important as the Group looks to deliver on its strategic change programme and faces a more intensive, intrusive regulatory environment. An effective control framework is vital to manage risk and to maintain the trust of all our stakeholders. We review this aspect through regular reporting from management, Group Internal Audit and our external auditors who set out the views of management as well as their own independent opinions. We work closely with the Group Risk Committee as some areas, such as compliance monitoring, provide formal reports to that committee.

The main internal control areas considered and reviewed in detail during 2013 were:

- Conduct related matters. Group Internal Audit (GIA) have implemented enhanced working practices to provide assurance that the Group delivers appropriate customer outcomes including changes to their methodology, reporting formats and grading approaches. They provided detailed assurance reports over the implementation of revisions made to our product governance processes and management's reviews of our front and back book products. Reviews were also performed of our core operational processes for savings and mortgages. We are conscious of the impact that failures in IT controls can have on our customers, as evidenced by high profile systems outages in the banking sector. The committee considered the findings of IT controls work by GIA and Deloitte during the year.
- Prudential related matters. The committee has also been careful to maintain focus on prudential areas as well as the conduct agenda. GIA provided assurance over capital and liquidity management processes including the associated regulatory documents.
- Strategic change. The committee is conscious that the ambitious strategic change programme can give rise to an increased risk profile and approved the recruitment of additional headcount in GIA to create a team dedicated to providing assurance in this area. We also received reports on the capitalisation of costs associated with this strategic programme and are satisfied with the outcome.

- Internal audit plans. The committee provided oversight and direction for the implementation of a revised approach to developing the internal audit plan. Risk assessment activity was undertaken in conjunction with members of the Group Risk Committee to provide GIA with a clear view on priority areas for the provision of internal audit assurance. Following this assessment, a programme of work for 2014 and associated resources for its delivery were approved.
- Our external auditors provide us with internal control reports in respect of key financial reporting processes and systems arising from the external audit review. During the year, Deloitte did not highlight any material control weaknesses.
- We track the status of issues raised in control reports closely, both from our internal and external auditors. During the year, the volume and age profile of control issues has remained within our risk appetite.
- The committee reviews the use of the confidential reporting channels in the Group each year. Awareness of 'whistle blowing' arrangements is maintained in a number of ways including internal communications and training modules.

Oversight of internal audit

The committee receives regular reports from GIA setting out the results of their assurance activity including their opinion on the effectiveness of the internal control environment and performance against a range of measures included in their balanced scorecard.

We have continued to review the performance of our internal audit function to ensure that it remains fit for purpose. In early 2013, the function devised a performance improvement plan to ensure that it remained fit for purpose given increased scrutiny under the new regulatory regime. As a result, changes were made to internal audit approaches including reporting formats and grades.

The committee undertook a specific review of skill sets in the function to ensure they were appropriate to deliver the internal audit plan and approved the establishment of quality assurance resource to provide ongoing assurance over the effectiveness of internal audit delivery.

The committee also oversaw an independent external review of the effectiveness of the internal audit function and the agreement of actions to address the findings. Many of these findings arose against the Chartered Institute of Internal Audit's newly published Guidance for Effective Internal Audit in the Financial Services Sector. The committee considered a gap analysis of practice compared to the Guidance, approved action plans and is monitoring their implementation.

The committee considers an effective, independent internal audit function to be a cornerstone of effective corporate governance and has enshrined this in an Internal Audit Charter which can be viewed at www.ybs.co.uk/your-society/inside-your-society/corporate-governance/committees.html

Oversight of external audit

Each year the committee approves the proposed audit plan presented by the external auditor including a discussion of key risk areas to ensure that there is agreement on the focus of work and materiality measures.

The external auditor provides regular reports to the committee on their work on the interim financial statements and the Annual Report and Accounts prior to the committee recommending approval. These reports include:

- Work performed in areas of significant risk and their conclusions for each area.
- Their views on the judgements made in applying accounting policies.
- Summary of any misstatements which they have identified.
- Internal control related issues.

The committee carries out a formal assessment of the effectiveness of the external auditor and their processes each year. This assessment is facilitated by GIA and is based on a framework published by the Audit Committee Institute. It comprises:

- The completion of a formal questionnaire by members of the committee and regular attendees at meetings to solicit their views on the calibre of the firm, the capabilities of external audit personnel, the scope of the audit, effectiveness of communications and the independence of the audit. Follow up interviews are held where appropriate.
- Workshops held with colleagues who have been involved with the audit process to ascertain their views of the strengths and weaknesses of the team and the approach adopted.
- A report from GIA summarising strengths and issues raised.

During 2013, Deloitte also undertook a client satisfaction survey using an independent partner of the firm to obtain the views of the Chairman of the Audit Committee, the Chief Executive and the Finance Director. The results of this survey and the output from our own assessment process was considered by the committee.

The committee takes into account the performance of the external auditor when considering their re-appointment as well as their length of tenure and the date of rotation of the audit partner. Deloitte were appointed in July 2009 following a competitive tender process and the external audit partner will rotate off the audit after the 2013 year end. During 2013, the committee considered the need for a competitive tender. The committee concluded that they were happy with the performance and independence of Deloitte and recommended that they be re-appointed at the AGM for the current year.

New corporate governance code requirements mean that the audit contract should be put out to tender at least every ten years. Under the transitional arrangements, this means that the contract will need to be re-tendered no later than 2019.

External auditor objectivity and independence

The Group has a policy on the use of the external auditor for non-audit work which is overseen by the committee. The purpose of this policy is to ensure the continued independence and objectivity of the external auditor and this policy can be found as an Appendix to the Audit Committee Terms of Reference (www.ybs.co.uk/your-society/inside-your-society/corporate-governance/committees.html). 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 considers whether formal committee approval is required. The level of fees incurred is regularly monitored. The external auditor undertook a number of non-audit related assignments for the Group during 2013. 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.

The committee reviewed the approach to non-audit services in 2013 and concluded that tighter rules were not required and that no specific ceiling on overall fees was necessary at this point in time.

Details of the fees paid for non-audit services during the year can be found in Note 7 on page 96.

System of internal controls

The Board recognises the importance of sound systems of internal control in the achievement of its objectives and the safeguarding of member and Group 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 Group 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 Group's ability to react accordingly. It is the role of management to implement the Board's policies on risk and control. It is also recognised that all colleagues have responsibility for internal control as part of their accountability for achieving objectives. People 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.

GIA 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 2013 there were no material breaches of control or regulatory standards other than the conduct issues discussed on page 14, 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 45 to 51.

Audit Committee effectiveness

The effectiveness of the committee is assessed annually. A self-assessment exercise, co-ordinated by GIA, is performed using questionnaires and interviews with members and attendees at committee meetings. The results are also reported to the Board. The 2013 review concluded that the committee has operated effectively during the year.

Committee members are expected to undertake relevant training as part of their ongoing development as an individual Board member. Each year, as well as undertaking individual training as members consider appropriate, the committee as a whole receives training on current topics. In 2013, this comprised updates on: conduct risk issues, cybercrime, the legal and regulatory environment, governance developments, internal audit and financial reporting changes and current areas of interest and concern.

On behalf of the Board

Philip Johnson
Chair of the Audit Committee
25th February 2014

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 sustainable financial performance and its ability to provide value and fair outcomes to its membership and customers.

Risk Governance

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, made up of non-executive directors and attended by senior executives, considers all risk matters relating to the Group, including credit risk, operational risk, market risk, liquidity risk, funding risk, business risk, and regulatory (including prudential and conduct risk) 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, ensuring the sustainability of YBS and thereby ensuring that no stakeholder suffers 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, and that they 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 department provides periodic independent reports on risk positions and risk management activities for consideration by the Group Risk Committee, its sub-committees and the Board. The Group's Chief Risk Officer provides a formal update to each Board meeting covering all areas of risk management, including both routine reporting and ad hoc issues.

Risk Vision and Strategy

The Board recognises that risk in various forms arises naturally from the Group's provision of various financial services to customers. The Group's Risk Vision promotes advanced risk management to support and direct financial security, fair outcomes, and a Group built on trust. 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, 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, highlighting the importance of having the right culture and cultural leadership and requiring evidentially good conduct behaviour across the five key pillars of customer treatment, product governance, sales suitability, complaints and redress, and reward and remuneration.
- A Prudential Risk Philosophy that considers the macro-economic, regulatory and political environment, the volatility of outlook for that environment, and the internal risk management capabilities of the Group to determine and manage the appropriate risk appetite for individual areas of the business. This relates most specifically to the strategic priority of the sustainable financial performance of the Group.

The Group has a framework of consistently articulated risk appetites and a regularly updated Group Risk Map by which it 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 how each risk sits against the Group's risk management capability. 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 and reviewed monthly and the Group's risk sub-committees monitor the dashboards relevant to their activities. The dashboards are reviewed in detail on a quarterly basis by the Group's Chief Officers, and the Group Risk Committee also reviews the dashboards relating to the most significant risks on a quarterly basis.

Risk Culture

The risk framework of appetite statements, risk map and dashboards, risk management information, and the risk committee structure testify to a robust and embedded risk culture that continues to mature. The Group operates a "Three Lines of Defence" model for risk management where the first line comprises the business operations, and their responsibility is to manage risk on a day-to-day basis; the second line consists primarily of the Group Risk function which facilitates the operation of the framework, coaches the business operations, and provides challenge; the third line of defence is formed by the Internal Audit function which monitors the framework and provides assurance that adequate controls are in place and functioning correctly.

Stress and scenario testing are also widely used throughout the Group and involve a large number of colleagues. Such testing ranges from the stress testing required of the capital and liquidity regulatory submissions (the Internal Capital Adequacy Assessment Process, the "ICAAP"; and the Individual Liquidity Adequacy Assessment, the "ILAA") together with the annual reverse stress tests which attempt to produce illustrative scenarios that might cause the Group to fail, to regular scenario analysis, and the daily stress testing of liquidity and market risk.

Group Risk Committee ('GRC')

The Group Risk Committee oversees the Group's risk governance framework and provides an entity-wide perspective on all risk matters. It normally meets four times a year but will meet more frequently when the need arises. Its current membership comprises four non-executive directors: Lynne Charlesworth, Kate Barker, David Paige, and Mark Pain; and it is also attended by senior executives including the Chief Executive, the Chief Operating Officer, Finance Director and the Chief Risk Officer. It has delegated responsibility for the Group's risk strategy, risk appetite, risk monitoring, and capital management. Its duties include:

Monitoring of:

- The prudential risk environment.
- The conduct risk environment.
- The risk horizon, both from the perspective of risks to the Group's objectives, and from the perspective of tail risks.

Approval of:

- The risk management strategy.
- The Group's risk appetite.
- The regulatory capital submission (ICAAP).
- The regulatory liquidity submission (ILAA).
- Recovery and resolution plans.
- Conduct risk oversight plan.
- The project to implement Internal Ratings Based (IRB) approach to capital requirements for retail credit risk.

Oversight of:

- Risk appetite adherence.
- Conduct risk.
- Periodic investigative deep dives into ad hoc areas.

The committee's full Terms of Reference are available from the Corporate Governance section of our website (www.ybs.co.uk/your-society/inside-your-society/corporate-governance/committees.html).

During 2013, the committee met four times in the execution of its responsibilities and, in particular, considered the following matters:

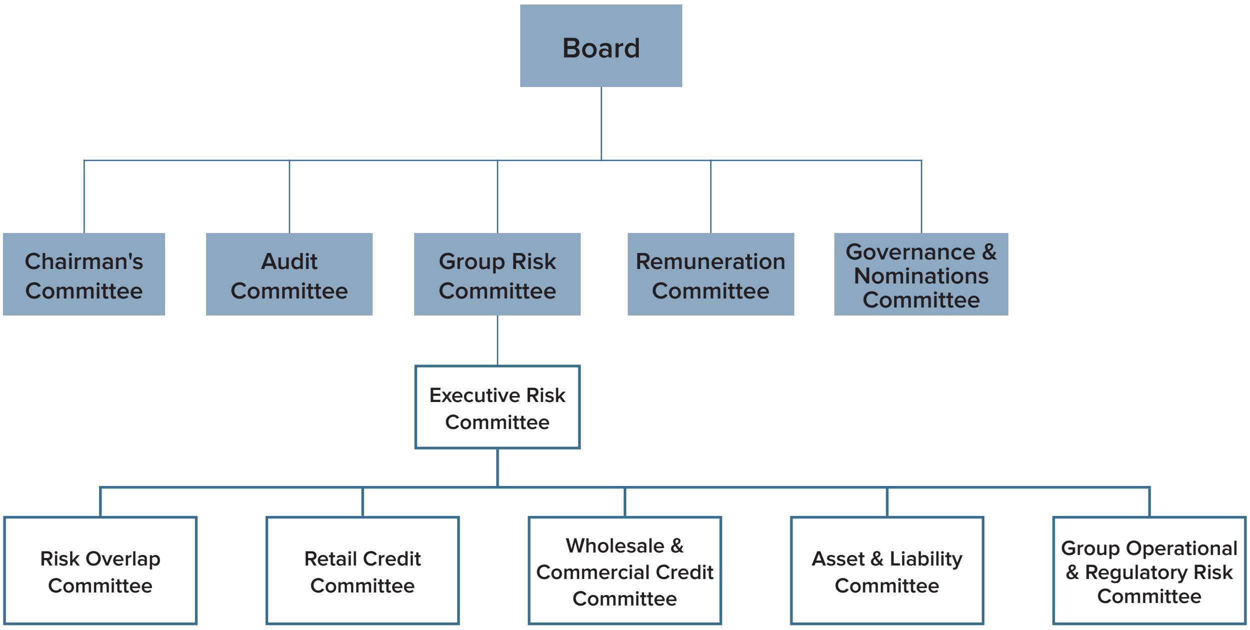
- External economic, political and market risks, and assessment of their potential impact on the Group, in particular the London and South-East property markets.
- Regulatory oversight including the programme of submissions to the Prudential Regulation Authority (ICAAP, ILAA, and reverse stress tests) and also approval and monitoring of the programme of conduct risk oversight.
- Agreement of a qualitative and quantitative risk appetite framing the parameters for risk acquisition and risk management for 2014.
- Agreement of a risk management strategy directing the Group's approach to best practice risk processes and a strong approach, based on a mutual philosophy, toward conduct risk management and prudential risk management.
- Changes to the infrastructure of sub-committees governing risk in the organisation (see below).
- Recalibration of the measurement of enterprise-level risks to the Group.
- Product governance oversight.
- Self-evaluations to ensure that the committee is fulfilling its responsibilities.
- Oversight of the governance and monitoring of health and safety risk.
- Business continuity and disaster recovery arrangements for the Group.
- Determination of a risk overlay impacting the level of senior management bonus payable.
- Approval and oversight of the project to implement IRB approach to capital requirements for retail credit risk.

In 2013, in line with recommended best practice, GRC approved changes to its structure, limiting the membership of GRC to non-executive directors, thus ensuring that the committee takes a sufficiently strategic view of the Group's activities and risk environment. As part of this review of structures and processes, GRC approved a change to the operation of the risk sub-committees that have day-to-day responsibility for risk management oversight. The Executive Risk Committee (ERC) was established as an umbrella for five sub-committees. ERC takes place once a month and runs for an entire day: the sub-committees meet in sequence on that day, making risk management oversight a focus of attention for the Group. The component committees of ERC and their areas of coverage are as follows:

- Risk Overlap Committee: issues that straddle more than one committee, and higher-level areas such as the macro-economic environment, enterprise-wide risk and control, and capital.
- Retail Credit Committee: exposure limit setting and monitoring, arrears monitoring, forbearance, roll rates, possessions, impairment provisions and losses, affordability, scorecard and model effectiveness, lending controls, current accounts, and approval of relevant policies.
- Wholesale and Commercial Credit Committee: counterparty limit setting and monitoring, structured credit, Residential Mortgage Backed Securities (RMBS), commercial lending, housing association lending, and approval of wholesale credit and commercial lending policies.
- Asset & Liability Committee (ALCO): net interest margin, interest rate risk, interest rate view, Treasury performance, mortgages and savings, liquidity and funding, retail and wholesale markets, and approval of the financial risk management policy.
- Group Operational and Regulatory Risk Committee (GORRC): product governance, processes and systems, people and resources, business continuity and disaster recovery, regulatory risk, conduct risk, financial crime, information security, health and safety, supplier management, complaint handling, Quality Assurance and Training and Competence frameworks, project risk, and approval of relevant policies including those of its sub-committees.

The structure and how it fits into the Group's risk and governance framework is shown diagrammatically, below.

Governance & Risk Forums (shaded boxes indicate the Board and its committees)



The sub-committees' memberships and terms of reference were reviewed and updated as part of this process and where the sub-committee itself has sub-committees (e.g. sub-committees overseeing areas such as data governance and cybersecurity), then those memberships and terms of reference were also updated to ensure both consistency and effectiveness of oversight and decision making. After three months in operation, the effectiveness of the new structure was reviewed and a number of small improvements implemented in what will be a process of continuous improvement. The process has further formalised the risk governance structure and strengthened the risk culture of the Group.

Risk Overlap Committee

This committee has been established to cover issues that cut across the responsibilities of more than one committee, or that are more enterprise-wide in their nature, such as capital (review of the ICAAP, pillar 3 disclosures, and monitoring of changes to regulations affecting capital, etc), the Group's risk profile, or the risk management strategy. The chairs of the other risk sub-committees form part of the membership of Risk Overlap Committee.

Asset and Liability Committee (ALCO)

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.

The Group maintains and monitors a liquidity and funding risk appetite comprising qualitative statements and specific metrics. The Group holds sufficient liquidity to continue trading and protect members even under highly stressed conditions. On an annual basis, a range of liquidity stress scenarios are developed covering, in the last iteration, a total of 11 scenarios assessed over three timeframes. The worst-case three-month scenario forms the basis of our liquidity adequacy assessment. The Group's liquidity risk appetite triggers a warning whenever liquidity falls to within 10% of our total liquidity or regulatory requirements.

The stress test to ensure regulatory liquidity is adequate, and within our risk appetite, is run daily and reported within the business. The whole range of liquidity stress tests that prove our overall liquidity adequacy are also run, reviewed and reported daily. The weekly ALCO meeting reviews an extended projection of funding and liquidity against a longer-term forecast for both the measures outlined above. All three views of liquidity adequacy are reported monthly to ALCO and to the Board, with quarterly reporting to GRC.

The Group's funding risk appetite seeks to ensure that a stable and diverse funding base is maintained to support balance sheet lending activities and to meet operational requirements. This statement is supported by a range of limits and key risk indicators which are monitored daily and monthly. For wholesale funding, the appetite is for funding which is diversified in terms of investor profile, currency, geography, instrument type and maturity spectrum; for retail funding it is diversified in terms of product and distribution type.

Detail of actual exposures at the year-end is contained in Note 35 on pages 127 to 129.

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. The market risk position is monitored daily and reviewed by ALCO at least monthly. The Board receives monthly summaries of risk positions and ALCO 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 ALCO and the Board, with quarterly reporting to the Group Risk Committee.

The Group's principal source of market risk is interest rate risk, monitoring of which focuses on four main measures:

- 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 point (0.01%) 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.
- Re-pricing gap analysis is used primarily for the identification of instrument re-pricing concentrations.

More details of these risk management measures can be found in Note 36 on pages 130 to 131.

The Board recognises that these key measures for managing interest rate risk cannot be individually 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 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 on page 131.

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.

Retail Credit Risk 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.

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 is well aware of the risk disparity between the mortgage books 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 Retail Credit Risk Committee. In particular the committee monitors arrears, loan-to-value ratios, expected losses, scorecard performance, and affordability. Retail Credit Risk Committee has three sub-committees that oversee lending criteria, model validation, and collections and recoveries.

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

Details of actual retail credit risk exposures are contained in Note 39 on pages 135 to 142.

Wholesale and Commercial Credit Committee

Wholesale and commercial credit risk

The Wholesale and Commercial Credit Committee 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 analysis presented to the committee. Limits are also set against the aggregate exposure to equally-rated institutions and to all institutions based in any one country. Over the last few years, the Group has suspended a significant number of lines to other institutions, radically reducing the number of firms it is prepared to have exposure to. Additionally, all new derivative transactions are covered by an ISDA (International Swaps and Derivatives Association) master agreement and a credit support annex that mitigates our exposure.

The Wholesale and Commercial Credit Committee also maintains oversight of the Group's commercial lending activities. Wholesale and commercial credit risk management information is reported to Wholesale and Commercial Credit Committee and the Board on a monthly basis, and quarterly to the Group Risk Committee.

Details of actual wholesale and commercial credit risk exposures are contained in Note 38 and Note 39 on pages 132 to 142.

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.

Group Operational and Regulatory Risk Committee oversees the functioning of the operational risk framework and compliance with regulatory requirements. It has 10 sub-committees which oversee areas of risk such as data governance, financial crime, cyber security, and supplier management to a greater level of detail, and which then feed information through to the committee.

The Group's operational risk management framework sets out the group-wide strategy for identifying, assessing and managing operational risk. The framework 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 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 the Board monthly, and quarterly to the 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 and sophistication of such activity in the financial services market.

2013 has seen a continuing focus on conduct risk management to ensure that fair outcomes for customers are paramount – a focus that aligns perfectly with the Group's strategic vision. Our conduct risk strategic framework and risk appetite which was approved by the Board in 2012 has been further developed and refined to include more detailed risk appetite measures, outcome testing and monitoring of our five core pillars of conduct behaviours.

This will continue to be an area of significant focus for the Group during the coming years. It has become clear that the Group's processes and systems were not providing robust assurance that fair outcomes were always being delivered to customers. This became especially clear in relation to some of our product literature supporting our Protected Capital Account and also within our arrears collection operation. In the arrears collection area it was felt that a lack of robustness in some processes could lead to the unnecessary charging of administration fees. In addition to working to put these things right, the Group acted very quickly during 2013 and sought advice from an expert external firm which provided advice to the Group to help identify any other areas that it may wish to review. All of the advice provided is being acted upon and an ongoing assurance investment programme will ensure that the new higher standards are maintained.

On behalf of the Board

Lynne Charlesworth
Chair of Group Risk Committee
25th February 2014

Directors' Remuneration Report

Dear Member

On behalf of the Board, I am pleased to present our directors' remuneration report for 2013, which sets out our policy on pay, benefits and bonuses for the directors and senior managers and details the amounts earned by the directors for the year ended 31st December 2013.

YBS is committed to best practice in corporate governance and we have always been as transparent as possible in this report in order to assist our members in understanding how directors are remunerated, particularly in terms of variable pay, and how we measure the performance of the Group.

New regulations have come into effect, which impact the presentation and disclosure of directors' remuneration. This year we have included additional information in this report and the layout of this report reflects those new regulations in so far as they are considered relevant to building societies. This report is, therefore, presented in two main sections: the Remuneration Policy and the Annual Remuneration Report. The Remuneration Policy sets out the forward-looking remuneration policy and the Annual Remuneration Report provides details on the amounts earned in respect of the year ended 31st December 2013 and how the Remuneration Policy will be operated for the year commencing 1st January 2014.

2013 key decisions and annual bonus out-turns

As described by our Chairman on page 2, the Group has had another successful year, with increased profits and capital and liquidity positions maintained above regulatory limits. In addition, throughout 2013, the Group has aligned with Prudential Regulation Authority (PRA) guidelines to ensure a sustainable approach to our capital position and to continue to strengthen our controls for monitoring our commitment to deliver fair customer outcomes.

It is in this context that the Remuneration Committee (RemCo) has determined the payments to executive directors and senior managers for 2013. In summary, the average base salary increase awarded as part of the annual pay review for executive directors (excluding the CEO) in 2013 was 2.9%. The CEO's salary was increased by 3.9%. These increases were in line with the range of base pay increases awarded to other colleagues in the Group which ranged from 0% to 3.9% (2.47% average). These pay awards were applied from 1st May 2013.

In 2013, the executive directors, Chief Officers and other colleagues with a material impact on the Group's risk profile (known as Code Staff) participated in a non-pensionable annual bonus plan.

As set out in the remuneration report for 2012, in order to reduce any incentive to take undue risk, the ratio of fixed and variable pay for executive directors and Chief Officers for 2013 was adjusted. This was achieved by reducing the "on target" annual bonus payments and increasing base salary.

The maximum annual bonus for all executive directors and Chief Officers for the year ended 31st December 2013 was 50% of base salary, with 30% of base salary payable for "on target" performance.

It is proposed that undeferred bonuses of between 11.77% and 44.13% of salary be awarded to the directors, of which 50% would be deferred in respect of 2013 (60% for the CEO). These payments reflect delivery of pre-tax profit, achievement against cost target and customer service. Individual performance was also considered in determining the proposed bonus pay outs.

The Group's incentive arrangements are designed to reward colleagues for achieving stated business goals in a manner that is consistent with the Group's approach to effective risk management. Aligned to this approach, RemCo, in considering all risk factors, found no reason to apply any adjustments to the award of 2013 bonuses to executive directors and Chief Officers.

As a result of the conduct related issues outlined earlier some reductions have been made to the 2012 deferred bonus for the executive directors and appropriate Chief Officers of between 5% and 30%.

The committee will finalise these variable pay awards after the 2014 AGM to ensure the voting on this report is properly considered.

In order to ensure the prioritisation of sustainable financial performance; ensure a prudent approach to risk and to comply with the PRA's remuneration code part of the bonus is deferred. Deferred bonuses may be reduced or forfeited if the sustainable level of capital required to support the Group's growth rate is not generated each year, or in the event of other material breaches of the Group's risk appetite.

Further details regarding base salary increases for the executive directors are set out on page 65. Details of deferred and non-deferred bonuses for the executive directors are set out on page 61.

Key items for 2014

The committee will continue to focus its efforts during 2014 upon designing and implementing remuneration arrangements that ensure executive directors' performance is aligned with the delivery of our long-term strategic objectives. Performance is measured in relation to the achievement of profit, control of costs, customer service and the delivery of strategic objectives.

The Group's approach to senior management remuneration for 2014 will remain broadly unchanged from 2013, however, the committee will continue to monitor our approach to pay in an environment of continuing regulatory change and the wider market around executive pay to ensure that remuneration is simple, competitive and aligned to sound risk management. Quality and audit controls will continue to underpin all our schemes.

Any changes to the base salaries for executive directors will be determined in May 2014, at the same time as all other colleagues.

The maximum potential annual bonus for executive directors will remain unchanged at 50% of salary. The committee is satisfied that the targets set for 2014 will drive significant sustained improvement in the performance of the Group.

The committee will continue to monitor the Group's remuneration against best practice amongst other building societies and financial services organisations with regard to the disclosure of directors' remuneration, in particular, the voting arrangements for the remuneration policy.

We have strived to comply with the key disclosures required by the new regulations, the UK Corporate Governance Code and best market practice throughout this report. I trust that our members will endorse this report via advisory votes on each of the remuneration policy and the annual report on remuneration.

Simon Turner
Chair of the Remuneration Committee

About this Report

This report has been prepared on behalf of the Board and has been approved by the Board. In the interests of best governance practice, the Group considers the disclosure requirements applicable to listed companies. These requirements are set out in the Large and Medium Sized Companies and Groups Act (Accounts and Reports) Regulations 2008 and the UK Corporate Governance Code and are used as appropriate guidelines for the disclosure in relation to directors' remuneration.

This report also covers information on the remuneration policy of Chief Officers and Code Staff.

A summary of this report will be sent to all members eligible to vote at the 2014 Annual General Meeting and members will have the opportunity to vote on both the remuneration policy and the annual remuneration report, at the 2014 AGM which will be on an advisory basis.

Introduction

The Group's remuneration policy serves to help the committee and the Board align remuneration decisions to the Group's strategy. The remuneration policy is determined with regard to the interests of members and the Group. Each year, this policy is reviewed and approved by the Board.

The key objectives of the Group's remuneration policy for executive directors, Chief Officers and other Code Staff are summarised below.

- The remuneration of executive directors, Chief Officers and other Code Staff should deliver an appropriate balance between encouraging strong financial performance, ensuring sound risk management and delivering fair customer outcomes.
- The remuneration of executive directors, Chief Officers and other Code Staff should be competitive with those of comparable organisations 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, Chief Officers and other Code Staff should be variable, based primarily on the Group's financial, risk and service performance (in particular, the net promoter score) and 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. The proportion of variable pay, however, is designed to ensure that it is feasible for none to be paid in years where business or personal performance does not merit payment.
- Personal reviews of executive directors, Chief Officers and other Code Staff are carried out at least annually to assess their performance in meeting individual and strategic objectives. These reviews are formally reflected in pay reviews which take effect from 1st 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 (RemCo).
- No executive director, Chief Officer or member of Code Staff is involved in deciding his or her own remuneration.
- The policy complies with the PRA Remuneration Code.

The chart below provides a summary of the different elements of pay which form the basic remuneration package of the executive directors, Chief Officers and other Code Staff.

Fixed elements

Base salary + benefits + pension contributions

Performance related elements

Short-term performance	Long-term performance
The short-term element of the annual bonus which is based on achieving stretching targets that support the Group's strategy and aligns to key performance indicators.	The deferred element of the annual bonus, which is subject to the achievement of longer-term performance conditions.

A proportion of both the short-term and deferred elements of variable pay for any colleague whose Total Remuneration is greater than £500,000 per annum will be paid in the form of a share equivalent instrument and subject to retention conditions, further aligning the reward of those colleagues to long-term performance. The £500,000 threshold is known as the "de minimis[1]", as currently defined within the PRA Remuneration Code.

[1] Colleagues above the "de minimis" – those whose total remuneration is greater than £500,000 per annum and/or where variable remuneration totals more than 33% of their total remuneration – must have a proportion of their variable remuneration paid in shares or share equivalent instruments that are subject to claw-back provisions.

Section 1. Remuneration Policy

Executive Directors

The following table describes each of the components of the remuneration package for the executive directors. More detailed information on how the Group intends to implement the policy for the current financial year is set out in the Annual Remuneration Report on page 61.

Element of remuneration	Purpose and link to strategy	Operation	Opportunity	Performance metrics
Base salary	Core element of fixed remuneration with the aim to recruit, motivate and retain executives of the calibre required.	Base salaries are reviewed annually (or more frequently if required), and are influenced by a range of factors including but not limited to: • role, experience and individual performance; • the economic environment and overall financial performance of the Group; • the range of salary increases awarded across the Group; and • typical pay levels for comparable roles in comparable organisations.	Salary increases are reviewed in the context of salary increases for the wider colleague population and the committee considers very carefully any increase out of line with increases across the Group. Higher increases may be awarded where there is a strong commercial rationale to do so, taking into account all relevant factors, including but not limited to: • increase in scope and responsibility; • a new director being moved to market positioning over a period of time; • a salary falling significantly below market positioning; or • in other exceptional circumstances where there is a strong commercial rationale as endorsed by RemCo.	As for all colleagues within the Group, individual performance is assessed against business and personal objectives.
Benefits	Fixed element of remuneration with the aim to recruit, motivate and retain executives of the calibre required.	Executive directors receive benefits in line with market practice and principally include private medical insurance, life insurance, a concessionary mortgage and savings scheme and Permanent Health Insurance. Other benefits may be provided based on individual circumstances. Such benefits may include (but are not limited to) car or relocation allowances.	Set at a level which the committee considers appropriate and provides sufficient level of benefit based on individual circumstances.	Not applicable.

Element of remuneration	Purpose and link to strategy	Operation	Opportunity	Performance metrics
Pension	Helps recruit and retain executives.	Executive directors are eligible to participate in the defined contribution pension plan or a defined benefit plan. In appropriate circumstances, such as where contributions exceed the annual or lifetime allowance, executive directors may be permitted to take a cash supplement instead of contributions to the plan.	Executive directors receive a defined pension contribution equal to a maximum of 16% of base salary. This is partly paid as a cash supplement to adhere to prevailing tax thresholds. There is one remaining executive director in the Defined Benefit section. The Defined Benefit section closed to new members on the 31st December 1999, however, it is still open to future accrual for existing members.	Not applicable.

The annual bonus scheme rewards performance and productivity and is responsive and flexible to the business needs of the Group. The scheme is reviewed prior to the start of each year to ensure the bonus opportunity, performance measures and weightings of those measures are appropriate and support the Group's strategy. The maximum annual bonus opportunity is 50% of base salary. For achievement of "on target" performance level under the annual bonus scheme, up to 30% of base salary (60% of the maximum opportunity) pays out. The annual bonus is made up of a short-term (undeferred) element and a deferred element.

Element of remuneration	Purpose and link to strategy	Operation	Opportunity	Performance metrics
Short-term (undeferred) element	To drive and reward the achievement of short-term financial and strategic business targets and the delivery of personal objectives relevant to the Group's strategic objectives.	For colleagues over the de minimis 40% of any bonus earned is paid out in the financial year following the year in which it is earned. 50% of the short-term element due to these colleagues will be paid in the form of a share equivalent instrument, subject to a six month retention requirement. For other executive directors, 50% of any bonus earned is paid out in the financial year following the year in which it is earned. The ability to reduce short-term bonus awards (malus[2]) or apply claw back is applicable.		Performance is measured against challenging financial targets in key operational areas, with the relevant areas and the respective weighting varying each year based upon the Group's strategic objectives.

[2] Malus: Where issues associated with colleague conduct are evident, or where the Group or business unit in which a colleague is engaged suffers a material downturn, a material failure of risk management, or misstatement of the Group's audited results, RemCo may reduce whole or part of a bonus and/or any unvested awards.

Element of remuneration	Purpose and link to strategy	Operation	Opportunity	Performance metrics
Deferred Element	To deliver variable pay in a form that prevents undue risk taking and which drives the achievement of sustainable financial performance and complies with the PRA's remuneration code.	For colleagues over the de minimis, 60% of any bonus is deferred, and paid out 20% in the second year, 20% in the third year and 20% in the fourth year following the year in which the bonus is earned. 50% of the deferred element due to these colleagues will be paid in the form of a share equivalent instrument, subject to a six month retention requirement. For other executive directors, 50% of any bonus is deferred, and paid out 25% in the second and 25% in the third year following the year in which the bonus is earned. The ability to reduce or lapse deferred awards (malus) or apply claw back is applicable.		Performance is measured against challenging longer-term financial targets, varying each year based upon the Group's strategic objectives. These performance conditions typically include conditions relating to Group profit, capital and liquidity.

Non-executive Directors

The following table describes each of the components of the remuneration package for the non-executive directors.

Element of remuneration	Purpose and link to strategy	Operation	Opportunity	Performance metrics
Non-executive director fees	Sole element of non-executive director remuneration set at a level that reflects market conditions and is sufficient to attract individuals with appropriate knowledge and experience.	Fees are reviewed regularly. The committee determines and recommends to the Board the remuneration of the Chairman. Fees paid to non-executive directors are determined and approved by the Board as a whole on recommendation from the CEO.	Non-executive directors receive a basic fee and an additional fee for chairmanship and/or membership of a committee and/or oversight roles and for holding the position of Senior Independent Director. Fees are based on the level of fees paid to non-executive directors serving on Boards of comparable organisations and the time commitment and contribution expected for the role. The non-executive directors do not participate in any Group supported pension arrangements.	Non-executive directors do not participate in any annual bonus or long-term incentive arrangements. Whilst non-executive directors' fees are not subject to any specific performance measures, the overall performance of non-executive directors is reviewed on a regular basis.

The committee retains the discretion to make payments outside the terms of this policy where there is a commercial need (including interim executive director and non-executive director appointments) and where it considers it absolutely necessary to do so in exceptional circumstances, taking into account the interests of members.

Explanation of performance metrics chosen for executive directors' annual bonus plan

Performance metrics for awards under the annual bonus plan are set to drive business performance and link to the Group's strategy, whilst not encouraging excessive risk taking. The committee considers that the measures encourage the delivery of sustainability based on growth.

The committee considers carefully the target ranges to be attached to annual bonus, taking into account a number of factors which include future growth expectations, the setting of stretching but achievable targets and due consideration to customer and member outcomes.

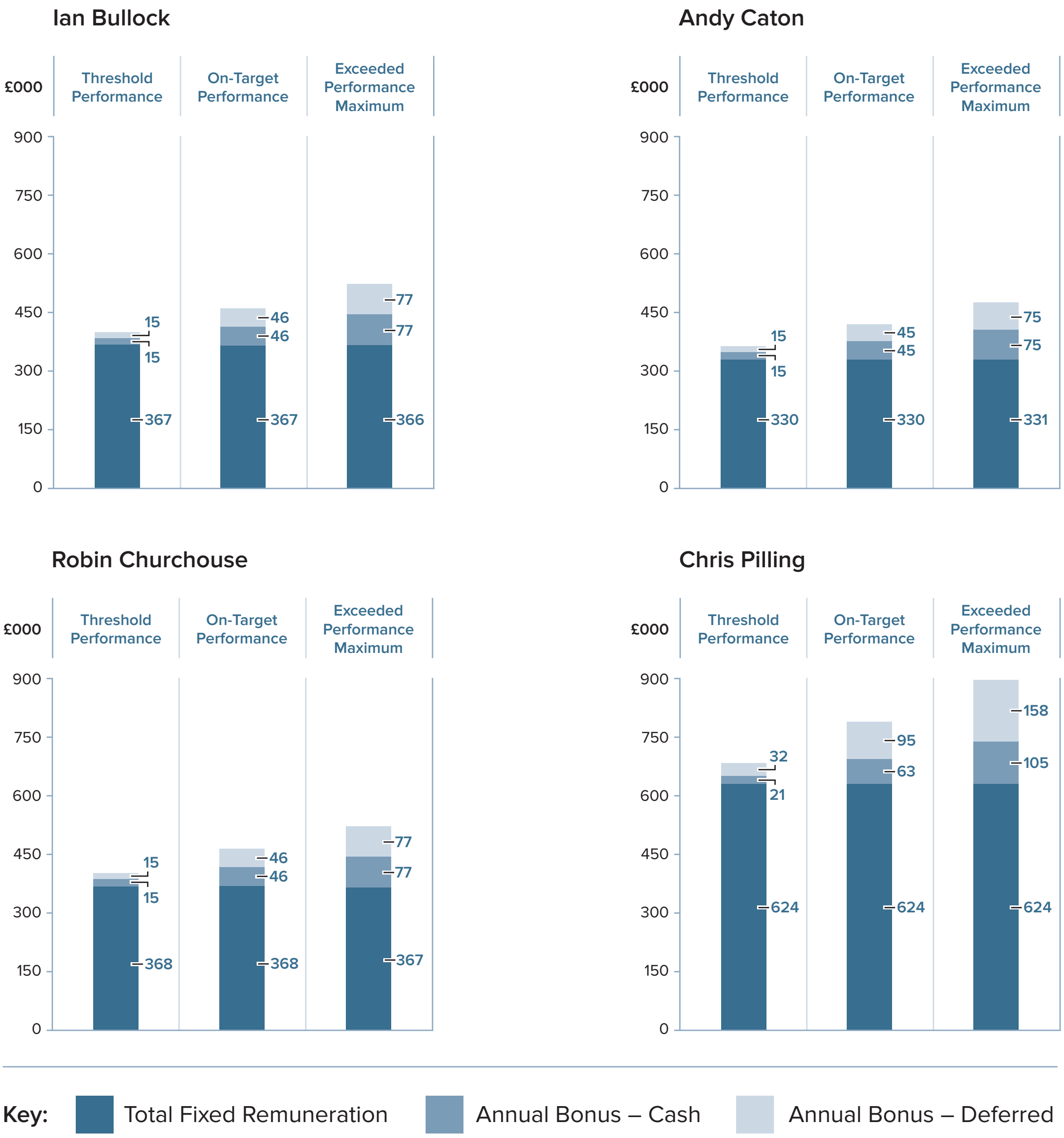
Remuneration Scenarios

The charts below show the relative split of remuneration between fixed pay (base salary, benefits and pension) and variable pay (annual bonus) for the CEO and other executive directors. The charts illustrate how much the CEO and executive directors could potentially earn under different performance scenarios, i.e. Threshold, On Target and Exceeded Performance.

The committee believes an appropriate portion of remuneration links reward to Group and individual performance and is aligned to its strategic priorities.

	Fixed remuneration	Total Annual Bonus	Short-term element of the annual bonus	Deferred element of the annual bonus
Below Threshold Performance	Base salary, benefits and pension	No bonus earned	No bonus earned	No bonus earned
Threshold Performance	Base salary, benefits and pension	10% of salary	CEO – 4% of salary Others – 5% of salary	CEO – 6% of salary Others – 5% of salary
On Target Performance	Base salary, benefits and pension	30% of salary	CEO – 12% of salary Others – 15% of salary	CEO – 18% of salary Others – 15% of salary
Exceeded Performance – Maximum	Base salary, benefits and pension	50% of salary	CEO – 20% of salary Others – 25% of salary	CEO – 30% of salary Others – 25% of salary

Fixed and variable remuneration illustrations based upon different performance levels – 2013



In developing the scenarios, the following assumptions have been made:

- Total Fixed Remuneration refers to salary, pension and benefits paid over the course of the calendar year.
- Pension and benefits are those disclosed in the single figure table on page 61 for the year ending 31st December 2013.
- The deferred element of the annual bonus is shown before the consideration of any movement in the share equivalent instrument.

Executive pay relative to the wider colleague population

The committee takes into account the remuneration paid to the wider colleague population when approving executive pay in a number of ways, including the salary increases awarded to the wider colleague population across the Group and consideration of the remuneration policy as applied to all colleagues.

Although no formal consultation takes place with colleagues on executive remuneration, the Group has various ways of engaging with colleagues in relation to their overall people experience, including the consideration of information from a colleague survey, where colleagues are invited to share their views on a range of issues.

Approach to new hires

When agreeing the components of a remuneration package for the appointment of executive directors, the committee will apply the following principles:

- the packages will be sufficient to facilitate the recruitment of individuals of the required calibre to lead the business and effectively execute the strategy for members;
- the committee will look to align the remuneration package offered with the Group's broader remuneration policy; and
- the committee will ensure that the level of pay is deemed necessary but not excessive.

The committee has discretion within the policy to make remuneration decisions where it considers it necessary to do so. In determining appropriate remuneration arrangements, the committee will consider, without limitation, the quantum of the package on offer compared to similar positions in the market, the structure of the remuneration and the experience of the candidate to ensure that arrangements are in the best interests of both the Group and its members without paying in excess of what is deemed necessary to recruit a director of the required calibre.

The committee may make awards on hiring an external candidate to compensate the candidate for the forfeiture of any award entered into with a previous employer. In determining any such 'buy out', the committee will consider all the relevant factors including the likelihood of the awards vesting should the external candidate have remained in their previous employment, the form in which they were awarded and the time over which they would have vested. The committee would seek to implement buyout and recruitment awards in line with the Group's remuneration framework so far as practical.

Where considered appropriate, special recruitment awards will be liable to forfeiture or "clawback" in the event of early departure.

Directors' service contracts

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

Service contracts for Chief Officers and other Code Staff have notice periods varying between three months and one year, depending on the particular role.

Non-executive directors are appointed 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 Group, a non-executive director may be asked to serve a further term by exception. All directors are subject to election by members, generally at the AGM following their appointment by the Board, and thereafter subject to re-election by members at least every 3 years.

Payments for loss of office of executive directors

The Group's policy on the principles on which the determination of payments for loss of office will be approached are summarised below.

Provision	Policy
Termination payment	Payment of basic salary and other contractual benefits for the notice period. If a payment in lieu of notice is made, the provisions of the relevant service contract will apply to determine the amount of any payment due.
Annual Bonus plan leaver provisions	On termination of office, the leaver provisions within the annual bonus plan will apply. Under "good leaver" circumstances the annual bonus plan rules state that any bonus will be pro-rated to reflect the time served during the performance period. Any deferred payments are due subject to future performance conditions and payable at the end of the corresponding performance periods as they would be for continuing colleagues. If an individual is deemed to have not left under "good leaver" circumstances, no bonus payment(s) will be made. In the case of death, there is the assumption of eligibility to the date of death and payments are made on this basis. The payment of any deferred amounts, including deferred amounts from previous years, is accelerated and payable at the next payment date.

Member engagement

The Group has regular dialogue with members and welcomes feedback on executive director and non-executive directors' remuneration.

Section 2. Annual Report on Remuneration

Executive director remuneration

The remuneration of the executive directors of the Group for the year ended 31st December 2013 and the previous year is set out in the tables below. This is audited information.

Director	Salary/ fees £000[1]	Variable pay £000[2]	Deferred Variable Pay from previous years £000	Taxable benefits £000[3]	Increase in accrued pension £000[4]	Group's contribution to pension scheme £000[5]	Total £000[9]
Year ended 31st December 2013							
Executive director							
Ian Bullock	333[6]	68	93	8	–	25	527
Andy Caton	300	18	88	10	21	–	437
Robin Churchouse	331[6]	61	91	11	–	25	519
Chris Pilling	601[6]	93[7]	153[7,8]	15	–	8	870
Total	**1,565**	**240**	**425**	**44**	**21**	**58**	**2,353**

Director	Salary/ fees £000[1]	Variable pay £000[2]	Deferred Variable Pay from previous years £000	Taxable benefits £000[3]	Increase in accrued pension £000[4]	Group's contribution to pension scheme £000[5]	Total £000[9]
Year ended 31st December 2012							
Executive Director							
Ian Bullock	286[6]	61	64	8	–	28	447
Andy Caton	264	59	60	9	9[10]	–	401[10]
Robin Churchouse	286[6]	60	63	11	–	28	448
Chris Pilling	462[6]	155[7]	99[7,8]	15	–	17	748
Total	**1,298**	**335**	**286**	**43**	**9**	**73**	**2,044**

Notes

1 Basic pay plus cash pension allowance refers to salary and cash pension allowance paid over the course of the calendar year, see note 6 below.

2 Includes proposed payments for the performance year in which they were earned (actual payment due the following year).

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: Robin Churchouse £10,623 and Chris Pilling £14,355.

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, 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.

6 Includes partial cash pension allowance, as a result of reduced employer pension scheme contributions.

7 50% of which is paid as a share equivalent instrument.

8 Includes payment to honour lost earnings incurred by Chris Pilling on leaving his previous employer.

9 For the executive directors other than Andy Caton, the total remuneration stated above is the "single figure for total remuneration" as set out in the new reporting regulations.

10 Andy Caton's accrued pension for 2012 was mis-stated in the 2012 Directors Remuneration Report as being £19,000. The actual accrued pension figure was £9,000.

Details of unpaid deferred elements under the annual bonus plan

Executive director	Performance Year	Due 2014 £000	Due 2015 £000	Due 2016 £000	Due 2017 £000	Total deferred £000
Ian Bullock	2010	32	–	–	–	32
	2011	32	32	–	–	64
	2012[1]	29	29	29	–	87
	2013	–	34	34	–	68
	Total	**93**	**95**	**63**	**–**	**251**
Andy Caton	2010	29	–	–	–	29
	2011	31	31	–	–	62
	2012[1]	28	28	28	–	84
	2013	–	9	9	–	18
	Total	**88**	**68**	**37**	**–**	**193**
Robin Churchouse	2010	31	–	–	–	31
	2011	32	32	–	–	64
	2012[1]	28	28	28	–	84
	2013	–	31	31	–	62
	Total	**91**	**91**	**59**	**–**	**241**
Chris Pilling	2010	–	–	–	–	–
	2011	79	55	–	–	134
	2012[1]	74	74	74	–	222
	2013	–	46	46	46	138
	Total	**153**	**175**	**120**	**46**	**494**
Total		**425**	**429**	**279**	**46**	**1,179**

Notes

[1] Deferred elements in respect of the 2012 performance period for executive directors are subject to a 5% reduction as referred to on page 52.

All deferred elements are subject to future performance conditions, and may be reduced or forfeited as appropriate subject to the malus and/or clawback rules. The future performance conditions that are imposed on the deferred element typically include conditions relating to Group profit, capital and liquidity.

Non-executive director remuneration

Director	Basic Fees £000	Committee fees[1] £000	Total £000
Year ended 31st December 2013			
Non-executive director			
Ed Anderson (Chairman)	146	–	146
Kate Barker[3]	44	20	64
Roger Burden (Retired 17.04.2013)	13	3	16
Lynne Charlesworth	65	18	83
Philip Johnson	44	18	62
David Paige	44	20	64
Simon Turner	44	20	64
Mark Pain (appointed 01.08.2013)	19	6	25
Guy Parsons (appointed 01.05.2013)[2]	30	5	35
Total	**449**	**110**	**559**
Year ended 31st December 2012			
Non-executive director			
Ed Anderson	142	–	142
Kate Barker[3]	43	16	59
Roger Burden	43	6	49
Lynne Charlesworth (Vice-Chair from 18.04.2012)	57	21	78
Philip Johnson	43	18	61
Richard Davey (retired 18.04.2012)	18	5	23
David Paige	43	19	62
Simon Turner	44	18	62
Total	**433**	**103**	**536**

Notes

[1] Details of non-executive director committee membership and role-holders are set out in the table on page 38.

[2] Guy Parsons was appointed to the 'People' oversight role from 1st August 2013.

[3] Kate Barker's committee fees for 2013 include £5,330 for her duties as a trustee of the Norwich & Peterborough pension scheme.

Individual elements of remuneration

As set out in the 2012 Directors Remuneration Report, we made some changes to executive directors' remuneration in 2013. The "on target" bonus payment was reduced from 60% of salary for the CEO and 45% for executive directors and Chief Officers, to 30% in all cases, with effect from 1st January 2013.

Base salary and fees

Executive directors

The approach to the annual review of salaries for senior roles is the same as for all colleagues in the Group. Dependent upon individual market positioning and individual performance, colleagues were eligible to receive a pay award of between 0% and 3.9%. The CEO's salary was increased by 3.9%, other executive directors by an average of 2.9% and all other colleagues by an average of 2.47%. These pay awards were applied from 1st May 2013.

The ratio of fixed and variable remuneration was adjusted for executive directors and Chief Officers. As described above, from 1st January 2013, in order to ensure that overall remuneration packages remained competitive, basic pay was increased 10.27% (20.55% for the CEO). This change was made to reduce further, any incentive to take undue risk in return for higher levels of variable pay. The tables on page 61 refer to 2013 remuneration and include four months' pay at the prior level and eight months' pay at the increased level.

The base salaries from 1st May 2013 are as set out below:

	£
Ian Bullock	312,072
Andy Caton	303,009
Robin Churchouse	310,257
Chris Pilling	532,314

For 2014, the base salaries for executive directors will be determined in May 2014.

Non-executive directors' fees

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 Chief People Officer, using external benchmarking data, and with reference to the responsibilities, skills and time commitment required for the role.

A recommendation is made to the Board which determines any change in the remuneration of non-executive directors. Any such changes take effect from 1st July. In 2013, the fees of the Chairman and other non-executive directors were increased by 3%. However, as a result of the increased complexity of RemCo matters and subsequent demands upon its members, RemCo membership fees rose from £4,235 to £5,100 (20.4%).

Additional fees (as shown in the table below) 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 membership.

Non-executive director fees (annual equivalents)	2012 Up to 30th June £	2012 From 1st July £	2013 Up to 30th June £	2013 From 1st July £	Overall Annual Fees 2012 £	Overall Annual Fees 2013 £
Chairman's Basic Fees	140,000	144,000	144,000	148,320	142,000	146,160
Vice-Chair Basic Fees	61,800	63,530	63,530	65,440	62,665	64,485
Non-Executive Director Basic Fees	42,230	43,420	43,420	44,730	42,825	43,278
Additional fee for:						
• Member of Audit Committee	7,210	7,420	7,420	7,650	7,315	7,535
• Chair of Audit Committee	17,510	18,000	18,000	18,450	17,755	18,225
• Member of Remuneration Committee	4,120	4,325	4,325	5,100	4,222	4,712
• Chair of Remuneration Committee	10,000	12,000	12,000	12,360	11,000	12,180
• Member of Group Risk Committee	7,210	7,420	7,420	7,650	7,315	7,535
• Chair of Group Risk Committee	17,510	18,000	18,000	18,450	17,755	18,225
• Conduct Risk Oversight Role	7,210	7,420	7,420	7,650	7,315	7,535
• People Oversight Role	n/a	4,235	4,235	4,370	2,118	4,303

Benefits

For 2013, each executive director was provided with benefits which comprised a company car (or an equivalent allowance), private medical insurance and permanent health insurance. No significant changes are envisaged for 2014.

In addition, in common with all other colleagues, the executive directors can participate in a concessionary mortgage scheme which is subject to a maximum concessionary amount of £160,000.

Pension

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 Group's pension scheme.

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

Defined Contribution Plan

For those executive directors receiving contributions under the defined contribution section, a total payment equal to a maximum of 16% of base salary is paid. Part of this employer contribution is paid directly into the pension scheme and the remainder as a cash allowance due to prevailing tax restrictions.

Defined Benefit Plan

The table below shows the pension benefits under the defined benefit pension plan. 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 below table.

	Contributions from Directors* £000	Increase in accrued pension £000	Accrued pension as at 31st December £000	Transfer value of accrued benefits as at 31st Dec 2012 £000	Transfer value of accrued benefits as at 31st Dec 2013 £000	Movement in transfer value less directors' contributions £000
Andy Caton	–	21	139	1,865	2,312	447

*With effect from 1st April 2010, pension contributions formerly made by members of the Group's pension scheme are now made on their behalf by the Group, with members instead sacrificing the equivalent amount of their salary. Andy Caton made an effective contribution of 8% of salary.

Similar benefit structures exist for Chief Officers and other Code Staff.

Annual Bonus

In 2013, the executive directors, Chief Officers and other Code Staff participated in a non-pensionable annual bonus plan, part of which is delivered after the end of the performance period and part of which is subject to deferral.

2013 maximum annual bonus

The maximum annual bonus for all executive directors and Chief Officers for the year ended 31st December 2013 was 50% of base salary, with 30% of base salary payable for "on target" performance.

2013 performance measures

The performance measures applied for the year ended 31st December 2013 were as follows:

Performance measure	% of total bonus
Pre-tax profits	50%
Cost	25%
Customer service (measured by the net promoter score)	25%

Individual performance is also considered in determining any bonus payment due.

The committee feels that these measures allow a clear line of sight between the key financial and customer performance metrics of the business and the ultimate level of variable pay delivered.

2013 deferral and payment in share equivalent instruments

The following table explains the percentage of bonus deferred and the performance measures that apply to the deferred elements for relevant Code Staff and for the CEO.

All deferred elements are subject to future performance conditions, and may be reduced or forfeited as appropriate. If the first deferred element is not paid, this does not impact on the later deferred elements, which standalone and are subject to the relevant performance conditions for that year.

	Relevant Code Staff
Percentage of bonus deferred	For the relevant Code Staff (excluding the CEO), 50% of any bonus earned is paid following the end of the performance period and 25% is paid in each of the following two years.
Bonus delivery	Cash
Performance measures	Payments will be reduced or forfeited if the sustainable level of capital required to support the Group's growth rate is not generated each year. This is done via a scale adjustment measured against a minimum level of return on mean assets (ROMA) for each year based upon the growth achieved. In addition, consideration is given to the management of specific business risk appetite measures and payment can be amended where material breaches are identified. Deferred payments are subject to the same conditions as above.

	CEO
Percentage of bonus deferred	For the CEO, the operation of the annual bonus is designed to comply with the PRA's remuneration code and reflect best practice. Therefore, 40% of any bonus earned is paid following the end of the performance period and 20% is paid in years two, three and four respectively.
Bonus delivery	50% of both the short-term (undeferred) and 50% deferred elements due to the CEO would be paid in the form of a share equivalent instrument, which will be subject to a six month retention requirement. The remaining 50% of both the short-term (undeferred) and 50% deferred elements will be paid in cash.
Performance measures	Payments will be reduced or forfeited if the sustainable level of capital required to support the Group's growth rate is not generated each year. This is done via a scale adjustment measured against a minimum level of ROMA for each year based upon the growth achieved. In addition, consideration is given to the management of specific business risk appetite measures and payment can be amended where material breaches are identified. Deferred payments are subject to the same conditions as above.
Share equivalent instrument	The share equivalent instrument is an award of units, which are valued based upon a ROMA multiplier. The ROMA multiplier is the ratio of the actual ROMA for the relevant financial year divided by the target ROMA for the year. The number of units awarded in 2013 is the element of the bonus earned in 2013 which is to be delivered via the share equivalent instrument divided by the deemed initial unit value of £1. The unit value at the end of the relevant performance period is the initial unit value multiplied by the ROMA multiplier, subject to a cap on unit value of £1.25 per unit.

The committee feels that the deferred element of the bonus and the associated risk adjustment supports the Group's aim of taking a long-term view of success and ensuring a focus on a sustainable business ethic.

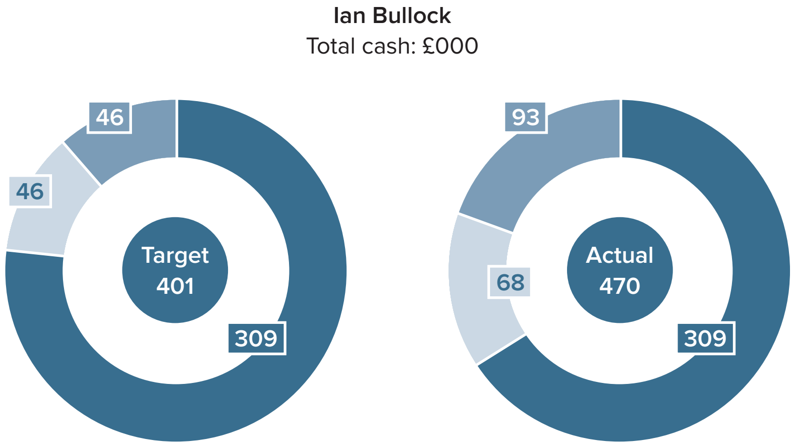
2013 annual bonus out-turn

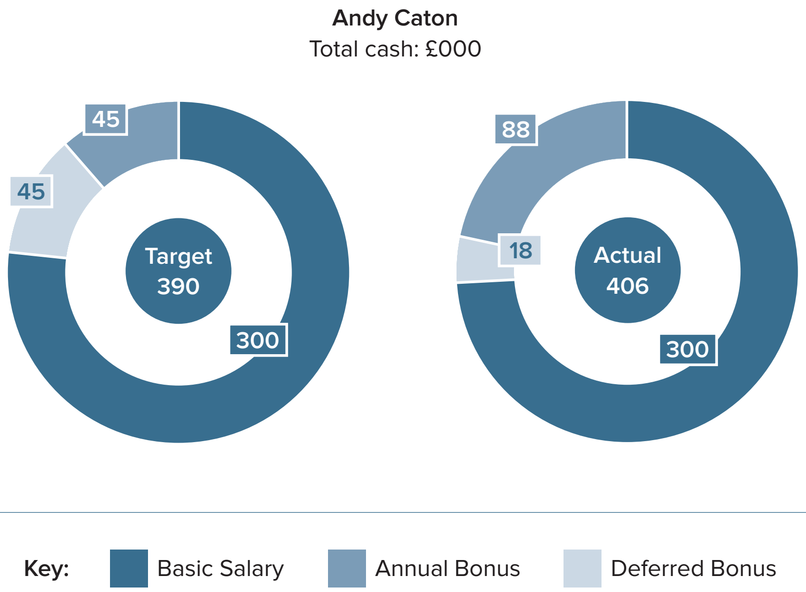
The following provides the pre-tax profit, cost and customer service target reference points for the executive directors for 2013. To ensure that the voting of members on the Directors' Remuneration Report at the AGM can be considered before payments are made, the committee signs-off variable pay awards after the relevant AGM.

Performance condition	2013 target as a % of salary	Calculated pay out as a % of salary (Assuming on-target personal performance)
Pre-tax profit	15.0%	29.8%
Cost	7.5%	0.0%
Customer service	7.5%	5.5%
Total	**30.0%**	**35.3%**

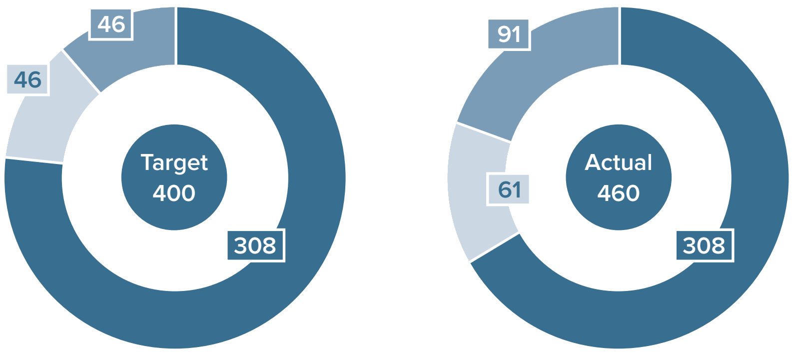
Details of unpaid deferred elements under the annual variable pay scheme are shown in the additional information at the end of this report.

These proposed bonus pay-outs are illustrated in the diagrams below, displaying total cash at target (base salary, bonus and deferred bonus) versus actual achievement for 2013:

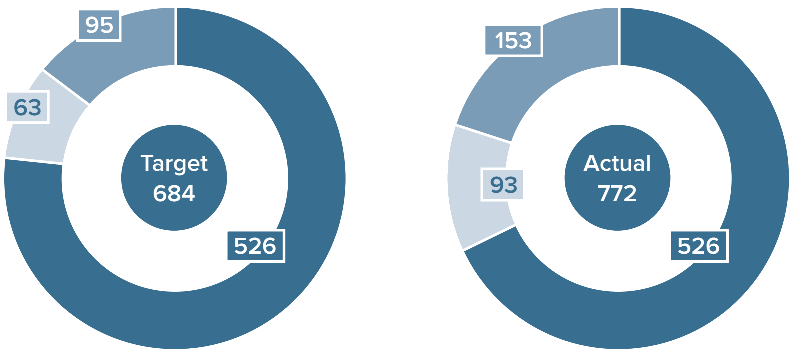




Robin Churchouse
Total cash: £000



Chris Pilling
Total cash: £000



Key: Basic Salary Annual Bonus Deferred Bonus

Annual bonus for the year ended 31st December 2014

The 2014 annual bonus will be operated in the way set out above for 2013, including the performance measures described above.

The committee considers that the specific pre-tax profit, cost and customer service targets for 2014 are matters that are commercially sensitive and should therefore remain confidential to the Group as they would provide our competitors with insight into our business plans and expectations. The targets will be disclosed in the Group's Report and Accounts in respect of the 2014 financial year.

Aggregate remuneration data (fixed and variable pay) for Code Staff

The Prudential Sourcebook for Banks, Building Societies and Investment Firms (Remuneration Disclosures) Instrument 2010 requires the publication of aggregate remuneration data for the Group as a whole and in summary form for senior managers and colleagues whose actions have a material impact on the risk profile of the firm (“**Code Staff**”), as follows:

	Eligible earnings £000	Variable pay (non-deferred) 2013 £000	Percentage of 2013 variable pay as cash	Deferred variable pay from previous years[2] £000	Outstanding deferred remuneration[3] £000	Number of beneficiaries
Code Staff[1,4]	5,279	970	95%[5]	983[6]	1,819	34

Notes

1 Senior managers and colleagues 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 Payments deferred from previous years which become payable as a result of performance in 2013.

3 In relation to current and previous years.

4 Figures for Code Staff that left the Group during 2013 are included within the above table.

5 All Code Staff receive variable pay paid as cash, except the CEO, who receives 50% in a share equivalent instrument.

6 Deferred elements in respect of the 2012 performance period for a small number of Code Staff were subject to reduction as referred to on page 52.

Payments to past directors

There were no payments made to past directors during the financial year ended 31st December 2013.

Payments for Directors loss of office

There were no payments made for loss of office during the financial year ended 31st December 2013.

Change in CEO pay

The table below sets out in relation to salary and annual bonus the percentage change from the prior year at pay review for the CEO compared to the wider colleague population. This includes all colleagues including other executive directors.

Pay Review Percentage Change 2013	2013 Pay Review Salary Increase	Annual Bonus Target Change
CEO	3.90%[1]	- 30%
Colleague average	2.47%	0%

Notes

1 the ratio of fixed and variable remuneration was adjusted for the CEO on 1st January 2013. The CEO’s base pay was increased by 20.55% to ensure that the overall package remained competitive.

Details of the Remuneration Committee

The committee is responsible for determining, on behalf of the Board, the overall group-wide remuneration policy (including bonus levels) for all colleagues and, in particular, the policy and the level of remuneration of the executive directors, Chief Officers and other senior managers. The full Terms of Reference of the committee can be found at www.ybs.co.uk/your-society/inside-your-society/corporate-governance/committees.html.

The committee normally meets at least five times a year with additional meetings as required. In 2013 it met 7 times. The committee takes independent external professional advice as appropriate, and monitors comparative remuneration packages within the financial sector.

The committee is made up of at least three non-executive directors. In 2013, they were Roger Burden (up to retirement from office in April 2013), Guy Parsons (from May 2013), David Paige and Simon Turner (Chair of the committee).

The Group's CEO, the Chief People Officer and senior managers from the Group's Risk Management function present and comment upon proposals and supporting evidence as and when required and attend meetings at the committee's request. The Group's Chairman, Ed Anderson, also attends meetings other than when his own remuneration is being discussed.

Remuneration Committee advisers

Deloitte LLP ("Deloitte") is retained to provide independent advice to the committee as required. Deloitte is a member of the Remuneration Consultants Group and, as such, voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. Deloitte's fees for providing remuneration advice to the committee amounted to £25,680 for the year ended 31st December 2013.

When appropriate, the committee considers external data from independent national surveys of the financial sector and a comparator group of financial institutions to ensure remuneration remains competitive. Independent reward specialists carry out a comprehensive overall review of senior management remuneration, generally once every three years. The last review was undertaken in association with Towers Watson in 2013. Towers Watson's fees for 2013 were £10,100.

Statement of member voting – 2013

The Group remains committed to on-going member dialogue and takes an active interest in voting outcomes. The following table sets out actual voting in respect of the resolution to approve the Director's Remuneration Report ('DRR') at the Group's Annual General Meeting in 2013:

Resolution	Votes for	% of vote	Votes against	% of vote	Votes withheld
Approval of the DRR	175,297 (3,753)*	88.9%	21,916	11.1%	4,879

*Includes the discretionary votes given to the Chairman (number in brackets)

On behalf of the Board

Simon Turner
Chair of the Remuneration Committee
25th February 2014

Directors’ Responsibilities Statement

The following statement, which should be read in conjunction with the statement of the Auditor’s responsibilities on pages 74 to 78, 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 Prudential Regulation Authority under the Financial Services Act 2012.

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.

We consider that the Annual Report and Accounts, taken as a whole is fair, balanced, and understandable and provides the information necessary to assess the Group’s performance, business model and strategy.

On behalf of the Board

Ed Anderson
Chairman
25th February 2014

Independent Auditor's Report
to the members of Yorkshire Building Society

Opinion on the financial statements of Yorkshire Building Society

In our opinion the financial statements:

- give a true and fair view, in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31st December 2013 and of the Group's and the Society's income and expenditure 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.

The financial statements comprise the Group and Society Income Statements, the Group and Society Statements of Comprehensive Income, the Group and Society Balance Sheets, the Group and Society Statements of Movements in Member's Interests, the Group and Society Cash Flow Statements, and the related Notes 1 to 42. The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Going concern

We have reviewed the directors' statement contained within the Directors' Report on page 28 that the Group is a going concern. We confirm that

- we have not identified material uncertainties related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern which we believe would need to be disclosed in accordance with IFRSs as adopted by the European Union; and
- we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team:

Risk	How the scope of our audit responded to the risk
Loan loss provisions	
Determining impairment provisions against loans to customers is judgemental requiring an estimate to be made of the likely loss within the residential mortgage and commercial lending portfolios. This requires the estimation of customer default rates, house price movements, sales costs, forced sale discounts and likelihood of repossession which may be sensitive to changes in the economic environment.	We challenged the appropriateness of management's key assumptions used in the impairment calculations for loans and receivables, including the estimation of house prices, sales costs, forced sale discounts and likelihood of repossession, by benchmarking against internal and external data, and testing the underlying controls in the provisioning process. We also tested the accuracy and completeness of the provision calculation by testing an extraction of source data from the core lending systems and recalculating the provision in accordance with the approved provisioning policy, and the identification of impaired accounts.
Fair value adjustments	
The Group's assessment of the utilisation of the fair value adjustments that were established upon the merger of the Society with Norwich & Peterborough Building Society and Chelsea Building Society in prior years which requires significant judgement.	We tested the movement in the fair value adjustments that were established upon the merger of the Society with Norwich & Peterborough Building Society and Chelsea Building Society in prior years, and challenged the appropriateness of the unwind of these adjustments over time.

Risk	How the scope of our audit responded to the risk
Revenue recognition	
The recognition of revenue on loans using an effective interest rate method requires significant judgement by management to determine key assumptions related to the expected life of each loan and the cash flows relating thereto. Such assumptions are also sensitive to changes in the economic environment.	We challenged the appropriateness of management's key assumptions used in the recognition of revenue using the effective interest rate method as described in Note 1 by comparison against historical customer behaviour and by performing analytical procedures to assess the sensitivity of key assumptions.
Provisions for customer remediation	
The assessment of the Group's calculation of provisions for customer remediation in relation to arrears collections operations and the sales of retail products is judgemental due to the uncertainty around complaint volumes, uphold rates and redress and other costs.	We challenged the appropriateness of management's key assumptions used in the customer complaint remediation provision by testing estimated future cash flows and volumes of complaints against historical analysis of critical data inputs including complaint volumes, uphold rates and redress costs, and also by performing an assessment to understand the potential for any regulatory fines.
Financial Services Compensation Scheme	
Accounting for the Financial Services Compensation Scheme ("FSCS") is reliant on data extracted from the core savings system and involves making assumptions regarding the Society's share of industry protected deposits. There is also uncertainty regarding the extent to which additional levies will be raised to cover future capital shortfalls on the loans to HM Treasury and the extent of any contingent liabilities to be disclosed in the financial statements.	We challenged the accuracy of the provision for the FSCS levy by performing an independent calculation of the amount based on information published by the FSCS and internal data from the core savings system. In respect of the deposit balances guaranteed by the FSCS we also tested the extraction of the data from the core savings system and tested the identification of the underlying accuracy of the system data.
Capitalisation of costs	
The capitalisation of costs relating to a range of business initiatives, some of which have resulted in significant Information Technology expenditure. In order to be capitalised such expenditure needs to meet the recognition criteria for capitalised costs, and then be subject to an impairment assessment to establish their carrying value. This requires significant judgement to determine the net present value of future cash flows deriving from this expenditure, including the application of an appropriate discount factor.	We challenged whether the expenditure that had been capitalised met the recognition criteria for capitalised costs, and the appropriateness of the carrying value of the capitalised assets.

Risk	How the scope of our audit responded to the risk
Hedge accounting	
The hedge accounting requirements are complex and require significant skilled input and oversight by management, as well as robust systems and controls particularly due to the number of both micro and macro hedge arrangements in the Group.	We tested management's application of hedge accounting which comprised testing hedge documentation, and independently reperforming a sample of hedge effectiveness tests conducted by management during the year.
Treasury instruments	
The valuation of derivatives and certain investment securities held at fair value requires significant judgement to determine appropriate inputs including quoted market prices, but where these are not available, inputs such as interest rates, volatility, exchange rates, counterparty credit ratings and valuation adjustments need to be considered which often require significant judgement.	We considered the appropriateness of the valuation techniques as set out in Notes 15 and 40, which have been used to calculate the fair values of derivatives and certain investment securities, which included certain structured credit investments. This included recalculating a sample of valuations. We also tested the quoted priced used, and where required, challenged the inputs into the valuations such as interest rates, volatility, exchange rates, counterparty credit ratings and any valuation adjustments that were considered necessary in determining the fair value of these instruments.
Deferred taxation	
The recognition and measurement of deferred tax assets, which is significantly reliant upon the underlying profit forecasts of the Group.	We tested the recognition and measurement of the deferred tax asset, and challenged the underlying profit forecasts of the Group in order to determine whether full recognition of the deferred tax asset was appropriate.

The Audit Committee's consideration of these risks is set out on pages 39 to 41.

Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

Our application of materiality

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

We determined planning materiality for the Group to be £10.2 million, which is less than 7.5% of normalised pre-tax profit.

We agreed with the Audit Committee that we would report to the committee all audit differences in excess of £0.1 million, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

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

Adequacy of explanations received and accounting records

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

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

We have nothing to report on in respect of these matters.

Our duty to read other information in the Annual Report

Under the ISAs (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed.

We confirm that we have not identified any such inconsistencies or misleading statements.

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 which 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.

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 or the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

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 and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Stephen Williams ACA (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor Leeds

25th February 2014

Income Statements

for the year ended 31st December 2013

	NOTES	Group 2013 £m	Group 2012 Restated* £m	Society 2013 £m	Society 2012 Restated* £m
Interest receivable and similar income	3	**1,405.6**	1,380.7	**1,311.3**	1,329.8
Interest payable and similar charges	4	**(874.0)**	(1,034.7)	**(903.7)**	(1,071.8)
Net interest income		**531.6**	346.0	**407.6**	258.0
Fees and commissions receivable		**33.9**	49.9	**31.0**	42.6
Fees and commissions payable		**(8. 7)**	(6.7)	**(7.7)**	(6.0)
Net fee and commission income		**25.2**	43.2	**23.3**	36.6
Income from investments in subsidiaries	10	**–**	–	**–**	106.8
Net gains/(losses) from fair value volatility on financial instruments	5	**15.9**	(11.8)	**20.0**	(8.1)
Net realised (losses)/profits	6	**(41.7)**	77.9	**(29.1)**	77.9
Other operating income		**12.4**	5.1	**40.2**	23.0
Total income		**543.4**	460.4	**462.0**	494.2
Administrative expenses	7	**(261.4)**	(217.3)	**(262.7)**	(215.7)
Merger and acquisition costs	7	**(1.6)**	(16.4)	**(1.6)**	(16.2)
Depreciation and amortisation		**(37.0)**	(16.3)	**(36.4)**	(15.6)
Operating profit before provisions		**243.4**	210.4	**161.3**	246.7
Impairment of loans and advances to customers	9	**(22.8)**	(39.3)	**(4.2)**	(4.0)
Provisions	28	**(21.3)**	(13.0)	**(19.4)**	(13.0)
Impairment of investments in subsidiaries	10	**–**	–	**(4.2)**	(10.0)
Operating profit and profit before tax		**199.3**	158.1	**133.5**	219.7
Tax expense	11	**(51.2)**	(34.2)	**(37.2)**	(30.9)
Net profit		**148.1**	123.9	**96.3**	188.8

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

* A restatement has been made to the prior period due to a change in accounting policy regarding the Financial Service Compensation Scheme (FSCS) levy. Further details of this are given in the basis of preparation on page 85.

The notes on pages 85 to 147 form part of these accounts.

Statements of Comprehensive Income

for the year ended 31st December 2013

		Group		Society	
		2013	2012 Restated*	**2013**	2012 Restated*
	NOTES	**£m**	£m	**£m**	£m
Net profit		**148.1**	123.9	**96.3**	188.8
Items that will subsequently be reclassified to profit and loss:					
Available for sale investments:					
Valuation gains taken to equity		**4.0**	33.2	**4.0**	33.2
Amounts transferred to income statement (included in net realised profits)		**(23.0)**	(40.4)	**(23.0)**	(40.4)
Cash flow hedges:					
Gains/(losses) taken to equity		**68.3**	(34.8)	**68.3**	(34.8)
Amounts transferred to income statement (included in net realised profits)		**2.5**	6.2	**2.5**	6.2
Tax relating to items that may be reclassified	11	**(12.1)**	7.2	**(12.1)**	7.3
Items that will not be reclassified subsequently to profit and loss:					
Remeasurement of net retirement benefit obligations	26	**(20.4)**	(22.5)	**(20.4)**	(22.5)
Tax relating to items not reclassified	11	**0.5**	3.5	**0.5**	3.4
Total comprehensive income for the year		**167.9**	76.3	**116.1**	141.2

* A restatement has been made to the prior period due to a change in accounting policy regarding the Financial Service Compensation Scheme (FSCS) levy. Further details of this are given in the basis of preparation on page 85.

The notes on pages 85 to 147 form part of these accounts.

Statements of Financial Position

as at 31st December 2013

		Group			Society		
		2013	2012 Restated*	2011 Restated*	**2013**	2012 Restated*	2011 Restated*
ASSETS	NOTES	**£m**	£m	£m	**£m**	£m	£m
Liquid assets							
Cash in hand and balances with the Bank of England	13	**3,314.6**	4,165.3	1,598.4	**3,314.6**	4,165.3	1,598.4
Loans and advances to credit institutions	14	**482.0**	573.7	582.3	**120.8**	361.3	362.6
Debt securities	15	**624.6**	492.5	2,737.1	**1,871.2**	1,307.8	3,040.3
Loans and advances to customers	16	**29,515.8**	27,572.4	27,022.2	**17,948.1**	17,829.7	18,630.0
Derivative financial instruments	34	**273.0**	380.6	373.8	**174.2**	303.8	370.5
Investments	10	**1.4**	1.4	2.2	**11,186.1**	9,801.6	8,857.1
Intangible assets	17	**34.9**	34.3	30.4	**34.9**	34.2	30.2
Investment properties	18	**16.5**	17.3	25.5	**16.3**	17.1	25.3
Property, plant and equipment	19	**124.0**	113.0	109.6	**106.7**	95.2	91.3
Deferred tax assets	20	**47.2**	105.6	110.1	**45.8**	85.1	100.4
Retirement benefit surplus	26	**3.8**	22.0	32.9	**3.8**	22.0	32.9
Other assets	21	**15.6**	19.0	22.5	**30.8**	34.7	37.6
Total assets		**34,453.4**	33,497.1	32,647.0	**34,853.3**	34,057.8	33,176.6
LIABILITIES							
Shares	22	**26,290.3**	26,817.5	25,973.4	**26,290.3**	26,817.5	25,973.4
Amounts owed to credit institutions	23	**2,621.4**	911.1	765.4	**2,621.4**	911.1	765.4
Other deposits	24	**501.4**	475.7	510.3	**1,965.9**	1,995.2	1,589.5
Debt securities in issue	25	**2,793.6**	2,784.3	2,591.2	**1,847.9**	1,938.3	2,244.6
Derivative financial instruments	34	**194.8**	517.4	609.1	**197.1**	522.8	619.8
Current tax liabilities		**9.2**	21.5	22.3	**6.2**	5.4	7.6
Deferred tax liabilities	20	**4.8**	12.2	18.6	**3.7**	9.5	15.1
Retirement benefit obligations	26	**3.4**	3.5	1.2	**3.4**	3.5	1.2
Other liabilities	27	**85.6**	78.8	79.6	**148.0**	105.2	74.8
Provisions	28	**84.0**	103.5	102.8	**82.1**	103.5	102.8
Subordinated liabilities	29	**48.7**	122.8	230.9	**48.7**	122.8	230.9
Subscribed capital	30	**6.8**	7.3	177.0	**6.8**	7.3	177.0
		32,644.0	31,855.6	31,081.8	**33,221.5**	32,542.1	31,802.1
Total equity attributable to members		**1,809.4**	1,641.5	1,565.2	**1,631.8**	1,515.7	1,374.5
Total liabilities		**34,453.4**	33,497.1	32,647.0	**34,853.3**	34,057.8	33,176.6

* A restatement has been made to the prior periods due to a change in accounting policy regarding the Financial Service Compensation Scheme (FSCS) levy. Further details of this are given in the basis of preparation on page 85.

The accounts on pages 79 to 147 were approved by the Board of directors on 25th February 2014 and were signed on its behalf by:

Ed Anderson	Chairman
Lynne Charlesworth	Vice Chairman
Chris Pilling	Chief Executive

The notes on pages 85 to 147 form part of these accounts.

Statements of Changes in Members' Interest

for the year ended 31st December 2013

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Group				
At 1st January 2013	**1,694.4**	**(59.3)**	**6.4**	**1,641.5**
Reallocation of tax*	**(16.5)**	**–**	**16.5**	**–**
Current year movement net of tax	**128.0**	**54.4**	**(14.5)**	**167.9**
At 31st December 2013	**1,805.9**	**(4.9)**	**8.4**	**1,809.4**
Restated**				
At 1st January 2012	1,589.5	(36.3)	12.0	1,565.2
Current year movement net of tax	104.9	(23.0)	(5.6)	76.3
At 31st December 2012	1,694.4	(59.3)	6.4	1,641.5
Restated**				
At 1st January 2011	1,412.8	(32.6)	(38.0)	1,342.2
Transfer of engagements***	60.2	–	4.3	64.5
Current year movement net of tax	116.5	(3.7)	45.7	158.5
At 31st December 2011	1,589.5	(36.3)	12.0	1,565.2

* Taxation relating to the 'Available for sale reserve' has been reallocated to match the underlying transactions.

** A restatement has been made to the prior periods due to a change in accounting policy regarding the Financial Service Compensation Scheme (FSCS) levy. Further details of this are given in the basis of preparation on page 85.

*** Merger with Norwich & Peterborough 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 85 to 147 form part of these accounts.

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Society				
At 1st January 2013	**1,568.6**	**(59.3)**	**6.4**	**1,515.7**
Reallocation of tax*	**(16.5)**	**–**	**16.5**	**–**
Current year movement net of tax	**76.2**	**54.4**	**(14.5)**	**116.1**
At 31st December 2013	**1,628.3**	**(4.9)**	**8.4**	**1,631.8**
Restated**				
At 1st January 2012	1,399.0	(36.3)	11.8	1,374.5
Current year movement net of tax	169.6	(23.0)	(5.4)	141.2
At 31st December 2012	1,568.6	(59.3)	6.4	1,515.7
Restated**				
At 1st January 2011	1,243.5	(32.6)	(38.2)	1,172.7
Transfer of engagements***	56.1	–	4.3	60.4
Current year movement net of tax	99.4	(3.7)	45.7	141.4
At 31st December 2011	1,399.0	(36.3)	11.8	1,374.5

* Taxation relating to the 'Available for sale reserve' has been reallocated to match the underlying transactions.

** A restatement has been made to the prior periods due to a change in accounting policy regarding the Financial Service Compensation Scheme (FSCS) levy. Further details of this are given in the basis of preparation on page 85.

*** Merger with Norwich & Peterborough 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 85 to 147 form part of these accounts.

Statements of Cash Flows

for the year ended 31st December 2013

	NOTES	Group 2013 £m	Group 2012 Restated* £m	Society 2013 £m	Society 2012 Restated* £m
Cash flows from operating activities:					
Profit before tax		**199.3**	158.1	**133.5**	219.7
Working capital adjustments	42	**85.8**	(120.0)	**92.8**	(91.6)
Net increase in operating assets	42	**(2,163.2)**	(677.3)	**(1,689.6)**	(204.1)
Net increase in operating liabilities	42	**1,208.8**	955.2	**1,153.8**	1,395.5
Net cash flows (used in)/from operating activities		**(669.3)**	316.0	**(309.5)**	1,319.5
Cash flows from investing activities:					
Purchase of property, plant and equipment and intangible assets		**(48.2)**	(27.0)	**(48.2)**	(26.8)
Proceeds from sale of property, plant and equipment		**1.0**	7.4	**1.0**	7.4
Purchase of debt securities		**(445.7)**	(825.1)	**(945.7)**	(1,425.1)
Proceeds from sale and redemption of debt securities		**292.7**	3,140.4	**374.1**	3,228.3
Net cash flows (used in)/from investing activities		**(200.2)**	2,295.7	**(618.8)**	1,783.8
Cash flows from financing activities:					
Redemption of securities		**(437.9)**	(949.0)	**(37.4)**	(846.8)
Issue of securities		**500.0**	1,127.5	**–**	527.5
Redemption of subordinated capital		**(114.3)**	(176.9)	**(114.3)**	(176.9)
Interest paid on subordinated liabilities and subscribed capital		**(16.1)**	(29.0)	**(16.1)**	(29.0)
Net cash flows used in financing activities		**(68.3)**	(27.4)	**(167.8)**	(525.2)
Taxation paid		**(24.1)**	(26.2)	**(14.6)**	(12.7)
Net (decrease)/increase in cash and cash equivalents		**(961.9)**	2,558.1	**(1,110.7)**	2,565.4
Opening balance		**4,713.8**	2,155.7	**4,501.4**	1,936.0
Total closing cash and cash equivalents		**3,751.9**	4,713.8	**3,390.7**	4,501.4
Cash and cash equivalents:					
Cash and balances with central banks		**3,269.9**	4,140.1	**3,269.9**	4,140.1
Loans and advances to banks	14	**482.0**	573.7	**120.8**	361.3
		3,751.9	4,713.8	**3,390.7**	4,501.4

* A restatement has been made to the prior period due to a change in accounting policy regarding the Financial Service Compensation Scheme (FSCS) levy. Further details of this are given in the basis of preparation on page 85.

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 85 to 147 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 European Union (EU) and are effective at 31st December 2013 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 28, 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.

A restatement has been made to the prior period due to a change in accounting policy. The change is a result of IFRIC 21 which came into effect this year and has resulted in a restatement of the amount included in relation to our Financial Service Compensation Scheme (FSCS) levy. IFRIC 21 includes clarification regarding the trigger point of the levy and the impact of this is a restatement of £8.6m.

This restatement is made up as follows:

- 2012 income statement adjustment £1.0m (reported levy of £6.1m, to a restated levy of £5.1m)
- 2011 income statement adjustment £2.9m (reported levy of £5.6m, to a restated levy of £2.7m)
- 2011 reserves adjustment £4.7m, relating to prior years

To see how this has affected the closing balance sheet provision for FSCS each year, please refer to Note 28 on page 118.

Changes as a result of the above impact cash flow items with no overall impact on cash.

In line with tax legislation the tax charge has not been restated and instead the tax impact will be processed through the current period computation.

Accounting Developments

The following Accounting Standard amendments have been applied in the year:

- Amendment to IFRS 7 'Financial Instruments Disclosures' (December 2011) 'Disclosures – Offsetting Financial Assets and Financial Liabilities' extends the scope of IFRS 7 disclosures but does not change the recognition or measurement of transactions in the financial statements.
- IFRS 13 'Fair Value Measurement' was effective for periods commencing on or after 1st January 2013. The new standard established a single source of guidance for fair value measurement under IFRSs. The new standard did not have a significant impact on the financial statements.
- IFRS 11 'Joint Arrangements' was effective for periods commencing on or after 1st January 2013. The new standard did not have a significant impact on the financial statements.
- IFRS 12 'Disclosure of Interests in Other Entities' was effective for periods commencing on or after 1st January 2013. The new standard did not have a significant impact on the financial statements.
- IAS 1 (amendment) 'Presentation of Items of Other Comprehensive Income' is effective on or after 1st July 2012. The amendment did not have a significant impact on the financial statements.
- IAS 19 'Retirement and Benefit Obligations (Revised)' was effective for periods commencing on or after 1st January 2013. The effect of this revised standard did not have a significant impact on the financial statements. The comparative period has not been restated as the impact on results would be less than £0.1m.
- Annual improvements to IFRSs 2009-2011 were effective on or after 1st January 2013. These improvements did not have a material impact on the financial statements.

INTRODUCTION (continued)

The following Standards which have not been applied in these financial statements were in issue but not yet effective for the 2013 year end:

- IAS 39 'Financial Instruments: Recognition and Measurement' (Amended June 2013) is effective on or after 1st January 2014. This amendment relates to Novation of Derivatives and Continuation of Hedge Accounting.
- IAS 32 (Amended) 'Offsetting Financial Assets and Financial Liabilities' is effective on or after 1st January 2014. This amendment is intended to address the differences in the respective accounting standards regarding offsetting of financial instruments. It is not expected to have any impact on the financial statements.
- IAS 27 (revised) 'Separate Financial Statements' is effective on or after 1st January 2014. The application of this revised standard does not have a material impact on the financial statements.
- IAS 28 (revised) 'Investments in Associates and Joint Ventures' is effective on or after 1st January 2014. The application of this revised standard does not have a material impact on the financial statements.
- IFRS 9 'Financial Instruments' was issued in December 2011 and is effective for periods commencing no earlier than 1st January 2015. The standard is yet to be issued in its final form so the impact on the accounts cannot be determined.

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 method is 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 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 fair 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.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

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 parallel movements in the fair value 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.

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 for residential, three months or more or other qualitative factors for commercial. 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 sale 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.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Segmental reporting

The chief operating decision maker has been identified as the Board of directors, 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 comparative figures have been restated, 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 immediately in the Income Statement.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see below), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised as of that date.

The measurement period is the period from the date of acquisition to the date the Group obtains complete information about facts and circumstances that existed as of the acquisition date, and is subject to a maximum of one year.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

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 predominantly 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 profit and loss

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 profit and loss. 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.

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.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

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 an immediate 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.

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 in the Statement of Financial Position to the extent that it is recoverable by the Group being the present value of available refunds and reductions in future contributions to the scheme. 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 and otherwise is 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 recover 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 date 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 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 of payment.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

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 and recognises collateralised borrowing for the proceeds received. 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.

As explained on pages 39 to 41 the Audit Committee has confirmed that the accounting estimates and judgements applied are considered to be appropriate.

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). In relation to retail mortgages the most critical estimate is the future level of house prices where a variance of 10% equates to £6.6m of provision. Other sensitivities include the emergence period, (where a variance of three months equates to £2.8m) and the loss given default rate (where a 10% variance equates to £3.8m of provision). Retail mortgages account for 98% of our loan book and 93% of our impairment provision. As such, sensitivities around our commercial book would not have a significant impact on the 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 proportion of the number of customer balances that will remain with the Society for one year following the end of the initial product deal period. A 1% increase in this estimate would increase the value of the loans by less than £1m. Changes to fair values associated with acquired mortgage assets or other loans are recognised immediately. Where this is an uplift, this is recognised through net interest margin.

Fair value arising from business combinations

As described on page 88, identifiable assets and liabilities are initially measured at fair value. Such estimates are highly judgemental, particularly where a fair value is measured in respect of the critical judgements noted above. The amount recognised reflects management's best estimate. On the basis that both the Chelsea and N&P mergers are outside of the measurement period, the impact of identified changes in underlying assumptions are recognised immediately in the Income Statement. Management has been through an extensive evaluation to identify any significant changes.

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

Regulatory and other provisions

Note 28 provides details of regulatory and other provisions which includes amounts provided in relation to customer redress claims totalling £54.8m (including fair value adjustments made on the merger with Norwich & Peterborough Building Society). The customer redress provision is in respect of a range of customer claims for mis-selling and is calculated using management's estimate of the complaint volumes, redress payments, referral levels to the Financial Ombudsman Service, complaint handling costs and other costs. The main sensitivity is the level of complaint volumes where a 10% increase in the expected level of complaints would increase the provision by £3.3m.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

Financial Services Compensation Scheme (FSCS)

The FSCS levy in respect of failed financial institutions is calculated using the Group's share of industry protected deposits and projected forward interest rates. A 1% increase in the interest rate assumption would increase the provision by £4.5m. More detail of the FSCS and the Society's provision are contained in Note 28.

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 its net surplus/deficit. These are outlined in Note 26. The impact of a 1.0% decrease in the rate used to discount the future value of the liabilities would be to increase the present value of the liabilities by £145.8m. 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 £15.6m.

3. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group		Society	
	2013 £m	2012 £m	**2013 £m**	2012 £m
On assets held at amortised cost				
Loans secured on residential property	**1,240.9**	1,168.2	**785.6**	746.0
Connected undertakings	**–**	–	**373.1**	380.3
Other loans	**16.9**	17.5	**16.9**	17.5
Other liquid assets/cash and short-term funds	**18.9**	18.0	**18.7**	17.1
On available for sale securities	**12.9**	21.1	**12.9**	21.1
On held to maturity securities	**1.2**	5.8	**12.4**	13.9
On financial instruments held at fair value through the Income Statement				
Derivatives	**113.9**	149.0	**90.8**	132.8
Other assets	**0.9**	1.1	**0.9**	1.1
Total interest receivable	**1,405.6**	1,380.7	**1,311.3**	1,329.8

Included within interest receivable and similar income is interest earned on impaired loans: Group £17.2m, Society £4.9m (2012 – Group £24.8m, Society £11.6m) which, once included in the mortgage and loans balance, is considered within the impairment calculation.

4. INTEREST PAYABLE AND SIMILAR CHARGES

	Group		Society	
	2013 £m	2012 £m	**2013 £m**	2012 £m
On liabilities held at amortised cost				
Shares held by individuals	**593.6**	683.2	**593.6**	683.2
Deposits from banks	**6.5**	6.0	**6.5**	6.0
Deposits from other financial institutions	**0.1**	0.9	**0.1**	0.9
Deposits from connected undertakings	**–**	–	**–**	1.4
Other deposits	**2.8**	3.5	**2.8**	3.5
Certificates of deposit	**–**	0.1	**–**	0.1
Other debt securities	**76.2**	88.9	**65.0**	79.4
Subordinated liabilities	**15.7**	21.8	**15.7**	21.8
Subscribed capital	**0.4**	7.2	**0.4**	7.2
Other interest payable	**1.0**	1.0	**1.0**	1.0
On financial instruments held at fair value through the Income Statement				
Deposits from connected undertakings	**–**	–	**37.1**	40.4
Derivatives	**177.7**	222.1	**181.5**	226.9
Total interest payable	**874.0**	1,034.7	**903.7**	1,071.8

5. NET GAINS/(LOSSES) FROM FAIR VALUE VOLATILITY ON FINANCIAL INSTRUMENTS

	Group		Society	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Assets held at fair value	**6.1**	(4.6)	**6.1**	(4.6)
Embedded derivatives	**8.2**	5.3	**8.2**	5.3
Derivatives and hedging	**1.6**	(12.5)	**5.7**	(8.8)
Net gains/(losses) from fair value volatility on financial instruments	**15.9**	(11.8)	**20.0**	(8.1)

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 (LOSSES)/PROFITS

	Group		Society	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Net realised profit on sale of debt securities	**10.7**	16.1	**10.7**	16.1
(Losses)/profits on capital repurchase	**(39.8)**	61.8	**(39.8)**	61.8
Loss on sale of equity release mortgage portfolio*	**(12.6)**	–	**–**	–
	(41.7)	77.9	**(29.1)**	77.9

The losses on capital repurchase in 2013 relate to the buyback of certain remunerated capital at a premium to nominal value – see Note 29.

* On 2nd July 2013 the Group disposed of the equity release mortgage portfolio acquired on the merger with Chelsea Building Society in 2010, for consideration of £218.3m.

7. ADMINISTRATIVE EXPENSES

	Group		Society	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Staff costs				
Salaries and wages	**115.9**	110.5	**115.9**	108.8
Social security costs	**11.0**	10.6	**11.0**	10.5
Pension costs – defined benefit plans	**4.2**	2.9	**4.2**	2.5
Pension costs – defined contribution plans	**4.6**	3.8	**4.6**	3.8
Other staff costs	**1.8**	0.9	**1.8**	0.9
Operating lease rentals	**9.9**	8.2	**12.5**	10.5
Professional consultancy costs	**25.5**	13.9	**25.3**	13.8
Other expenses	**90.1**	82.9	**89.0**	81.1
	263.0	233.7	**264.3**	231.9
Less: merger and acquisition costs	**(1.6)**	(16.4)	**(1.6)**	(16.2)
	261.4	217.3	**262.7**	215.7

Merger and acquisition costs comprise professional fees, external project resource and termination payments and are disclosed separately on the face of the Income Statement.

The Society operates a salary sacrifice scheme whereby the employee agrees to a reduction in salary in return for the Society making pension 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	
	2013 £000	2012 £000	**2013 £000**	2012 £000
Fees payable to the auditor and their associates for the audit of the annual accounts	**345**	336	**292**	252
Fees payable to the auditor and their associates for other services to the Group				
Audit-related assurance services (including £47,000 for review of interim accounts)	**90**	47	**47**	47
Tax advisory services	**24**	28	**24**	28
Corporate finance services (including due diligence)	**–**	26	**–**	26
Other services				
All other services (including £300,000 (2012 – nil) for regulatory reporting)	**732**	232	**732**	232
	1,191	669	**1,095**	585

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 pages 39 to 44.

Staff numbers

The average number of persons employed by the Group during the year (including executive directors) was as follows:

	2013		2012	
	Full time	**Part time**	Full time	Part time
Building Society				
Central administration	**2,135**	**438**	1,975	428
Branches	**1,192**	**453**	1,173	454
Subsidiaries' offices	**–**	**–**	35	23
	3,327	**891**	3,183	905

8. REMUNERATION OF AND TRANSACTIONS WITH DIRECTORS

Total directors' remuneration amounted to £2.9m (2012 – £2.6m).

Full details of directors' remuneration, bonuses and pensions are given in the Directors' Remuneration Report on pages 52 to 72. In addition, past directors' pensions in respect of services as directors (closed scheme) amounted to £18,000 (2012 – £17,000).

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 2013 will be available for inspection at the head office for a period of 15 days up to and including the Annual General Meeting. For further information see Note 41.

9. IMPAIRMENT

Loans and advances to customers

	Group		Society	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
At 1st January				
Collective	**6.3**	8.0	**0.3**	0.5
Individual	**55.8**	52.7	**5.8**	3.0
	62.1	60.7	**6.1**	3.5
Amounts written off during the year				
Collective	**–**	–	**–**	–
Individual	**(40.2)**	(39.0)	**(1.0)**	(2.1)
	(40.2)	(39.0)	**(1.0)**	(2.1)
Impairment adjustment for the year				
Collective	**6.4**	(1.7)	**7.9**	(0.2)
Individual	**17.9**	42.1	**(3.3)**	4.9
	24.3	40.4	**4.6**	4.7
At 31st December				
Collective	**12.7**	6.3	**8.2**	0.3
Individual	**33.5**	55.8	**1.5**	5.8
	46.2	62.1	**9.7**	6.1
The charge for the year comprises:				
Impairment adjustment for loans and advances	**24.3**	40.4	**4.6**	4.7
Recoveries relating to amounts previously written off	**(1.5)**	(1.1)	**(0.4)**	(0.7)
Net provision charge for the year	**22.8**	39.3	**4.2**	4.0

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

£3.1m (2012 – £2.7m) of the £46.2m (2012 – £62.1m) provision balance shown above, and £0.4m (2012 – £2.7m) of the £22.8m (2012 – £39.3m) net provision charge, relates to the commercial lending portfolio.

Debt Securities

	Group		Society	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
At 1st January	**12.9**	12.9	**12.9**	12.9
Amounts written off during the year	**(6.9)**	–	**(6.9)**	–
At 31st December	**6.0**	12.9	**6.0**	12.9

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

10. INVESTMENTS

	Group		Society	
	2013 **£m**	2012 £m	**2013** **£m**	2012 £m
Equities	**1.4**	1.4	**1.4**	1.4
Joint ventures	**–**	–	**0.3**	0.3
Subsidiaries	**–**	–	**11,184.4**	9,799.9
	1.4	1.4	**11,186.1**	9,801.6

Investment in equities

The Group holds equity investments relating to participation in banking and credit card service operations which are classified as available for sale assets. During the year no impairment charge (2012 – £0.7m) was made in respect of an investment in a private equity portfolio.

Investment in joint venture

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

	2013 **£m**	2012 £m
Share of joint ventures		
Gross assets	**0.3**	0.3
Gross liabilities	**(0.3)**	(0.3)
	–	–

10. INVESTMENTS (continued)

Investment in subsidiaries

Society	Shares £m	Loans £m	Total £m
Cost			
At 1st January 2013	**114.3**	**9,716.5**	**9,830.8**
Additions	**–**	**2,366.8**	**2,366.8**
Repayments	**–**	**(1,004.7)**	**(1,004.7)**
At 31st December 2013	**114.3**	**11,078.6**	**11,192.9**
Impairment losses			
At 1st January 2013	**(0.5)**	**(30.4)**	**(30.9)**
Written off	**–**	**26.6**	**26.6**
(Provided)/released in the year	**(8.0)**	**3.8**	**(4.2)**
At 31st December 2013	**(8.5)**	**–**	**(8.5)**
Net book value			
At 31st December 2013	**105.8**	**11,078.6**	**11,184.4**
Cost			
At 1st January 2012	222.0	8,653.6	8,875.6
Additions	–	2,184.8	2,184.8
Repayments	(107.7)	(1,121.9)	(1,229.6)
At 31st December 2012	114.3	9,716.5	9,830.8
Impairment losses			
At 1st January 2012	(0.5)	(20.4)	(20.9)
Provision charge	–	(10.0)	(10.0)
At 31st December 2012	(0.5)	(30.4)	(30.9)
Net book value			
At 31st December 2012	113.8	9,686.1	9,799.9

Income from investment in subsidiaries

The Society has not recognised any dividend income from its subsidiaries during the year (2012 – £106.8m).

The £8.0m provision charge on shares in subsidiaries, the £26.6m write-off and £3.8m provision release on loans to subsidiaries in 2013 relate to the sale of a subsidiary that had a portfolio of equity release mortgages. In 2012, an impairment charge of £10.0m was recognised in respect of that subsidiary. At a Group level the impairment charge on the mortgages is recognised via impairment of loans and advances to customers.

10. INVESTMENTS (continued)

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

	Principal activity
Accord Mortgages Ltd	Mortgage lending
BCS Loans and Mortgages Ltd	Loan and mortgage broker
Chelsea Mortgage Services Ltd	Non-trading
YBS Investments (No. 1) Ltd	Non-trading
YBS Investments (No. 2) Ltd	Non-trading
YBS Properties (Edinburgh) Ltd	Property holding
YBS Properties Ltd	Property holding
Yorkshire Building Society Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds
Yorkshire Building Society Estate Agents Ltd	Non-trading
Yorkshire Guernsey Ltd	Non-trading
Yorkshire Key Services Ltd	Computer services
Brass No. 1 PLC	Funding vehicle
Brass No. 2 PLC	Funding vehicle
Brass No. 3 PLC	Funding vehicle
Flexible Choice Ltd	Non-trading
Lynch Wood Services Ltd	Non-trading
Norwich and Peterborough Covered Bonds LLP	Non-trading
Norwich and Peterborough Estate Agents Ltd	Non-trading
Norwich and Peterborough Insurance Brokers Ltd	Non-trading
Norwich and Peterborough (LBS) Ltd	Mortgage finance
Norwich and Peterborough Sharedealing Services Ltd	Non-trading

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

All the entities are wholly owned except for Yorkshire Building Society Covered Bonds LLP, Brass No. 1 PLC, Brass No. 2 PLC and Brass No. 3 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 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Current tax:				
UK corporation tax at 23.25% (2012 – 24.5%)	**34.2**	48.2	**37.6**	32.0
Corporation tax – adjustment in respect of prior periods	**(1.0)**	(1.1)	**(0.9)**	0.1
Total current tax	**33.2**	47.1	**36.7**	32.1
Deferred tax (Note 20):				
Current year	**18.1**	(7.7)	**0.6**	(1.0)
Adjustment in respect of prior periods	**(0.1)**	(5.2)	**(0.1)**	(0.2)
Total tax expense in Income Statement	**51.2**	34.2	**37.2**	30.9

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 2013 £m	Group 2012 Restated* £m	Society 2013 £m	Society 2012 Restated* £m
Profit before tax	**199.3**	158.1	**133.5**	219.7
Tax calculated at a tax rate of 23.25% (2012 – 24.5%)	**46.3**	38.7	**31.0**	53.8
Effects of:				
Income not subject to tax	**(0.9)**	(0.6)	**(1.6)**	(26.3)
Expenses not deductible for tax purposes	**4.6**	0.9	**6.4**	3.4
Adjustment to tax charge in respect of previous periods	**(1.1)**	(6.3)	**(1.0)**	(0.1)
Change in accounting policy*	**2.0**	(0.2)	**2.0**	(0.2)
Change in tax rate	**0.3**	1.7	**0.4**	0.3
Total tax expense in Income Statement	**51.2**	34.2	**37.2**	30.9
Tax expense/(credit) recognised directly in equity:				
Tax on available for sale securities	**(4.4)**	(1.8)	**(4.4)**	(1.8)
Tax on pension costs	**(4.8)**	(5.5)	**(4.8)**	(5.5)
Deferred tax on cash flow hedges	**16.5**	(7.0)	**16.5**	(7.0)
Adjustment to tax in respect of previous periods	**0.1**	(2.8)	**0.1**	(2.8)
Change in tax rate	**4.2**	6.4	**4.2**	6.4
	11.6	(10.7)	**11.6**	(10.7)

The main rate of corporation tax was reduced to 23% from 1st April 2013 and will reduce further to 21% from 1st April 2014, and to 20% from 1st April 2015.

* A restatement has been made to the prior period due to a change in accounting policy regarding the Financial Service Compensation Scheme (FSCS) levy. Further details of this are given in the basis of preparation on page 85.

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. 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. As a result of the Group's internal divisional analysis being developed, the composition of our reportable segments has changed and as such the prior period has been restated. Details of the new reportable segments are listed below:

- Retail business – comprising prime residential owner occupied lending, non-owner occupied lending, prime intermediary lending, traditional member savings, non-traditional savings and consumer banking (excluding personal lending).
- Non-retail business – the prime commercial lending portfolio (including social housing).
- Secondary business – including non-prime residential owner occupied lending, personal lending and non-prime commercial lending.
- Central functions – this includes supporting business units, the treasury function and other head office group functions which have not been apportioned across the aforementioned segments.

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

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.

Following the further development of our internal divisional analysis, recharging of funding across the Group has been included using the Group's transfer pricing methodology, which is based on our external cost of funds. The prior period has also been restated to include this recharge.

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

2012 has also been restated for the impact of the change in accounting policy regarding the Financial Services Compensation Scheme (FSCS) levy. Further details regarding this restatement are provided in the basis of preparation on page 85. This restatement only impacts the central segment.

2013	Notes	Retail £m	Non-retail £m	Secondary £m	Central £m	Total £m
Net interest income		467.4	10.3	41.0	12.9	531.6
Non-interest income (net)	a	30.6	3.6	–	3.4	37.6
Net realised profits and fair value		–	–	1.7	(27.5)	(25.8)
Management expenses	b, c	(177.6)	(3.2)	(2.7)	(116.5)	(300.0)
Operating profit/(loss) before provisions		320.4	10.7	40.0	(127.7)	243.4
Impairment and other provisions		(12.8)	(0.4)	(9.7)	(21.2)	(44.1)
Profit/(loss) before tax		307.6	10.3	30.3	(148.9)	199.3
Total assets		27,675.4	582.0	1,225.3	4,970.7	34,453.4
Total liabilities		27,380.3	–	–	5,263.7	32,644.0
Equity		–	–	–	1,809.4	1,809.4

12. SEGMENTAL REPORTING (continued)

2012 (Restated[1])	Notes	Retail £m	Non-retail £m	Secondary £m	Central £m	Total £m
Net interest income		299.5	2.8	41.0	2.7	346.0
Non-interest income (net)	a	47.9	3.4	–	(3.0)	48.3
Net realised profits and fair value		–	–	0.7	65.4	66.1
Management expenses	b	(171.4)	(2.8)	(3.2)	(72.6)	(250.0)
Operating profit/(loss) before provisions		176.0	3.4	38.5	(7.5)	210.4
Impairment and other provisions		(20.4)	(2.7)	(16.2)	(13.0)	(52.3)
Profit/(loss) before tax		155.6	0.7	22.3	(20.5)	158.1
Total assets		25,365.9	428.6	1,586.2	6,116.4	33,497.1
Total liabilities		27,821.1	–	–	4,034.5	31,855.6
Equity		–	–	–	1,641.5	1,641.5

[1] A restatement has been made to the 2012 figures, as described above, due to the following:

- A change in the composition of our reportable segments.
- Inclusion of recharging of funding across the Group.
- A change in the accounting policy regarding the FSCS levy.

Notes

a Non-interest income (net) includes fees and commissions receivable, fees and commissions payable, and other operating income.

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

c £18.8m of property, plant and equipment, investment properties and intangible assets were impaired in 2013. This impacts all segments and is included in management expenses.

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

	Group		Society	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Cash in hand	**18.3**	17.0	**18.3**	17.0
Cash ratio deposit with the Bank of England	**44.7**	25.2	**44.7**	25.2
Other deposits with the Bank of England	**3,251.6**	4,123.1	**3,251.6**	4,123.1
	3,314.6	4,165.3	**3,314.6**	4,165.3

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	
	2013 **£m**	2012 £m	**2013** **£m**	2012 £m
Loans and advances to banks	**482.0**	573.7	**120.8**	361.3

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

15. DEBT SECURITIES

	Group		Society	
	2013 **£m**	2012 £m	**2013** **£m**	2012 £m
Debt securities issued by:				
Public bodies	**313.4**	133.6	**313.4**	133.6
Other borrowers	**311.2**	358.9	**1,557.8**	1,174.2
	624.6	492.5	**1,871.2**	1,307.8

All debt securities are listed on a recognised investment exchange.

Debt securities of £0.6bn (2012 – £0.5bn) are due in over one year.

Group	Held at fair value £m	Embedded derivatives £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1st January 2013	**4.9**	**(10.0)**	**360.8**	**136.8**	**492.5**
Additions	**–**	**–**	**445.7**	**–**	**445.7**
Disposals and repayments	**–**	**–**	**(249.7)**	**(49.6)**	**(299.3)**
Exchange translation	**–**	**–**	**0.3**	**(0.2)**	**0.1**
Other changes in value	**2.5**	**7.6**	**(25.2)**	**0.7**	**(14.4)**
At 31st December 2013	**7.4**	**(2.4)**	**531.9**	**87.7**	**624.6**
Movements in debt securities during the year were:					
At 1st January 2012	16.2	(31.9)	2,182.0	570.8	2,737.1
Additions	–	–	825.1	–	825.1
Disposals and repayments	(6.2)	–	(2,638.8)	(431.8)	(3,076.8)
Exchange translation	–	–	(3.0)	(2.4)	(5.4)
Other changes in value	(5.1)	21.9	(4.5)	0.2	12.5
At 31st December 2012	4.9	(10.0)	360.8	136.8	492.5

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.

15. DEBT SECURITIES (continued)

Society	Held at fair value £m	Embedded derivatives £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1st January 2013	**4.9**	**(10.0)**	**360.8**	**952.1**	**1,307.8**
Additions	**–**	**–**	**445.7**	**500.0**	**945.7**
Disposals and repayments	**–**	**–**	**(249.7)**	**(119.2)**	**(368.9)**
Exchange translation	**–**	**–**	**0.3**	**(0.2)**	**0.1**
Other changes in value	**2.5**	**7.6**	**(25.2)**	**1.6**	**(13.5)**
At 31st December 2013	**7.4**	**(2.4)**	**531.9**	**1,334.3**	**1,871.2**
Movements in debt securities during the year were:					
At 1st January 2012	16.2	(31.9)	2,182.0	874.0	3,040.3
Additions	–	–	825.1	600.0	1,425.1
Disposals and repayments	(6.2)	–	(2,638.8)	(521.2)	(3,166.2)
Exchange translation	–	–	(3.0)	(2.4)	(5.4)
Other changes in value	(5.1)	21.9	(4.5)	1.7	14.0
At 31st December 2012	4.9	(10.0)	360.8	952.1	1,307.8

16. LOANS AND ADVANCES TO CUSTOMERS

	Group		Society	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Loans and advances to customers comprise:				
Loans secured on residential property				
Loans fully secured on residential property	**29,120.6**	27,044.9	**17,536.7**	17,320.2
Other loans secured on residential property	**31.2**	38.3	**10.9**	13.2
Loans secured on commercial property	**373.5**	354.6	**373.5**	354.6
Unsecured loans	**7.9**	4.7	**7.9**	4.7
Fair value hedging adjustments	**28.8**	192.0	**28.8**	143.1
Impairment provisions	**(46.2)**	(62.1)	**(9.7)**	(6.1)
	29,515.8	27,572.4	**17,948.1**	17,829.7

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 (EIR) basis. Amounts totalling £28.4bn (2012 – £26.4bn) are due in over one year.

Fair value hedging adjustments of £28.8m (2012 – £192.0m) have been made to certain fixed rate mortgages that are in fair value hedging relationships.

Note 35 details the extent to which these assets are encumbered.

17. INTANGIBLE ASSETS

	Construction in progress £m	Purchase software £m	Internally generated assets £m	Other £m	Total £m
Group					
Cost					
At 1st January 2013	–	**21.4**	**27.0**	**18.5**	**66.9**
Additions	**6.6**	**5.0**	**11.4**	–	**23.0**
Disposals	–	**(1.5)**	**(19.8)**	–	**(21.3)**
Transfers	–	–	**(0.6)**	–	**(0.6)**
At 31st December 2013	**6.6**	**24.9**	**18.0**	**18.5**	**68.0**
Amortisation					
At 1st January 2013	–	**15.4**	**11.1**	**6.1**	**32.6**
Charged in year	–	**2.1**	**5.3**	**1.5**	**8.9**
Impairment	–	–	**13.0**	–	**13.0**
Disposals	–	**(1.5)**	**(19.8)**	–	**(21.3)**
Transfers	–	–	**(0.1)**	–	**(0.1)**
At 31st December 2013	–	**16.0**	**9.5**	**7.6**	**33.1**
Net book value					
At 31st December 2013	**6.6**	**8.9**	**8.5**	**10.9**	**34.9**
Cost					
At 1st January 2012	–	39.5	15.6	26.9	82.0
Additions	–	4.4	11.4	–	15.8
Disposals	–	(22.5)	–	(8.4)	(30.9)
At 31st December 2012	–	21.4	27.0	18.5	66.9
Amortisation					
At 1st January 2012	–	35.1	8.4	8.1	51.6
Charged in year	–	2.8	2.7	3.0	8.5
Disposals	–	(22.5)	–	(5.0)	(27.5)
At 31st December 2012	–	15.4	11.1	6.1	32.6
Net book value					
At 31st December 2012	–	6.0	15.9	12.4	34.3

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.

Amortisation 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. Transfers relate to the reclassification of assets between intangible assets and property, plant and equipment.

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

17. INTANGIBLE ASSETS (continued)

	Construction in progress £m	Purchase software £m	Internally generated assets £m	Other £m	Total £m
Society					
Cost					
At 1st January 2013	–	**20.4**	**27.0**	**18.5**	**65.9**
Additions	**6.6**	**5.0**	**11.4**	–	**23.0**
Disposals	–	**(1.5)**	**(19.8)**	–	**(21.3)**
Transfers	–	–	**(0.6)**	–	**(0.6)**
At 31st December 2013	**6.6**	**23.9**	**18.0**	**18.5**	**67.0**
Amortisation					
At 1st January 2013	–	**14.5**	**11.1**	**6.1**	**31.7**
Charged in year	–	**2.0**	**5.3**	**1.5**	**8.8**
Impairment	–	–	**13.0**	–	**13.0**
Disposals	–	**(1.5)**	**(19.8)**	–	**(21.3)**
Transfers	–	–	**(0.1)**	–	**(0.1)**
At 31st December 2013	–	**15.0**	**9.5**	**7.6**	**32.1**
Net book value					
At 31st December 2013	**6.6**	**8.9**	**8.5**	**10.9**	**34.9**
Cost					
At 1st January 2012	–	29.0	15.6	26.9	71.5
Additions	–	4.4	11.4	–	15.8
Disposals	–	(13.0)	–	(8.4)	(21.4)
At 31st December 2012	–	20.4	27.0	18.5	65.9
Amortisation					
At 1st January 2012	–	24.8	8.4	8.1	41.3
Charged in year	–	2.7	2.7	3.0	8.4
Disposals	–	(13.0)	–	(5.0)	(18.0)
At 31st December 2012	–	14.5	11.1	6.1	31.7
Net book value					
At 31st December 2012	–	5.9	15.9	12.4	34.2

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.

Amortisation 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. Transfers relate to the reclassification of assets between intangible assets and property, plant and equipment.

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

18. INVESTMENT PROPERTIES

	Group		Society	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Cost				
At 1st January	**20.3**	29.9	**20.1**	29.7
Additions	**0.1**	0.1	**0.1**	0.1
Disposals	**–**	(9.6)	**–**	(9.6)
Transfers	**–**	(0.1)	**–**	(0.1)
At 31st December	**20.4**	20.3	**20.2**	20.1
Depreciation				
At 1st January	**3.0**	4.4	**3.0**	4.4
Charged in year	**0.6**	0.3	**0.6**	0.3
Impairment	**0.3**	–	**0.3**	–
Disposals	**–**	(1.7)	**–**	(1.7)
At 31st December	**3.9**	3.0	**3.9**	3.0
Net book value				
At 31st December	**16.5**	17.3	**16.3**	17.1
Fair value				
At 31st December	**19.2**	19.3	**18.8**	18.9

Investment properties are generally flats and offices, ancillary to branch premises and not used by the Group. Rental income of £2.2m on investment properties has been included within other operating income (2012 – £2.1m).

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

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 31st December 2013 has been arrived at on the basis of an internal valuation carried out by the Group's Estates Manager, an appropriately qualified surveyor.

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'.

The directors have considered the previous independent valuation of the investment properties undertaken on the basis of open market value. In the opinion of the directors the open market valuation of such investment properties as at 31st December 2013 was not materially different from their valuation incorporated in the financial statements.

19. PROPERTY, PLANT AND EQUIPMENT

	Construction in progress £m	Land and buildings £m	Equipment fixtures, fittings and vehicles £m	Total £m
Group				
Cost				
At 1st January 2013	**–**	**120.9**	**60.7**	**181.6**
Additions	**0.4**	**7.5**	**17.2**	**25.1**
Disposals	**–**	**(4.6)**	**(4.2)**	**(8.8)**
Transfers	**–**	**–**	**0.6**	**0.6**
At 31st December 2013	**0.4**	**123.8**	**74.3**	**198.5**
Depreciation				
At 1st January 2013	**–**	**24.7**	**43.9**	**68.6**
Charged in year	**–**	**1.9**	**6.8**	**8.7**
Impairment	**–**	**5.5**	**–**	**5.5**
Disposals	**–**	**(4.4)**	**(4.0)**	**(8.4)**
Transfers	**–**	**–**	**0.1**	**0.1**
At 31st December 2013	**–**	**27.7**	**46.8**	**74.5**
Net book value				
At 31st December 2013	**0.4**	**96.1**	**27.5**	**124.0**
Cost				
At 1st January 2012	0.5	118.6	87.1	206.2
Additions	1.1	1.9	8.1	11.1
Disposals	–	(0.8)	(35.0)	(35.8)
Transfers	(1.6)	1.2	0.5	0.1
At 31st December 2012	–	120.9	60.7	181.6
Depreciation				
At 1st January 2012	–	22.5	74.1	96.6
Charged in year	–	2.8	4.7	7.5
Disposals	–	(0.6)	(34.9)	(35.5)
At 31st December 2012	–	24.7	43.9	68.6
Net book value				
At 31st December 2012	–	96.2	16.8	113.0

In 2013, transfers relate to the reclassification of assets between property, plant and equipment and intangible assets.

In 2012, transfers relate to the reclassification of assets between property, plant and equipment and investment properties. In addition to this there is reclassification of assets from construction in progress to land and buildings, equipment, fixtures, fittings and vehicles as the assets are completed and put into service.

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 1st January 2013	**–**	**98.9**	**48.3**	**147.2**
Additions	**0.4**	**7.5**	**17.2**	**25.1**
Disposals	**–**	**(4.6)**	**(4.2)**	**(8.8)**
Transfers	**–**	**–**	**0.6**	**0.6**
At 31st December 2013	**0.4**	**101.8**	**61.9**	**164.1**
Depreciation				
At 1st January 2013	**–**	**19.7**	**32.3**	**52.0**
Charged in year	**–**	**1.6**	**6.6**	**8.2**
Impairment	**–**	**5.5**	**–**	**5.5**
Disposals	**–**	**(4.4)**	**(4.0)**	**(8.4)**
Transfers	**–**	**–**	**0.1**	**0.1**
At 31st December 2013	**–**	**22.4**	**35.0**	**57.4**
Net book value				
At 31st December 2013	**0.4**	**79.4**	**26.9**	**106.7**
Cost				
At 1st January 2012	0.5	96.2	41.1	137.8
Additions	1.1	1.9	7.9	10.9
Disposals	–	(0.4)	(1.2)	(1.6)
Transfers	(1.6)	1.2	0.5	0.1
At 31st December 2012	–	98.9	48.3	147.2
Depreciation				
At 1st January 2012	–	17.9	28.6	46.5
Charged in year	–	2.2	4.7	6.9
Disposals	–	(0.4)	(1.0)	(1.4)
At 31st December 2012	–	19.7	32.3	52.0
Net book value				
At 31st December 2012	–	79.2	16.0	95.2

In 2013, transfers relate to the reclassification of assets between property, plant and equipment and intangible assets.

In 2012, transfers relate to the reclassification of assets between property, plant and equipment and investment properties. In addition to this there is reclassification of assets from construction in progress to land and buildings, equipment, fixtures, fittings and vehicles as the assets are completed and put into service.

20. DEFERRED TAX ASSETS AND LIABILITIES

	Group		Society	
	2013 £m	2012 £m	2013 £m	2012 £m
The movement on the net deferred tax asset is as follows:				
At 1st January	**93.4**	91.5	**75.6**	85.3
Income statement (charge)/credit (Note 11)	**(18.0)**	12.9	**(0.5)**	1.2
Tax expense recognised directly in equity	**(33.0)**	(11.0)	**(33.0)**	(10.9)
At 31st December	**42.4**	93.4	**42.1**	75.6
Deferred tax assets and liabilities are attributable to the following items:				
Deferred tax assets				
Provision for loan impairment	**0.3**	0.4	**0.2**	0.3
Other provisions	**0.1**	0.2	**0.1**	0.2
Other temporary differences	**0.5**	0.5	**0.5**	0.5
Depreciation in excess of capital allowances	**2.9**	4.1	**2.8**	4.0
Transfer of engagements – tax value of losses carried forward	**9.8**	13.8	**9.8**	13.8
Pensions and other post retirement benefits	**1.9**	3.3	**1.9**	3.3
Implementation of IAS 39 – mortgages and hedging	**0.8**	1.1	**0.8**	1.1
Cash flow hedging	**1.2**	17.7	**1.2**	17.7
Transfer of engagements – fair value adjustments	**29.0**	51.3	**28.5**	44.2
Fair value volatility on financial instruments in securitisation entities	**0.7**	13.2	**–**	–
	47.2	105.6	**45.8**	85.1
Deferred tax liabilities				
Pensions and other post retirement benefits	**0.8**	5.1	**0.8**	5.1
Accelerated tax depreciation	**0.2**	0.3	**–**	–
Implementation of IAS 39 – mortgages and hedging	**2.2**	3.7	**1.8**	3.1
Other temporary differences	**0.6**	0.5	**0.5**	0.4
Transfer of engagements – fair value adjustments	**0.6**	2.6	**0.6**	0.9
Fair value volatility on financial instruments in securitisation entities	**0.4**	–	**–**	–
	4.8	12.2	**3.7**	9.5

Within deferred tax assets, are balances 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 four to five years. The deferred tax assets have not been discounted.

The deferred tax charge/(credit) in the Income Statement comprises the following temporary differences:

	Group		Society	
	2013 £m	2012 £m	2013 £m	2012 £m
Accelerated tax depreciation	**1.1**	0.9	**1.2**	0.9
Pensions and other post retirement benefits	**–**	0.4	**–**	0.4
Other provisions	**0.1**	0.4	**0.1**	0.4
Other temporary differences	**(1.0)**	(1.7)	**(0.8)**	(1.9)
Release of fair value adjustments on merger	**4.9**	0.3	**–**	(1.0)
Fair value volatility on financial instruments in securitisation entities	**12.9**	(13.2)	**–**	–
	18.0	(12.9)	**0.5**	(1.2)

21. OTHER ASSETS

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Prepayments and accrued income	**14.6**	16.1	**11.5**	11.3
Due from subsidiary undertakings	**–**	–	**19.6**	21.9
Other assets	**1.0**	2.9	**(0.3)**	1.5
	15.6	19.0	**30.8**	34.7

22. SHARES

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Shares comprising balances held by individuals	**26,415.3**	26,962.4	**26,415.3**	26,962.4
Fair value adjustments	**(125.0)**	(144.9)	**(125.0)**	(144.9)
	26,290.3	26,817.5	**26,290.3**	26,817.5

23. AMOUNTS OWED TO CREDIT INSTITUTIONS

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Amounts owed to:				
Banks	**2,618.4**	907.1	**2,618.4**	907.1
Other credit institutions	**3.0**	4.0	**3.0**	4.0
	2,621.4	911.1	**2,621.4**	911.1

24. OTHER DEPOSITS

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Amounts owed to:				
Group companies	**–**	–	**1,693.5**	1,695.8
Other customers	**501.4**	475.7	**272.4**	299.4
	501.4	475.7	**1,965.9**	1,995.2

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

25. DEBT SECURITIES IN ISSUE

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Certificates of deposit	**–**	1.0	**–**	1.0
Fixed rate notes	**1,275.9**	1,264.0	**1,275.9**	1,264.0
Floating rate notes	**1,446.0**	1,382.6	**500.3**	536.6
Fair value hedging adjustment	**71.7**	136.7	**71.7**	136.7
	2,793.6	2,784.3	**1,847.9**	1,938.3

Debt securities in issue include Group £2.8bn (2012 – £2.7bn) and Society £1.8bn (2012 – £1.9bn) 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 1st 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 Society also contributes to a group personal pension arrangement in relation to the Society's transfer of engagements of Norwich and 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 employees. The present value at 31st December 2013 of the defined benefit obligation (DBO) in relation to these schemes was £7.0m (2012 – £6.0m) 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 and Norwich and Peterborough Building Society. The total expense recognised for these defined contribution benefits is £8.0m (2012 – £6.2m).

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 1st 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 defined benefit section of the Scheme has a weighted average maturity of around 20 years and the defined benefit section of the Norwich and Peterborough Scheme also has a weighted average maturity of around 20 years.

From 1st January 2013, the Group has mandatorily adopted the amended IAS 19 which has resulted in a restatement of the prior year comparators. The impact of this restatement is less than £0.1m.

Summary of assumptions	31st Dec 2013 %	31st Dec 2012 %	31st Dec 2011 %	31st Dec 2010 %	31st Dec 2009 %
Retail Prices Index (RPI) inflation	**3.7**	3.2	3.3	3.8	3.8
Consumer Price Index (CPI) inflation	**2.7**	2.7	2.3	3.1	n/a
Discount rate	**4.5**	4.5	4.9	5.5	5.7
Rate of increase in pay	**4.7**	4.2	4.3	5.3	5.3
Rate of increase of pensions in payment*					
subject to a min of 3% and a max of 5%	**3.9**	3.8	3.7	4.0	4.0
subject to a min of 0% and a max of 5%	**3.3**	3.0	3.1	3.8	3.8
subject to a min of 0% and a max of 3%	**2.4**	2.2	2.4	2.9	n/a
subject to a min of 0% and a max of 2.5%	**2.1**	2.0	2.1	2.4	2.4
Rate of increase for deferred pensions*					
subject to a min of 0% and a max of 5%	**2.7**	2.7	2.3	3.1	3.8
subject to a min of 0% and a max of 2.5%	**2.5**	2.5	2.3	2.3	n/a

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

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:

	2013 Years	2012 Years
For a current 60 year old male	**28.6**	28.5
For a current 60 year old female	**28.3**	28.2
For a current 45 year old male	**30.5**	30.3
For a current 45 year old female	**29.5**	29.5

Categories of assets	31st Dec 2013 %	31st Dec 2012 %	31st Dec 2011 %	31st Dec 2010 %	31st Dec 2009 %
Equities	**32**	28	26	32	44
Bonds	**56**	61	63	56	55
Cash and other	**12**	11	11	12	1
	100	100	100	100	100

Reconciliation of funded status	31st Dec 2013 £m	31st Dec 2012 £m	31st Dec 2011 £m	31st Dec 2010 £m	31st Dec 2009 £m
Present value of defined benefit obligation	**(626.5)**	(589.3)	(532.9)	(456.7)	(317.3)
Assets at fair value	**626.9**	607.8	564.6	442.5	313.0
Funded status/defined benefit asset/(liability)	**0.4**	18.5	31.7	(14.2)	(4.3)
The 2009 and 2008 balances include those of the Barnsley scheme, as follows:					
Present value of defined benefit obligation					(9.9)
Assets at fair value					6.8
Funded status/defined benefit liability					(3.1)
The 2010 balances include those of the Chelsea scheme, as follows:					
Present value of defined benefit obligation				(116.9)	
Assets at fair value				106.6	
Funded status/defined benefit liability				(10.3)	
The 2012 and 2011 balances include those of the Norwich & Peterborough scheme, as follows:					
Present value of defined benefit obligation	**(98.0)**	(90.5)	(79.5)		
Assets at fair value	**94.6**	87.0	78.3		
Funded status/defined benefit liability	**(3.4)**	(3.5)	(1.2)		

Statement of comprehensive income (SCI)	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Actuarial (loss)/gain recognised in SCI	**(20.4)**	(22.5)	18.7	4.8	(50.4)
Cumulative actuarial (losses)/gains recognised at 1st January	**(1.7)**	20.8	2.1	(2.7)	47.7
Cumulative actuarial (losses)/gains recognised at 31st December	**(22.1)**	(1.7)	20.8	2.1	(2.7)

26. RETIREMENT BENEFIT OBLIGATIONS (continued)

Experience gain and losses	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
(Loss)/gain on change of assumptions	**(24.6)**	(44.9)	(19.4)	(5.9)	(80.0)
Gain on other experience	**2.7**	3.0	30.8	0.5	4.0
Experience gain/(loss) on assets	**1.5**	19.4	7.3	10.2	25.6
Actuarial (loss)/gain recognised in SCI	**(20.4)**	(22.5)	18.7	4.8	(50.4)

Components of pension expense as shown in the Income Statement	2013 £m	2012 £m
Service cost	**6.2**	5.7
Interest income	**(0.9)**	(1.7)
Total pension expense	**5.3**	4.0

Service cost is the Group's cost, net of employee contributions and inclusive of interest to the reporting date. Due to the adoption of IAS 19 (revised), interest cost and expected return on assets have been combined to form interest cost on net defined benefit obligation above.

Reconciliation of present value of defined benefit obligation	2013 £m	2012 £m
Present value of defined benefit obligation at 1st January	**589.3**	532.9
Defined benefit service cost	**6.2**	5.7
Interest cost	**26.2**	25.8
Actuarial loss	**21.9**	41.9
Defined benefit actual benefits paid	**(17.1)**	(17.0)
Present value of defined benefit obligation at 31st December	**626.5**	589.3
Movement in defined benefit fair value of assets		
Fair value of assets at 1st January	**607.8**	564.6
Expected return on assets	**27.1**	27.5
Actuarial gain on assets	**1.5**	19.5
Defined benefit actual company contributions	**7.6**	13.2
Defined benefit actual benefits paid	**(17.1)**	(17.0)
Fair value of plan assets at 31st December	**626.9**	607.8

None of the assets were invested in the Group's own financial instruments (2012 – £nil) or property (2012 – £nil).

Estimated contributions in 2014	2014 £m
Society contributions	**10.2**
Employee contributions	**–**
Total contributions	**10.2**

Society contributions include £1.5m 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.

26. RETIREMENT BENEFIT OBLIGATIONS (continued)

Scheme specific risks

The ultimate cost of the schemes to the Society will depend upon actual future events rather than the assumptions made. Many of the assumptions made are unlikely to be borne out in practice and, as such, the cost of the schemes may be higher or lower than disclosed. In general, the risk to the Society is that the assumptions underlying the disclosures, or the calculation of contribution requirements, are not borne out in practice and the cost to the Society is higher than expected. This could result in higher contributions being required from the Group and a higher deficit being disclosed. This may also impact the Society's ability to grant discretionary benefits or other enhancements to members.

The assumptions not being borne out in practice could include:

- The investment return on the Scheme's assets being lower than assumed, resulting in an unaffordable increase in the contributions required from the Society. The level of bond returns will be a key determinant of overall investment return; the investment portfolio is also subject to a range of other risks typical of the asset classes held, in particular equity returns, credit risk on bonds and exposure to the property market.
- Falls in asset values (particularly equities) not being matched by similar falls in the value of liabilities. This risk has been mitigated to some degree by the implementation of an asset liability matching investment strategy which is designed to match a proportion of the Scheme's interest rate exposure.
- Future levels of inflation being higher than assumed, resulting in higher than anticipated annual increases to benefits in payment, revaluations of benefits prior to retirement and salary increases. This risk has been mitigated to some degree by the implementation of an asset liability matching investment strategy which is designed to match a proportion of the Scheme's inflation exposure.
- Unanticipated improvements in the longevity of members leading to an increase in the Scheme's liabilities.

Assets

The Scheme's investment strategy, with a significant proportion of the assets invested in an asset liability matching strategy (consisting of index-linked Government and corporate bonds and swaps), is expected to reduce the volatility of the difference between the market value of the assets and the IAS 19 liabilities (at the date of implementation in October 2012, the strategy hedged around 70% of the Scheme's interest rate and inflation rate risk).

Disaggregation of assets	31st Dec 2013 %	31st Dec 2012 %
Equities	**32**	28
Bonds – index–linked gilts	**33**	37
Bonds – corporate and other	**21**	22
Swaps	**2**	2
Cash and other	**12**	11
	100	100

The majority of the Scheme's investments are in quoted assets, with the exception of the liability matching assets classified as 'Swaps' and reinsurance assets included in 'Cash and other', where a proportion of these will be invested in unquoted assets.

26. RETIREMENT BENEFIT OBLIGATIONS (continued)

Sensitivities

The IAS 19 liability measurement (DBO) and the Service Cost are sensitive to the assumptions made about future inflation and salary growth levels, as well as the assumptions made about life expectancy. They are also sensitive to the discount rate, which depends on market yields on Sterling-denominated high quality corporate bonds. A decrease in corporate bond yields will increase the liabilities although this will be partially offset by an increase in matching assets.

The table below shows the sensitivity of the defined benefit obligation and the assets to changes in these assumptions. The final assumptions are chosen by the Society.

Principal Sensitivity Illustrations

	Defined benefit obligation £m	Assets £m	**Net effect £m**
Total as at 31st December 2013	626.5	626.9	**0.4**
Change in defined benefit obligation/assets given the following change of assumption:			
Discount rate[1]: 1.00% decrease	145.8	110.9	**(34.9)**
Salary escalation: 0.75% increase	11.7	–	**(11.7)**
Inflation[2]: 0.50% increase	28.3	30.6	**2.3**
Life expectancy: 1 year average increase	15.6	–	**(15.6)**

[1] The change in the discount rate is assumed to be equivalent to a 1% decrease in gilt, swap and credit based interest rates.

[2] The sensitivities to the inflation assumption change include corresponding changes to the future salary increases and future pension increases assumptions, where the pension increases are subject to the relevant maximum and minimum rates of increase that apply to each tranche of benefit.

The sensitivity illustrations above are calculated changing each assumption in isolation, keeping all other assumptions constant. In practice this is unrealistic as the financial assumptions are correlated.

The asset liability matching strategy implemented for the Scheme means that a change in discount rate or inflation assumption has a similar impact on the liabilities and the assets, reducing the volatility of the net impact.

27. OTHER LIABILITIES

	Group		**Society**	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Accruals and deferred income	**38.4**	28.8	**37.6**	27.2
Income tax deducted at source	**38.2**	43.8	**38.2**	43.8
Other	**9.0**	6.2	**72.2**	34.2
	85.6	78.8	**148.0**	105.2

28. PROVISIONS

Movements in provisions during the year were as follows:

	FSCS Levy £m	Customer Redress £m	Other £m	Total £m
Group				
At 1st January 2013	**35.5**	**61.1**	**6.9**	**103.5**
Amounts utilised during the year	**(21.4)**	**(19.0)**	**(0.4)**	**(40.8)**
Provision charge/(release) during the year	**11.8**	**12.7**	**(3.2)**	**21.3**
At 31st December 2013	**25.9**	**54.8**	**3.3**	**84.0**
2012 Restated*				
At 1st January 2012	40.2	58.3	4.3	102.8
Acquired on transfer of engagements	(9.8)	(6.2)	(1.0)	(17.0)
Amounts utilised during the year	–	–	4.7	4.7
Provision charge during the year	5.1	9.0	(1.1)	13.0
At 31st December 2012	35.5	61.1	6.9	103.5
2011 Restated*				
At 1st January 2011	36.1	9.0	0.6	45.7
Acquired on transfer of engagements	9.5	50.2	4.1	63.8
Amounts utilised during the year	(8.1)	(0.9)	(0.4)	(9.4)
Provision charge during the year	2.7	–	–	2.7
At 31st December 2011	40.2	58.3	4.3	102.8
Society				
At 1st January 2013	**35.5**	**61.1**	**6.9**	**103.5**
Amounts utilised during the year	**(21.4)**	**(19.0)**	**(0.4)**	**(40.8)**
Provision charge/(release) during the year	**11.8**	**10.8**	**(3.2)**	**19.4**
At 31st December 2013	**25.9**	**52.9**	**3.3**	**82.1**
2012 Restated*				
At 1st January 2012	40.2	58.3	4.3	102.8
Acquired on transfer of engagements	(9.8)	(6.2)	(1.0)	(17.0)
Amounts utilised during the year	–	–	4.7	4.7
Provision charge during the year	5.1	9.0	(1.1)	13.0
At 31st December 2012	35.5	61.1	6.9	103.5
2011 Restated*				
At 1st January 2011	36.1	9.0	0.6	45.7
Acquired on transfer of engagements	9.5	50.2	4.1	63.8
Amounts utilised during the year	(8.1)	(0.9)	(0.4)	(9.4)
Provision charge during the year	2.7	–	–	2.7
At 31st December 2011	40.2	58.3	4.3	102.8

28. PROVISIONS (continued)

* A restatement has been made to the prior period due to a change in accounting policy regarding the Financial Service Compensation Scheme (FSCS) levy. The change is a result of the early adoption of IFRIC 21 and has resulted in a restatement of the amount included in relation to our Financial Service Compensation Scheme (FSCS) levy for 2012, 2011 and prior years. This change to the trigger point has also been incorporated in our 2013 charge.

Financial Services Compensation Scheme

The FSCS has borrowings of £18bn in the form of loans from HM Treasury as a consequence of the default of a number of deposit taking institutions. The FSCS levies member firms to recover the interest cost on those loans. Whilst it is anticipated that the majority of the loans will be recovered from the failed institutions (although not expected until the early 2020s), the FSCS has notified the sector of an expected shortfall of £1,089m. The FSCS is recovering the shortfall by levying member firms, in three equal instalments beginning in the scheme year 2013/14. The Group's share of the shortfall is estimated to be £29m. Fair value adjustments were made on merger with Chelsea and Norwich and Peterborough building societies to provide for the possibility of such a shortfall.

The Group has recognised in this year's results a provision for a levy of £11.8m for the scheme year 2013/14, including £5.2m in respect of the shortfall.

The Group also has a potential exposure to future levies from further capital losses. However the qualification and timing of such losses has yet to be determined, and accordingly the Group has not recognised a provision for such contingent liabilities.

Customer remediation and conduct issues

Provisions have been made in respect of various customer claims. The largest provision (£25.6m) relates to financial advice mis-selling by Chelsea and Norwich and Peterborough building societies prior to their respective mergers with the Yorkshire Building Society in 2010 and 2011 and is calculated using management's estimate of complaint volumes, redress payments and complaint handling costs. The second largest provision (£20.9m) relates to the Group's approach to Mortgage Collection administration fee charging and sales of investments linked to stock market performance and has been calculated using management's estimates of complaint volumes, redress payments and other costs. The provision, all of which is expected to be utilised in 2014, represents management's best estimate of the likely costs, although the costs could vary between £10m and £25m. The remaining provision of £8.3m relates to sales of payment protection insurance (PPI) and is calculated using management's estimate of complaint volumes, referral levels to the Financial Ombudsman Service (FOS), claim rates upheld internally and by FOS, redress payments and complaint handling costs.

Other

Other provisions include provisions for claims relating to negligent valuations undertaken prior to 2010 by a subsidiary of Norwich and Peterborough Building Society and property related provisions. The release in the year relates to a reduction in the estimated number of negligent valuation claims.

29. SUBORDINATED LIABILITIES

Group and Society	2013 £m	2012 £m
6.63% Subordinated Bonds 2015	**10.2**	10.2
Floating Subordinated Bonds 2018	**5.0**	5.0
11⅜% Subordinated Bonds 2022	**5.0**	5.0
6⅜% Subordinated Bonds 2024	**4.1**	4.1
13½% Convertible Tier 2 Capital Notes 2025	**25.7**	100.2
Fair value hedging adjustments	**(1.3)**	(1.7)
	48.7	122.8

During 2013 the Group completed a capital buyback by re-purchasing £75m of the 13½% Convertible Tier 2 Capital Notes. The result of the buyback of subordinated liabilities was a loss of £39.8m after taking account of fees. This was offset to a degree by a £9.8m profit on the unwinding of the associated hedging instrument. As the debt was paying interest at 13½%, the Group will save significant interest costs in future years.

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 Prudential Regulation Authority under the following conditions:

- Redemption of all (but not some only) of the 11⅜% Notes at par on 27th November 2017 after giving not less than thirty nor more than 60 days' notice to the holders. In the event the Society does not redeem the notes on 27th 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.
- Redemption of all (but not some only) of the 13½% Convertible Tier 2 Capital Notes will occur on 1st April 2025 unless the notes are converted to Profit Participating Deferred Shares (PPDS). The 'Conversion Trigger' shall occur if on any Calculation Date the Society's Consolidated Core 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%. 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).

The rights of repayment of the holders of subordinated liabilities 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.

30. SUBSCRIBED CAPITAL

Group and Society	2013 £m	2012 £m
5.649% Permanent Interest Bearing Shares	**6.2**	6.2
Fair value hedging adjustments	**0.6**	1.1
	6.8	7.3

All Permanent Interest Bearing Shares (PIBS) are unsecured and denominated in sterling. Interest is payable half yearly on 27th March and 27th 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 Prudential Regulation 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 liabilities, 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 the Group's capital management strategies can be found in the Risk Management Report on page 46.

	2013 £m	2012 Restated*** £m
Tier 1		
General reserve	**1,805.9**	1,694.4
Subscribed capital	**6.8**	7.3
Pension fund adjustments*	**(3.0)**	(16.6)
Intangible fixed assets	**(34.9)**	(34.3)
Deductions from Tier 1 capital	**(11.4)**	(13.3)
	1,763.4	1,637.5
Tier 2		
Subordinated liabilities**	**40.5**	117.2
Collective allowances for impairment	**12.7**	6.3
Deductions from Tier 2 capital	**(11.4)**	(13.3)
	41.8	110.2
Other items excluded	**(5.8)**	(4.1)
Total capital	**1,799.4**	1,743.6
Risk weighted assets	**12,595.4**	11,905.7
Core Tier 1 ratio	**13.9%**	13.7%
Tier 1 ratio	**14.0%**	13.8%
Solvency ratio	**14.3%**	14.6%

* The regulatory capital rules allow a pension fund surplus/deficit to be deducted from/added back to regulatory capital and in case of a deficit a deduction taken instead for an estimate of the additional contributions to be made in the next five years, less associated deferred tax.

** Subordinated liabilities are adjusted for amortisation in the regulatory capital value of instruments with less than five years to maturity.

*** A restatement has been made to the prior period due to a change in accounting policy regarding the Financial Service Compensation Scheme (FSCS) levy. Further details of this are given in the basis of preparation on page 85.

The above ratios, deductions and definitions are in accordance with Prudential Regulation Authority guidelines.

Throughout the year the Executive Risk Committee has kept the Group's capital position under review as well as regulatory developments under Basel III.

32. FINANCIAL COMMITMENTS

	Group and Society 2013 £m	Group and Society 2012 £m
Committed undrawn standby facilities	**169.8**	171.9

The Society has an obligation under the Building Societies Act 1986 to discharge the liabilities incurred up to 11th 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 11th 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 31st December 2013, but for which no provision has been made in the accounts, amounted to Group £11.0m and Society £11.0m (2012 – Group £5.2m and Society £5.2m).

Amounts payable under non-cancellable operating leases are as follows:

	2013		2012	
Group	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Within one year	**8.7**	**1.3**	5.2	1.1
Between one and five years	**26.6**	**2.0**	16.1	2.8
Over five years	**22.2**	**–**	22.0	–
	57.5	**3.3**	43.3	3.9

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 and advances to customers	Loan period is typically up to 25 years Primarily mortgage products offering a variety of fixed and variable interest rates	Amortised cost*
Derivative financial instruments	Primarily medium-term Value derived from underlying price, rate or index	Fair value through profit and loss
Intercompany deposit from Covered Bond Limited Liability Partnerships	Long-term Fixed and variable interest rates	Fair value through profit and loss
Investments	Investment in subsidiary companies	Amortised cost/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, equity release 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 amount £m	Fair values Assets £m	Liabilities £m
At 31st December 2013			
Interest rate swaps designated as fair value hedges	**6,653.1**	**146.7**	**121.8**
Interest rate swaps designated as cash flow hedges	**2,349.9**	**27.1**	**19.7**
Cross-currency interest swaps designated as fair value hedges	**499.7**	**15.3**	**–**
Derivatives not designated as hedges:			
Interest rate swaps	**9,525.7**	**45.2**	**52.2**
Cross-currency interest rate swaps	**–**	**–**	**–**
Equity linked interest rate swaps	**537.5**	**38.3**	**0.9**
Call options	**2.7**	**0.2**	**–**
Forward foreign exchange	**69.1**	**0.2**	**0.2**
Interest rate options	**3.0**	**–**	**–**
Equity release swaps	**–**	**–**	**–**
Total derivatives held for hedging	**19,640.7**	**273.0**	**194.8**

Society	Contract/ notional amount £m	Fair values Assets £m	Liabilities £m
At 31st December 2013			
Interest rate swaps designated as fair value hedges	**5,903.1**	**63.4**	**121.8**
Interest rate swaps designated as cash flow hedges	**2,349.9**	**27.1**	**19.7**
Derivatives not designated as hedges:			
Interest rate swaps	**9,525.7**	**45.0**	**54.5**
Cross-currency interest rate swaps	**–**	**–**	**–**
Equity linked interest rate swaps	**537.5**	**38.3**	**0.9**
Call options	**2.7**	**0.2**	**–**
Forward foreign exchange	**69.1**	**0.2**	**0.2**
Interest rate options	**3.0**	**–**	**–**
Equity release swaps	**–**	**–**	**–**
Total derivatives held for hedging	**18,391.0**	**174.2**	**197.1**

The Group currently uses discount curves based on term LIBOR rates to fair value both collateralised and non-collateralised positions. However, from January 2014, in line with an increasing trend in the market, the Group will start to use 'Sterling Overnight Index Average' (SONIA) discount curves rather than term LIBOR rates.

Credit risk on derivative exposures is significantly mitigated within the Group by the existence of a Credit Support Annex (CSA) with the vast majority of our derivative counterparties. Under a CSA, cash is passed between parties to mitigate the counterparty risk inherent in the outstanding positions. Where cash collateral is received, to mitigate the risk inherent in amounts due to the Group, it is included as a liability within amounts owed to credit institutions. Where cash collateral is given to mitigate the risk inherent in amounts due from the Group, it is included as an asset in loans and advances to credit institutions.

34. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Group	Contract/ notional amount £m	Fair values Assets £m	Liabilities £m
At 31st December 2012			
Interest rate swaps designated as fair value hedges	4,038.7	37.8	205.6
Interest rate swaps designated as cash flow hedges	1,643.9	–	95.8
Cross-currency interest swaps designated as fair value hedges	3,253.3	148.5	63.5
Derivatives not designated as hedges:			
Interest rate swaps	8,296.0	153.4	78.6
Cross-currency interest rate swaps	40.8	4.8	–
Equity linked interest rate swaps	614.9	31.9	2.0
Call options	10.1	4.0	–
Forward foreign exchange	72.0	0.2	0.2
Interest rate options	12.0	–	–
Equity release swaps	204.9	–	71.7
Total derivatives held for hedging	18,186.6	380.6	517.4
Society			
At 31st December 2012			
Interest rate swaps designated as fair value hedges	4,038.7	37.8	205.6
Interest rate swaps designated as cash flow hedges	1,643.9	–	95.8
Derivatives not designated as hedges:			
Interest rate swaps	10,310.0	153.4	147.5
Cross-currency interest rate swaps	40.8	4.8	–
Equity linked interest rate swaps	614.9	31.9	2.0
Call options	10.1	4.0	–
Forward foreign exchange	72.0	0.2	0.2
Interest rate options	12.0	–	–
Equity release swaps	409.9	71.7	71.7
Total derivatives held for hedging	17,152.3	303.8	522.8

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 the 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 the monitoring of 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 Asset and Liability Committee (ALCO) 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.
- The Society also manages liquidity in line with the regulatory requirements issued by the PRA in the form of the Individual Liquidity Guidance (ILG). This is set by the PRA following the submission and subsequent regulatory review of the Individual Liquidity Adequacy Assessment (ILAA). The ILG determines the amount of highly liquid collateral (government and supranational debt securities and cash) that the Society is required to hold. The ILAA document is updated on an annual basis, approved by Group Risk Committee, and incorporates updates to both the ILG (which require regulatory review and approval before implementation) and internal liquidity stress test scenarios.

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.

The Group established its first securitisation programme in 2011. This year the latest securitisation structure, Brass No. 3 PLC was established with a £1,000m issue secured against certain loans of Accord Mortgages Ltd, of which £500m was retained by the Yorkshire Building Society for use as collateral to potentially access funding schemes launched by the Bank of England. The table below illustrates the remaining balance of external secured funding after redemptions in the mortgage pool since issuance.

	2013		2012	
	Assets pledged £m	**Secured funding £m**	Assets pledged £m	Secured funding £m
Secured against loans and advances to customers	**7,482.0**	**4,516.4**	4,542.5	2,911.6
Secured against liquid assets	**10.9**	**10.7**	5.3	5.0

Pledged assets include those available to Yorkshire Building Society Covered Bonds LLP, Brass No.1 PLC, Brass No.2 PLC and Brass No.3 PLC to provide collateral to support external funding transactions.

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 programmes operates under Mortgage Sale Agreements, where there is an equitable assignment of the loans from the Seller (Accord Mortgages Limited) to the Issuers (Brass No.1 PLC, Brass No.2 PLC and Brass No.3 PLC). Legal title remains with Accord and full transfer of title is not affected until the occurrence 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 future cash flows for all financial liabilities including interest payments. Further details of liquidity management are contained within the Risk Management Report on pages 48 to 49.

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 31st December 2013				
Shares	**23,098.4**	**3,437.5**	**–**	**26,535.9**
Amounts owed to credit institutions	**1,992.3**	**549.4**	**36.6**	**2,578.3**
Other deposits				
Society	**270.6**	**3.5**	**–**	**274.1**
Subsidiaries	**229.0**	**–**	**–**	**229.0**
	499.6	**3.5**	**–**	**503.1**
Debt securities in issue	**76.2**	**2,907.0**	**–**	**2,983.2**
Subordinated liabilities	**5.0**	**32.9**	**60.7**	**98.6**
Subscribed capital*	**0.3**	**1.4**	**1.7**	**3.4**
Operating lease payments	**10.0**	**28.6**	**22.2**	**60.8**
Derivative financial liabilities	**111.8**	**251.6**	**430.3**	**793.7**
Total	**25,793.6**	**7,211.9**	**551.5**	**33,557.0**
Group				
As at 31st December 2012				
Shares	21,747.5	5,419.0	1.7	27,168.2
Amounts owed to credit institutions	264.2	487.2	127.7	879.1
Other deposits				
Society	300.5	–	–	300.5
Subsidiaries	176.3	–	–	176.3
	476.8	–	–	476.8
Debt securities in issue	113.7	2,079.4	785.6	2,978.7
Subordinated liabilities	15.0	68.5	224.7	308.2
Subscribed capital*	0.3	1.4	1.7	3.4
Operating lease payments	6.3	18.9	22.0	47.2
Derivative financial liabilities	175.8	417.9	309.0	902.7
Total	22,799.6	8,492.3	1,472.4	32,764.3

* The table includes interest payments on subscribed capital 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, i.e. 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.

2013	Year end £000	Average £000	Maximum £000	Minimum £000
VaR	**5,426**	**3,968**	**7,026**	**1,272**
Basis risk	**34**	**108**	**205**	**12**
BP sensitivity	**(256)**	**(51)**	**321**	**(336)**

	Greater than one year £m	Greater than five years £m	Greater than 10 years £m
Repricing gap	**1,565**	**25**	**13**

2012	Year end £000	Average £000	Maximum £000	Minimum £000
VaR	2,911	3,055	5,548	790
Basis risk	153	45	153	(45)
BP sensitivity	334	134	334	(108)

	Greater than one year £m	Greater than five years £m	Greater than 10 years £m
Repricing gap	(1,582)	(103)	(8)

Detail of how the Group manages its interest rate risk is included in the Risk Management Report on pages 49 to 50.

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 50. Actual exposures were:

	2013 £m	2012 £m
Year end	**0.4**	0.4
Maximum	**0.6**	0.4

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 regularly reviewed internally and against the external rating agencies, with revocation or suspension taking place when considered appropriate.

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 overexposure to a given country or business type.

Whilst recognising that exposures will be maintained across a spectrum of counterparties the Board has maintained a low risk appetite for wholesale credit risk resulting in our inter-bank exposures being limited to operational requirements. Primary liquidity holdings, (which meet Individual Liquidity Guidance requirements) are buffer eligible and restricted to the Bank of England, UK Government and Multilateral Development Banks. Secondary liquidity holdings are used to support the OLR (Overall Liquidity Requirements) if considered internally to be liquid.

The following table breaks down exposures using composite external ratings and includes RMBS and Structured Credit Investments.

	2013 %	2012 %
AAA	**4**	88
AA+ to AA-	**87**	5
A+ to A-	**8**	6
Other	**1**	1
	100	100

The Group uses an internal credit ratings process to identify potential risks. Wholesale related credit risks are reported and discussed monthly at the Wholesale and Commercial Credit Committee. The Group's low risk appetite is reflected in the country exposures.

The Group's only Sovereign exposure is to the UK which now has an average external rating of 'AA+'. At the year end, Sovereign exposure to the UK was £4,774m (2012 – £4,148m) to the Bank of England and £327m (2012 – £111m) in UK Government bonds.

The largest exposure to a single institution (other than the UK Government & Multilateral Development Banks) was £314m (2012 – £242m) in both instances to a UK clearing bank.

38. WHOLESALE CREDIT RISK (continued)

Country	Wholesale Exposures (including RMBS & Structured Credit Investments) at 31st December 2013 (£m)	Wholesale Exposures (including RMBS & Structured Credit Investments) at 31st December 2012 (£m)
United Kingdom	**5,749.7**	4,806.5
Multilateral Development Banks	**152.5**	153.3
United States	**63.7**	43.9
Switzerland	**31.0**	31.0
Netherlands	**24.2**	28.0
Ireland	**20.8**	27.6
Cayman Islands	**15.7**	21.9
Germany	**3.9**	2.4
France	**2.5**	1.1
Australia	**2.1**	0.4
Denmark	**2.1**	0.4
Spain	**1.1**	–
Belgium	**<0.1**	–

The Society has maintained its low risk appetite for wholesale credit risk to financial institutions outside the UK.

None of the wholesale exposures were either past due or impaired and there are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

The key trigger events used to evaluate impairments are set out in Note 1 on pages 87 to 88.

In addition to the above direct exposures the Group regularly monitors 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 regards to this information.

38. WHOLESALE CREDIT RISK (continued)

Wholesale credit risk is recorded in the following Statement of Financial Position captions:

	2013 £m	2012 £m
Cash in hand and balances with the Bank of England	**3,314.6**	4,165.3
Loans and advances to credit institutions	**482.0**	573.7
Debt securities	**624.6**	492.5
Derivative financial instruments	**273.0**	380.6
Investments[1]	**1.4**	1.4
Total wholesale credit risk	**4,695.6**	5,613.5

Debt securities, which are shown after fair value and impairment adjustments, can be further analysed as:

UK Government securities	**313.4**	133.6
Medium-term notes issued by financial institutions	**161.4**	171.2
Mortgage backed securities[2]	**84.5**	133.7
Combination note[3]	**7.4**	4.9
Synthetic credit investments[4]	**34.8**	26.3
Collateralised debt obligations[5]	**23.1**	22.8
	624.6	492.5

[1] Principally an equity investment in VocaLink Holdings Limited which is associated with the Group's operation of cash machines.

[2] Mortgage backed securities are primarily backed by AAA rated UK prime residential mortgages.

[3] The combination note continues to pay contractual coupons with no evidence of impairment. Changes in fair value are taken directly to the Income Statement.

[4] There are three 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.

[5] There are investments in three 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.

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's exposure to credit risk on loans and advances to customers can be broken down as follows:

	Group		Society	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Retail mortgages	**29,178.4**	27,294.1	**17,590.1**	17,537.6
Commercial lending	**597.9**	503.3	**594.1**	498.9
Unsecured lending	**13.0**	14.0	**13.0**	14.0
Total gross exposure (contractual amounts)	**29,789.3**	27,811.4	**18,197.2**	18,050.5
Impairment, fair value, EIR and hedging adjustments	**(273.5)**	(239.0)	**(249.1)**	(220.8)
Total net exposure	**29,515.8**	27,572.4	**17,948.1**	17,829.7

Retail mortgages

The Group's exposure to mortgage related credit risk is monitored closely by the 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.

Geographic distribution of retail mortgage balances	**2013**	2012
	%	%
Scotland	**7.1**	7.2
North East	**3.7**	4.0
Yorkshire & Humberside	**10.1**	10.7
North West	**9.9**	10.4
Midlands	**12.3**	12.7
East of England	**4.7**	5.1
South West	**6.2**	6.3
Greater London	**21.6**	19.3
South East	**20.2**	19.7
Wales & Northern Ireland	**4.0**	4.3
Non-UK	**0.2**	0.3
	100.0	100.0

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 the relative properties 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	
	2013 %	2012 %	2013 %	2012 %
Greater than 100%	**3.4**	6.9	**–**	–
90% to 100%	**5.7**	8.9	**–**	–
75% to 90%	**26.9**	26.1	**41.9**	36.4
50% to 75%	**42.0**	36.2	**48.0**	54.2
Less than 50%	**22.0**	21.9	**10.1**	9.4
	100.0	100.0	**100.0**	100.0

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 54.1% (2012 – 55.4%).

Loan-to-value distribution of retail mortgage balances	2013		2012	
	Not impaired %	Impaired %	Not impaired %	Impaired %
Greater than 100%	**2.8**	**0.6**	6.0	0.9
90% to 100%	**5.3**	**0.4**	8.4	0.5
75% to 90%	**26.3**	**0.6**	25.5	0.6
50% to 75%	**41.5**	**0.5**	35.8	0.4
Less than 50%	**21.8**	**0.2**	21.7	0.2
	97.7	**2.3**	97.4	2.6

Retail mortgage customer type	Book		New Lending	
	2013 %	2012 %	2013 %	2012 %
First time buyer	**18.6**	18.1	**21.5**	22.3
Other buyers, i.e. movers	**42.0**	41.9	**43.8**	44.1
Remortgage	**33.9**	34.9	**29.3**	32.0
Buy-to-let	**5.5**	5.1	**5.4**	1.6
	100.0	100.0	**100.0**	100.0

39. CREDIT RISK ON LOANS AND ADVANCES TO CUSTOMERS (continued)

Retail mortgage arrears	Group		Society	
	2013	2012	**2013**	2012
Arrears outstanding as a percentage of debt	**%**	%	**%**	%
No arrears	**93.8**	93.5	**94.3**	94.4
Less than three months	**4.6**	4.8	**4.4**	4.4
Three months or more	**1.4**	1.5	**1.2**	1.0
Property in possession	**0.2**	0.2	**0.1**	0.2
	100.0	100.0	**100.0**	100.0
Number of properties in possession at the year end	**318**	471	**186**	240

The percentage of retail mortgages with arrears of three months or more (as a % of outstanding balances, including repossessions) has fallen during 2013 from 1.69% to 1.57%. The Group's retail mortgage arrears ratio is below the comparable CML ratio. 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 Wholesale and Commercial Credit Committee. Reporting includes analysis of book growth, sector analysis of book, geographic distribution, loan-to-value analysis and the movement of loans into arrears and between arrears bands. Loans against specialist properties are strictly limited and we do not lend against land only. The Group assesses whether current valuations are appropriate by re-valuing properties periodically using third party valuation data which takes into account the property type and geographical location. Third party valuation data is also used to assess the risk of loss on individual loans to monitor whether loan-to-value covenants are met. Where borrowers are more than two months in arrears, consideration is given to obtaining a professional valuation of the property.

At 31st December 2013 the Group has a commercial lending book (including lending to housing associations) of £597.9m. The Group originates commercial lending via its N&P brand, providing loans to commercial owner occupiers, commercial and residential property landlords (where the borrower is a corporate entity) and a small number of housing associations. The N&P commercial loan portfolio, which comprises 72.1% (2012 – 75.9%) of the total commercial lending book, is managed by a specialist team using a combination of lending policy rules, underwriting and close relationship management to assess new applicants and manage existing loans. The majority of loans were advanced against commercial properties using a vacant possession valuation to mitigate against future losses.

This proactive approach to account management has resulted in 0.53% of N&P commercial accounts being more than three months in arrears (as a % of outstanding balances, including repossessions) as at the year end (2012 – 0.87%). While arrears and losses to date have been low, as part of the merger, all N&P's commercial loans were subject to a fair value adjustment to reflect likely future losses on the portfolio.

We have a small closed commercial loan book which arose from the merger with Chelsea Building Society. The book is in run off and we do not write any new commercial businesses under the Chelsea brand. At 31st December 2013 there were 7 loans remaining with outstanding balances totalling £42.8m (2012 – £56.6m). All loans are performing and are covenant compliant apart from a £12.7m exposure secured on a retail park in southern Scotland. This borrower is in administration and we have appointed property professionals to manage and make cosmetic improvements to the park ahead of a disposal by sale later in 2014. We have negative equity and accrued arrears and expect to make a loss on the sale and have made provisions accordingly.

In addition to the N&P commercial lending book, we have an active business lending to housing associations, in England and Wales, via the Yorkshire Building Society brand, properly known as 'Registered Providers'. This sector has particularly robust credit characteristics and the lending is low risk albeit at low margins. We have an opportunistic approach to attracting new business and do so when returns and capital efficiency contribute to financial sustainability. At 31st December 2013 the loan book was £124.1m (2012 – £64.6m). We have written further term loan facilities in the region of £230m (2012 – £220m) and these will draw down over the next 2 to 3 years.

39. CREDIT RISK ON LOANS AND ADVANCES TO CUSTOMERS (continued)

The Group commercial loan portfolio (including lending to housing associations) is spread throughout the UK as follows:

Geographic distribution of commercial mortgage balances	2013 %	2012 %
Scotland	**2.3**	2.5
North East	**1.3**	1.5
Yorkshire & Humberside	**3.8**	3.1
North West	**11.9**	8.1
Midlands	**8.4**	10.2
East of England	**5.9**	7.6
South West	**5.3**	6.1
Greater London	**25.7**	27.2
South East	**28.8**	28.9
Wales	**6.6**	4.8
	100.0	100.0

N&P commercial mortgages by customer type	2013 %	2012 %
Housing Associations	**4.8**	5.7
Buy To Let	**16.0**	12.7
Commercial Mortgages	**79.2**	81.6
	100.0	100.0

N&P commercial mortgages by property type	2013 %	2012 %
Office	**31.9**	26.8
Industrial	**9.1**	10.8
Retail and leisure	**26.3**	25.7
Housing Associations	**4.8**	5.8
Other, including mixed use	**27.9**	30.9
	100.0	100.0

The average loan-to-value of the N&P commercial loan portfolio is 62.0% (2012 – 64.4%). The loan-to-value calculation has been undertaken using a combination of external professional valuations and indexation of the original valuation using data from the Investment Property Databank (IPD). IPD provides performance measurement services in the UK and Ireland on over 360 investment portfolios. Residential valuations are indexed using the Halifax house price index.

The total collateral held against N&P commercial loans is estimated to be £797m (2012 – £694m). £49.4m of the N&P exposures have an estimated LTV of greater than 100% (2012 – £61.5m). Of these, loans totalling £3m are in arrears. The largest N&P exposure to a single counterparty at 31st December 2013 is £8.5m (2012 – £8.8m).

Loans monitored on the “watch list” include those where there are circumstances which could impact on the quality and safety of the loan. Examples include borrowers requesting forbearance (such as changing loan repayments to interest only for a period), or reporting trading losses. Loans on the watch list total £9.2m (2012 – £12.8m). Our appetite and approach to the provision of commercial mortgages is to provide amortising term loans, typically over 10 – 25 years. We do not provide short-term, interest only facilities which require repayment on expiry through refinance. Where a period of interest only is agreed, it will be for a short period following which the loan will be structured to amortise over the remaining term. Buy to Let loans are mainly interest only (£70.4m, 2012 – £48.9m). These loans are continuously monitored to ensure that full repayment is made on the expiry of the loan term.

39. CREDIT RISK ON LOANS AND ADVANCES TO CUSTOMERS (continued)

N&P commercial mortgage arrears

	2013	2012
Arrears outstanding as a percentage of debt	%	%
No arrears	**98.1**	97.3
Less than three months	**1.4**	1.7
Three months or more	**0.2**	0.4
Property in possession	**0.3**	0.6
	100.0	100.0

Unsecured lending

The Group originates unsecured lending in the form of current accounts, via its N&P brand. In addition, the Group has an N&P branded personal loan portfolio that is in run-off. As at 31st December 2013 unsecured lending balances stood at £13.0m (current account overdrafts of £3.0m, personal loans of £6.0m and other unsecured loans of £4.0m). Within the Group, unsecured lending is managed by the Credit Risk area within Group Risk, with monthly reporting provided to the Retail Credit 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. As at 31st December 2013, accounts that have been in excess of their agreed overdraft for three or more consecutive months stand at 1.9% of the portfolio (2012 – 2.2%).

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 31st December 2013, accounts three or more months in arrears stand at 14.7% of the portfolio (2012 – 12.8%).

At the point of merger, as with all N&P loan books, a fair value adjustment was applied against all unsecured lending.

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	
	2013 £m	2012 £m	2013 £m	2012 £m
Not impaired:				
Neither past due nor impaired	**27,905.4**	25,942.1	**17,126.9**	16,965.5
Past due but not impaired	**1,080.2**	1,058.4	**646.0**	665.1
Impaired	**803.7**	810.9	**424.3**	419.9
Total loans and advances	**29,789.3**	27,811.4	**18,197.2**	18,050.5

Loans acquired from the Norwich & Peterborough and Egg in 2011, and the Chelsea in 2010, have been fair valued on a basis which makes allowances for anticipated losses over the remaining life of the loans. Impaired loans totalling £344.2m in the above analysis for 31st December 2013 have thus been fair valued and are, therefore, unlikely to contribute any significant further losses to the Group.

39. CREDIT RISK ON LOANS AND ADVANCES TO CUSTOMERS (continued)

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.

	Loans and advances		Collateral	
	2013	2012	**2013**	2012
Group	**£m**	£m	**£m**	£m
Neither past due nor impaired	**27,905.4**	25,942.1	**27,746.1**	25,657.1
Past due but not impaired	**1,080.2**	1,058.4	**1,067.5**	1,035.8
Impaired	**803.7**	810.9	**766.3**	757.5
Total loans and advances	**29,789.3**	27,811.4	**29,579.9**	27,450.4
Society				
Neither past due nor impaired	**17,126.9**	16,965.5	**17,013.9**	16,757.8
Past due but not impaired	**646.0**	665.1	**637.9**	651.3
Impaired	**424.3**	419.9	**405.8**	391.1
Total loans and advances	**18,197.2**	18,050.5	**18,057.6**	17,800.2

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 pages 87 to 88 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)	2014	5.0%	Judgemental
	2015	(2.5%)	
	2016	(2.5%)	
	2017	0.0%	
Probability of possession	10% to 70% for impaired accounts depending on the degree of impairment		Judgemental and experience
Emergence period	3 to 6 months		Experience
Loss given possession	5% to 45% for impaired accounts		Current experience
Forced sale discount	25%		Current experience

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 2013.

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.

The analysis below sets out a total of £471.6m mortgage balances which are subject to some form of forbearance in its widest sense. Balances totalling £272.8m are more than two months in arrears or properties in possession and therefore fall within the Group's individual provision calculation. The remaining £198.8m 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. Forbearance is included in mortgage provisions in the same way as any other debt, with that which is more than two months in arrears being recorded as impaired, and that which is less than or equal to two months being collectively assessed. If it were all to be incorporated as impaired the mortgage provision would increase from £46.2m to £46.5m.

No capitalisation or payment holiday forbearance has been granted.

	Positive arrears arrange-ments* £m	Negative arrears arrange-ments** £m	Permanent interest only*** £m	Temporary interest only £m	Term extension £m	Direct debit suspension £m	Total £m
Not in arrears	9.6	1.4	9.1	3.6	17.1	13.1	**53.9**
Less than one month	52.8	8.2	0.3	1.4	0.8	3.1	**66.6**
One to two months	60.1	14.0	0.1	0.2	–	3.9	**78.3**
Two to three months	52.6	14.0	0.2	0.5	–	1.0	**68.3**
Three to six months	107.6	16.9	–	1.0	0.1	0.5	**126.1**
Six to 12 months	55.6	2.4	–	0.1	–	–	**58.1**
12 months or over	14.3	0.2	–	–	–	–	**14.5**
Property in possession	5.8	–	–	–	–	–	**5.8**
	358.4	**57.1**	**9.7**	**6.8**	**18.0**	**21.6**	**471.6**

* 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 interest will continue to accrue on the unpaid amounts.

*** Excluding acquired mortgages which were measured at fair value.

39. CREDIT RISK ON LOANS AND ADVANCES TO CUSTOMERS (continued)

All requests for forbearance on commercial loans are subject to full credit risk appraisal and are predominately for a period of interest only which allows the borrower to improve income from trading or rent receipts, or pending the sale of the property. The appraisal process considers the likelihood of a loss being sustained from any borrower granted a concession and ensures that the concession is in the interests of both the borrower and the Group. In 2013 there are 35 accounts in the N&P commercial loans portfolio totalling £7.2m with an interest only concession (2012 – 43 accounts totalling £7.6m).

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.

	2013		2012	
Group	**Book Value £m**	**Fair Value £m**	Book Value £m	Fair Value £m
Assets				
Cash in hand and balances with the Bank of England	**3,314.6**	**3,314.6**	4,165.3	4,165.3
Loans and advances to credit institutions	**482.0**	**482.0**	573.7	573.7
Debt securities – fair value	**7.4**	**7.4**	4.9	4.9
Debt securities – embedded derivative	**(2.4)**	**(2.4)**	(10.0)	(10.0)
Debt securities – available for sale	**531.9**	**531.9**	360.8	360.8
Debt securities – held to maturity	**87.7**	**86.9**	136.8	133.0
Loans and advances to customers	**29,515.8**	**29,804.6**	27,572.4	27,876.4
Investments	**1.4**	**1.4**	1.4	1.4
Liabilities				
Shares	**26,290.3**	**26,177.8**	26,817.5	26,974.4
Amounts due to credit institutions	**2,621.4**	**2,621.4**	911.1	911.1
Other deposits	**501.4**	**501.4**	475.7	475.7
Debt securities in issue	**2,793.6**	**2,827.5**	2,784.3	2,798.8
Subordinated liabilities	**48.7**	**63.1**	122.8	157.7
Subscribed capital	**6.8**	**5.5**	7.3	5.1

40. FAIR VALUES (continued)

Society	2013 Book Value £m	2013 Fair Value £m	2012 Book Value £m	2012 Fair Value £m
Assets				
Cash in hand and balances with the Bank of England	**3,314.6**	**3,314.6**	4,165.3	4,165.3
Loans and advances to credit institutions	**120.8**	**120.8**	361.3	361.3
Debt securities – fair value	**7.4**	**7.4**	4.9	4.9
Debt securities – embedded derivative	**(2.4)**	**(2.4)**	(10.0)	(10.0)
Debt securities – available for sale	**531.9**	**531.9**	360.8	360.8
Debt securities – held to maturity	**1,334.3**	**1,331.7**	952.1	954.6
Loans and advances to customers	**17,948.1**	**18,070.0**	17,829.7	17,907.1
Investments	**11,186.1**	**11,186.1**	9,801.6	9,801.6
Liabilities				
Shares	**26,290.3**	**26,177.8**	26,817.5	26,974.4
Amounts due to credit institutions	**2,621.4**	**2,621.4**	911.1	911.1
Other deposits	**1,965.9**	**1,965.9**	1,995.2	1,995.2
Debt securities in issue	**1,847.9**	**1,875.9**	1,938.3	1,945.6
Subordinated liabilities	**48.7**	**63.1**	122.8	157.7
Subscribed capital	**6.8**	**5.5**	7.3	5.1

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 calculated using a Level 2 method, as described on page 144 and 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.

Loans and advances to customers 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 to certain fixed rate mortgages that are in hedging relationships. In addition, a fair value adjustment in relation to mortgage balances acquired as part of mergers takes account of the differential between market rates and product rates. Also as part of the mergers, mortgage loan balances were subject to fair value adjustments to reflect anticipated future losses on the portfolios in line with IFRS 3 'Business Combinations'. Consequently, a significant proportion of such balances are held on balance sheet at fair value. Overall the fair value is higher than carrying value by £289m which arises primarily due to the product rates being above prevailing market rates.

The fair value of loans and advances to customers uses a Level 2 method and 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. The estimated fair value of fixed rate loans represents the discounted amount of estimated future cash flows expected to be received. Expected cashflows are discounted at current market rates to determine fair value. 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.

All of the Group's financial liabilities are initially recorded at fair value less directly attributable costs and are subsequently measured at amortised cost other than derivative financial instruments or where an adjustment is made to certain fixed rate shares balances that are in hedging relationships. In addition, shares balances acquired as part of mergers are carried at fair value in accordance with IFRS 3 'Business Combinations'. Consequently the carrying value and the fair value are similar and in 2012 were not materially different. In 2013, the estimated fair value of share balances using a Level 2 method is now lower than the carrying value by £112m which arises primarily due to the product rates being above prevailing market rates.

40. FAIR VALUES (continued)

The fair value of debt securities, subordinated liabilities and subscribed capital are calculated using a Level 2 method based on observable market prices. The fair value of subordinated liabilities is higher than carrying value by £14m which arises primarily due to the interest rates on the notes being significantly above prevailing market rates.

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 31st December 2013				
Debt Securities – fair value	**–**	**7.4**	**–**	**7.4**
Embedded derivatives	**–**	**(2.4)**	**–**	**(2.4)**
Debt Securities – available for sale	**471.5**	**60.4**	**–**	**531.9**
Investments	**–**	**–**	**1.4**	**1.4**
Derivative assets	**–**	**273.0**	**–**	**273.0**
Derivative liabilities	**–**	**(194.8)**	**–**	**(194.8)**
	471.5	**143.6**	**1.4**	**616.5**

Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
As at 31st December 2012				
Debt Securities – fair value	–	4.9	–	4.9
Embedded derivatives	–	(10.0)	–	(10.0)
Debt Securities – available for sale	301.7	59.1	–	360.8
Investments	–	–	1.4	1.4
Derivative assets	–	380.6	–	380.6
Derivative liabilities	–	(517.4)	–	(517.4)
	301.7	(82.8)	1.4	220.3

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 £15.6m to the pension scheme (2012 – £19.4m).

Key management compensation

The key management personnel compensations are as follows:

	No. of key management personnel	2013 £000	No. of key management personnel	2012 £000
Short-term employee benefits		2,832		2,498
Post employment benefits		79		82
Total key management personnel compensation	13	2,911	12	2,580

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 2013	Amounts in respect of key management personnel and their close family members 2013 £000	No. of key management personnel 2012	Amounts in respect of key management personnel and their close family members 2012 £000
Mortgage loans				
At 1st January		433		508
Net movements in the year		(45)		(75)
At 31st December	2	388	2	433
Deposit accounts and investments				
At 1st January		1,082		734
Net movements in the year		(30)		348
At 31st December	12	1,052	11	1,082

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 £433,122.

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 £2,775 (2012 – £8,538), received interest totalling £13,637 (2012 – £21,090), 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:

	2013 £m	2012 £m
Shares in subsidiaries		
At 1st January	**113.8**	221.5
Net movements	**(8.0)**	(107.7)
At 31st December	**105.8**	113.8
Loans to subsidiaries		
At 1st January	**9,686.1**	8,633.2
Net movements	**1,392.5**	1,052.9
At 31st December	**11,078.6**	9,686.1
Deposits from subsidiaries		
At 1st January	**1,695.8**	1,198.1
Net movements	**(2.3)**	497.7
At 31st December	**1,693.5**	1,695.8
Interest receivable on loans	**373.1**	380.3
Interest payable on deposits	**(37.1)**	(41.8)
Fees and expenses receivable	**29.8**	23.0
Fees and expenses payable	**(2.7)**	(2.5)

Transactions with joint ventures

The Society holds 50% of the share capital of MutualPlus Ltd, a branch sharing company. The outstanding investment at 31st December 2013 and 31st December 2012 is less than £0.1m.

42. CASH FLOWS FROM OTHER OPERATING ACTIVITIES

	Group		Society	
	2013	2012 Restated*	**2013**	2012 Restated*
	£m	£m	**£m**	£m
Working capital adjustments:				
Depreciation and amortisation	**37.0**	16.3	**36.4**	15.6
Profit/(loss) on sale of assets	**(0.5)**	4.2	**(0.5)**	4.1
Interest on subordinated liabilities and subscribed capital	**16.1**	29.0	**16.1**	29.0
Provisions	**44.1**	52.3	**27.8**	27.0
Fair value of subordinated liabilities and subscribed capital	**(0.1)**	(100.9)	**(0.1)**	(100.9)
Loss/(profit) on realisation of debt securities	**41.7**	(77.9)	**29.1**	(77.9)
(Increase)/decrease in other assets	**(18.3)**	(8.3)	**(17.8)**	(8.9)
(Decrease)/increase in other liabilities	**(34.2)**	(34.7)	**1.8**	20.4
Working capital adjustments	**85.8**	(120.0)	**92.8**	(91.6)
(Increase)/decrease in operating assets:				
Loans and advances to customers	**(1,966.2)**	(565.6)	**(122.6)**	786.3
Investments	**–**	0.8	**(1,388.7)**	(944.5)
Derivative financial instruments	**(197.0)**	(112.5)	**(178.3)**	(45.9)
Net (increase)/decrease in operating assets	**(2,163.2)**	(677.3)	**(1,689.6)**	(204.1)
Increase/(decrease) in operating liabilities:				
Shares	**(527.2)**	844.1	**(527.2)**	844.1
Amounts owed to credit institutions	**1,710.3**	145.7	**1,710.3**	145.7
Other deposits	**25.7**	(34.6)	**(29.3)**	405.7
Net increase/(decrease) in operating liabilities	**1,208.8**	955.2	**1,153.8**	1,395.5

* A restatement has been made to the prior period due to a change in accounting policy regarding the Financial Service Compensation Scheme (FSCS) levy. Further details of this are given in the basis of preparation on page 85.

Annual Business Statement

1. STATUTORY PERCENTAGES

	2013 %	Statutory Limit %
Lending limit	**2.5**	25.0
Funding limit	**18.4**	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

	2013 %	2012 Restated* %
As a percentage of shares and borrowings:		
Gross capital	**5.79**	5.69
Free capital	**5.27**	5.18
Liquid assets	**13.73**	16.88
Profit after taxation for the financial year as a percentage of mean total assets	**0.44**	0.37
Management expenses as a percentage of mean total assets	**0.88**	0.76
Management expenses as a percentage of mean total assets adjusted for the effects of mergers, acquisitions and closures	**0.88**	0.71

* A restatement has been made to the prior period due to a change in accounting policy regarding the Financial Service Compensation Scheme (FSCS) levy. Further details of this are given in the basis of preparation on page 85.

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 AT 31ST DECEMBER 2013

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
E. J. S. Anderson, BSc, CPFA 22nd December 1950	Company Director	19th May 2003	Airport Operators Association Ltd Leeds International Pianoforte Competition University of Leeds
Ms K. M. Barker, CBE 29th November 1957	Economist	5th November 2010	Electra Private Equity Plc Essex Community Foundation Kate Barker Ltd Taylor Wimpey Plc
I. J. Bullock, BSc, FIA 7th November 1960	Building Society Sales and Marketing Director	12th April 2007	Accord Mortgages Ltd BCS Loans & Mortgages Ltd MutualPlus Ltd
A. M. Caton, BA 27th July 1963	Building Society Corporate Development Director	1st July 2004	Arkose Funding Limited Bradford Chamber of Commerce and Industry Bradford Enterprise Agency Limited 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 Yorkshire Building Society Charitable Foundation Yorkshire Guernsey Ltd
Mrs L. F. Charlesworth, BA, MBA 24th August 1956	Company Director	31st December 2006	St. James Investments Ltd St. James Investment Company UK No. 3 Ltd
R. J. Churchouse, MA, ACA 16th January 1966	Finance Director	1st 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 Key Services Ltd Yorkshire Key Services (No.2) Ltd

3. INFORMATION RELATING TO THE DIRECTORS AT 31ST DECEMBER 2013 (continued)

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
P. R. Johnson, FCA 12th October 1946	Chartered Accountant	1st June 2007	Cheadle Hulme School Cheadle Hulme School Enterprise Ltd Lakeland Ltd
D. V. Paige, BSc, FCA 3rd July 1951	Company Director	31st December 2006	IFG Group PLC Willis Ltd
M. A. Pain, BSc, FCA 15th June 1961	Company Director	1st August 2013	Aviva Insurance Limited Johnston Press Plc London Square (Caledonian Road) Limited London Square (Chigwell) Ltd London Square (Crimscott Street) Limited London Square Developments (Holdings) Limited London Square (Leonard St.) Limited LSL Property Services Plc Somerset House Enterprises Limited Somerset House Trust Spirit Pub Company Plc
G. Parsons, BA 31st July 1965	Company Director	1st May 2013	Commercial Services Kent Limited Commercial Services Trading Limited Gasp Trading Company Limited Kent County Trading Limited London & Partners Limited Nescot Business Services Limited Nescot Consortium Services LLC Tommy's Pork Store Limited Warmup Plc
C. J. Pilling, MA 30th March 1965	Building Society Chief Executive	31st December 2011	Department of Health
S. Turner, BSc 29th November 1951	Company Director	13th October 2005	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 31st 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.

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	A committee whose responsibility is 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.
Asset and Liability Committee	This committee is responsible for, under delegated authority of the Board, managing the Group's liquidity, market and currency risks.
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 Prudential Regulation Authority (PRA).
Buy-to-let (BTL)	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 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.

Derivative Financial Instruments	Contracts or agreements whose value is derived from one or more underlying prices, rates or indices 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 or counterparty fails to meet 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 Conduct Authority (FCA)	The UK conduct regulator which is responsible for regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets. The FCA's objective is to protect consumers, promote competition and enhance market integrity.
Financial Ombudsman Service (FOS)	An independent service which provides a service for settling disputes between financial service providers and their customers.
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.
Funding for Lending Scheme (FLS)	A scheme launched by the Bank of England and HM Treasury designed to boost lending to households and businesses. Banks and building societies participating in the scheme can access funding at rates below the natural market rate.
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.
Governance & Nominations Committee	A Board committee which considers matters relating to the composition of the Board and succession planning.
Gross capital	Represents the aggregate of general reserve, hedging reserve, available for sale reserve, subordinated liabilities and subscribed capital.

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 of 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.
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.
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	Property taken back into ownership by the Society as a result of borrowers inability to make contractual loan repayments.
PRA Remuneration Code	Guidance provided by the PRA on directors' remuneration.
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.
Prudential Regulation Authority (PRA)	The UK prudential regulator, which is a part of the Bank of England and alongside the FCA has responsibility for the oversight of building societies, banks and insurers. The PRA's objective is to promote the safety and soundness of regulated firms.
Remuneration Committee	This committee is responsible for considering and approving the remuneration of executive directors and other Chief Officers 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.
Residential Mortgage Backed Securities (RMBS)	An asset-backed security that represents a claim on the cash flows from residential mortgage loans through a process known as securitisation.
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.
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 liabilities	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 weighted assets.
Tier 2 capital	A measure of regulatory capital that includes subordinated liabilities and general provisions, less regulatory adjustments.
Total capital	The total capital resources, including retained earnings, PIBS, general provisions and subordinated liabilities, less regulatory adjustments.
UK Corporate Governance Code	The UK code on corporate governance, published by the Financial Reporting Council in October 2012, 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.

Principal Office:
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Auditors:
Deloitte LLP, 1 City Square, Leeds LS1 2AL.

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