REPORT & ACCOUNTS 2010

Yorkshire Building Society

Contents

Chairman's report

Ed Anderson

This is my fifth annual review as Chairman of Yorkshire Building Society and I am pleased to report that the Society has achieved a strong performance, despite a further year of tough market conditions, strengthening its position as a leading independent mutual building society.

We have achieved this by continuing to maintain a very prudent approach to our operation of the business.

The Board's view of the external environment is that while there has been a degree of improvement and stabilisation, for example in the wholesale funding markets, considerable uncertainties remain in many areas of the economy. For this reason we continue to believe that a very prudent approach remains the right strategy for the Society and is in the best interests of our members.

A comprehensive review of the Society's performance is set out in the Chief Executive's report on pages 4 to 9 and in the Business review on pages 10 to 23.

The role of the Board, in particular the non-executive directors, is to oversee the Society's management and performance which includes ensuring that changing regulatory requirements are met and that best practice is adopted in the area of corporate governance. An explanation of the Society's approach, and of the committees in place, for achieving robust governance is set out in the Corporate governance report on pages 43 to 51.

The Board's objectives for the Society in 2010 included:

- retaining its financial strength and resilience, achieving good results, and a return to profitability;
- prioritising members' interests, continuing to offer products that provide them with long-term value backed up by excellent service;
- increasing lending in a prudent way; and
- making substantial progress on the integration of Chelsea Building Society following our merger on 1 April 2010.

I believe that we delivered successfully in all these areas and the Board remains confident that not only is the Yorkshire in a strong position to operate successfully as a traditional mutual building society, but also we have a real opportunity to provide a genuine alternative to a concentrated and largely unpopular banking sector.

The Board's focus

To achieve its objectives in 2010, the Board focused most heavily on the following areas to ensure that the Society was able to continue to deliver financial security and long-term value to its members:

- **corporate governance;** many of the failures in the banking sector can be attributed to failures in the way those businesses were overseen and managed by their boards and management. For this reason it remains an absolute priority of the Board that the Society adheres to best practice and the highest standards in its own corporate governance. At the end of 2010 we carried out an independent external review of the Board's effectiveness which concluded in the early part of 2011. The evaluation process confirmed that the Society's Board is highly effective and well placed on all key aspects of its performance. The process identified a small number of areas for consideration including a recommendation to review the management information referred to the Board. This is currently the subject of a separate independent review. We have also included a formal Business review on pages 10 to 23 for the first time to further enhance our approach to reporting the Society's performance. Details of our approach to corporate governance are set out in the Corporate governance report on pages 43 to 51.
- **risk management;** in this specific and fundamental aspect of corporate governance, the Board ensured effective oversight and management of the major risks to which the Society is exposed, including operational and regulatory risk, credit risk, liquidity risk and market risk. The Group Risk Committee, which is chaired by a non-executive director, oversees our risk governance framework. Six of the Society's non-executive directors sit on the committee along with members of the General Management team, underlining the importance that we place on risk management. Details of our comprehensive approach to risk management are set out in the Business review on pages 10 to 23 and the Risk management report on pages 35 to 42;
- **financial strength and core business performance;** the Board closely oversaw the Society's core business performance including the restoration of profitability, the maintenance of strong capital and liquidity positions, and an increase in mortgage lending undertaken in a prudent and carefully controlled manner. The Board ensured that new and existing business operated on a cautious and sustainable basis, balancing the interests of new and existing members. The Board also addressed performance issues related to the impact of the recession such as ensuring effective arrears management

processes were in place. This was critical at a time when some borrowers inevitably faced difficulties meeting their mortgage commitments. In addition to regular Board meetings we held two sessions during the year at which a range of matters of strategic significance to the Society were explored in detail as well as the Strategic Plan for the next five years being agreed; and

- **merger management and integration;** the Board oversaw the programme to integrate the operations of Chelsea Building Society into the Yorkshire. Specific areas of focus included ensuring that planned operational and financial synergies were achieved at the same time as meeting the commitments made to the members of both societies in advance of the merger. The process of integrating the Chelsea has progressed well and is already delivering additional value to our members.

Regulation

As I set out in my report in the 2009 Annual Report & Accounts, in response to the financial crisis the regulatory environment has become significantly more onerous for all institutions regulated by the Financial Services Authority (FSA), including building societies. The Society remains supportive of regulatory change where it serves to better protect the interests of consumers and enhance the strength of the financial system. The Society seeks to meet the highest standards of compliance with both the letter and the spirit of regulation, and to operate above the minimum standards, because we believe this is consistent with our broader operating principles and serves the interests of our members.

Remuneration remained a major focus of regulators and of the Board throughout 2010 and a key regulatory development in this regard was the issue of a revised FSA Remuneration Code.

As a result of the FSA's revised rules, the Society's Remuneration Committee (details of which are set out on pages 48 and 52), has worked to ensure that the required changes have been incorporated into remuneration strategies, thereby reflecting good practice and driving appropriate risk-taking behaviours throughout the Society.

In the Board's view it is vital that the Society offers competitive remuneration packages to attract, retain and motivate senior management whilst adhering to the Code.

Board and General Management changes

There were a number of changes to the Board and the General Management team during 2010.

Roger Burden, a former non-executive director of Chelsea Building Society, was appointed as a non-executive director of the Yorkshire in April 2010. Roger is a former Chief Executive and Chairman of Cheltenham & Gloucester plc as well as a former Chairman of the Council of Mortgage Lenders.

We welcomed Kate Barker back to the Board in November 2010 as a non-executive director. Kate previously stepped down from the Board when she became a member of the Bank of England's Monetary Policy Committee in 2001, where she remained until May 2010.

Indira Thambiah stepped down as a non-executive director in September 2010 to become executive Chairman at Multiyork. We are grateful for her contribution to the Yorkshire's success and wish her well for the future.

Robin Churchouse was appointed to the Board as Finance Director in June 2010. Robin was previously General Manager, Risk & Planning, with responsibility for the Yorkshire's strategic planning as well as risk and capital management across the Society.

Robin succeeds Andrew Gosling who retired after nine years as Finance Director in May 2010. The Board wishes to thank Andrew for his contribution, in particular for his role in successfully navigating the Society through the financial crisis and helping to establish the strong foundations on which we are now building. We wish him well in his retirement.

Two new General Managers were appointed during 2010.

Mark Jenkins joined the Society in April as General Manager, Commercial Development. Mark is responsible for three key areas: buy-to-let, commercial and social housing lending. Mark spent 10 years with Price Waterhouse in Leeds, before joining Nationwide Building Society, where he spent a further 15 years. Mark joined Chelsea Building Society in September 2009.

Richard Wells joined the Society in November 2010 as General Manager, Risk, succeeding Robin Churchouse who became Finance Director. Richard has extensive experience of risk management at a senior level within the financial services industry.

Individual profiles of each of the Society's directors and General Managers can be found on pages 28 to 31.

Our people

On behalf of the Board I would like to thank our people for their ongoing commitment and loyalty over the course of what was a challenging year for the Yorkshire. The Society's performance is testament to the hard work and abilities of our senior management and staff. I was pleased to see how our people continued to focus on providing our members and customers with excellent service, thereby moving the Society closer to achieving our vision "to be the best organisation that our customers do business with".

The future

We remain alert to the continued uncertainties in the economic environment but are looking ahead with confidence and optimism. We will continue to run the Society in the interests of current and future members, which means continuing to adopt a sensible and prudent approach but also taking opportunities to develop the Society and deliver additional benefits to members.

Finally, it is with some regret that I have to announce that our Chief Executive, Iain Cornish, has decided that he wishes to step down, feeling that now is the right time to allow a new leader to take the Society forward. This is entirely a personal decision on Iain's part. On behalf of the Board and all the staff, we thank him for his tremendous contribution and wish him well in his future career.

During his eight years as Chief Executive, Iain has provided strong and outstanding leadership and, above all, demonstrated a deep commitment to mutuality and to serving the best interests of our members. Iain has guided the Society successfully through the worst market and economic crisis in a generation and leaves it a strong and independent Society committed to serving its members and extremely well positioned for the future. One of Iain's achievements is to have developed an extremely strong management team and they remain clearly focussed on continuing to manage the Society.

The process of finding a suitable successor to build on Iain's achievements at the Yorkshire has commenced and will be personally overseen by me with the support of all of the non-executive directors. In the meantime, Iain will remain Chief Executive and continue to work with the rest of the Board and senior management.

Ed Anderson
Chairman

Chief Executive's report

Iain Cornish

Our vision is "to be the best organisation that our customers do business with".

We aim to achieve our vision by providing our members and customers with financial security and long-term value across a comprehensive range of mortgage, savings, investment, insurance and share plan products backed up with excellent personal service.

Our members tell us that they support us in our ambition; 9 out of 10 respondents to our regular customer surveys tell us that they would recommend us to their family or friends.

Our strategic priorities represent the areas in which the Society is investing additional resources because they are the things that will provide the most significant contribution to the achievement of our vision, and include:

- delivering an exceptional customer experience across all of our brands and distribution channels, building on our already strong position;
- maintaining a high level of financial strength and stability. This includes offering interest rates which are attractive, but crucially are also sustainable, maintaining a strong funding position and cost efficiency combined with effective risk management and corporate governance;
- ensuring our people are well trained, fairly rewarded and committed to delivering for our members;
- continually improving our administrative processes and systems; and
- looking ahead and seizing opportunities; innovating to improve delivery of benefits to members and, in the right circumstances, taking further opportunities to grow by merging with smaller societies.

For many decades the Yorkshire has been run with the interests of current and future members very clearly at its heart. The vast majority of the Society's activities have been centred on lending to people to allow them to own their own homes, funded largely by the savings of individual members. A great deal of our business continues to be delivered face to face through our expanding branch network.

The cautious approach we have adopted through the worst financial and economic crisis in a generation, has left us in an extremely strong position to move ahead and meet the desire of consumers for a trusted provider who puts their interests first. This approach does not mean we are stuck in the past. We have rapidly expanded our internet and telephone-based services. We have also taken opportunities to develop the Group, for example, in the last three years we have merged with the Barnsley Building Society and the Chelsea Building Society. In both cases we have deliberately chosen to retain their

brands and also their branch networks, because we believe they are valued by their members and because it enables the Group to reach the broadest possible membership and offer customers the widest range of products and services, as well as providing them with real choice in how they do business with us.

Financial strength

We are pleased to be able to report a strong set of results for 2010 which have enhanced the resilience of the Society. This was delivered against a background of continued weakness in the UK economy and the housing market; and during a year which combined significant "business as usual" challenges with the challenge of integrating Chelsea Building Society into the Yorkshire's operation. The highlights of the Society's performance include:

- return to profitability; statutory operating profit £115m (2009: £12m loss) and core operating profit £128m (2009: £8m), representing a continuation of the trend reported at 30 June 2010;
- net interest margin restored; 1.03% (2009: 0.65%);
- higher total assets; 32% increase to £30.1bn (31 December 2009: £22.7bn), as a result of the Chelsea merger;

- increased members' balances; retail savings increased by 55% to £21.4bn (31 December 2009: £13.8bn);
- capital strength; core tier 1 capital ratio 12.4% (31 December 2009: 12.2%); re-built to pre-merger levels following the reduction that initially occurred as a result of the merger. This has been delivered well ahead of plan;
- continued to hold prudent levels of liquidity; group liquidity 21.1% (31 December 2009: 31.9%) as the intentionally held pre-merger "excess" was managed down in line with the reduced requirements of the enlarged Group;
- maintained asset quality; the percentage of loans over three months in arrears by volume was stable at 1.84% (31 December 2009: 1.84%);
- wholesale funding; the issuance of a €600m five year covered bond in September supporting our balanced funding strategy;
- performance of the Chelsea brand ahead of expectations; delivery of planned merger synergies and integration well advanced;
- on a like-for-like basis achieved a management expenses ratio of 0.51% after adjusting for the impact of the merger (31 December 2009: 0.54%); and
- improved ratings position; ratings agency Standard & Poors revised its outlook on the Society from "negative" to "stable" in November in recognition of the progress made in managing our integration of Chelsea and the expected improvement in our financial position.

The financial performance and the strong delivery against our other strategic priorities combined to significantly improve the Society's position and its long-term capacity to prosper and deliver benefits to members in the future.

The Society's financial performance and position are explained in detail in the Business review on pages 10 to 23.

Members

As a mutual organisation, the Yorkshire is owned by, and run for the benefit of, our current and future members and not on behalf of external shareholders. Last year was not easy for either borrowers or savers and the Society has remained very focussed on doing what it can to help its members through this difficult environment.

Whilst we clearly are operating within the constraints of a fragile economy and historically low interest rates, I believe we made good progress in 2010.

Savings

In such challenging times for savers, who have seen returns fall dramatically as a result of the record-low Bank of England base rate of interest, we have offered consistent returns. For example, at the end of 2010 the Group's average interest rate on cash ISAs was 2.21%, more than five times as high as the market average rate of 0.40%[1]. The Society provided protection to our investing members by doing our best to shelter them from the full effect of the low base rate. In late 2010 independent consumer body Which? found that in the market as a whole 1 in 4 savings accounts and cash ISAs paid 0.10% or less in annual interest[2]. In contrast, fewer than 1 in 12 accounts offered by the Society paid 0.10% or less in annual interest.

Unlike a number of our competitors, during 2010 the Group did not cut the rate of interest payable on any of its variable rate savings products, including Chelsea products following the merger.

The range of structured deposits, "Protected Capital Accounts", offered in association with Credit Suisse have been extremely popular with customers who do not wish to significantly deviate from the returns they would realise with a deposit savings account. These products offer a potential return above that possible from the traditional deposit account market, and with limited "down-side" risk. The products have been designed for customers who place importance on the capital protection and minimum return elements of a savings product but are willing to sacrifice an element of this minimum return in favour of potential additional returns.

A significant distinction between our approach and that in the wider market is that we position our savings products primarily to offer long-term value to savers. As such we do not adopt the tactics of promoting headline grabbing rates which are then either aggressively cut or heavily encased in small print. Our approach once again proved attractive to members and in 2010 we opened over 270,000 new savings accounts across our Yorkshire, Barnsley and Chelsea Building Society brands. Notwithstanding this approach, our savings accounts attracted over 900 "Best Buy" mentions during the year.

Following our merger we developed and launched the Chelsea savings internet channel. This means that Chelsea customers now benefit from being able to open

[1] Data sourced from Bank of England Statistics Interactive Database. Cash Individual Savings Account (ISA) rates are selected for £3,000 balances. Rates for Cash ISAs are weighted by month end balances reported on balance sheet returns of institutions in the same sample.

[2] Data sourced from Which? The accounts within these statistics are easy-access, notice savings accounts, and cash ISAs.

Chief Executive's report (continued)

and manage a range of savings products online for the first time, including e-Saver Reward, e-bonds and a Fixed Rate e-ISA. We also enhanced the range of savings products available through Barnsley Building Society branches, with the addition of Monthly Reward ISA, Rollover Bond and a Fixed Rate Anniversary ISA.

In addition to offering attractive interest rates on savings products we won the Moneywise "Best Cash ISA Service Provider" award in 2010 in recognition of our excellent service.

Mortgages

We remained committed to providing people with competitive mortgage products, allowing them access to the housing market. Our approach to the mortgage market was in part illustrated by the fact that we received the highest number of "Best Buy" mentions of any mortgage provider in 2010.

Our existing borrowing members' interests were also prioritised as we ensured that all borrowers were offered fixed rate mortgage products at the end of their existing mortgage deals which provide protection against possible interest rate rises in 2011 and beyond.

The Yorkshire assisted first time buyers by offering our unique "Offset Plus" product which allows borrowers to link the savings of family or friends to their mortgage, thereby reducing mortgage interest payments while at the same time giving family or friends full control over their savings. Further support has been provided to borrowers typically on the early rungs of the housing ladder by re-introducing, in a very controlled way, lending at up to 90% loan-to-value. The higher risk inherent in this lending has been carefully managed and all such mortgages are only available through Yorkshire branch-based advised sales.

Our borrowing members who have relatively low levels of mortgage debt in relation to the value of their homes were also rewarded. We offered these members a one year fixed rate "rollover" deal with no fee to fix and no early redemption charges, meaning that they can also benefit from the certainty of a fixed rate whilst not incurring charges or being tied into their mortgage deal.

Whilst being active in uncertain mortgage and housing markets, we protected the interests of individual borrowers and the wider membership and will continue to lend on a prudent basis.

Other benefits

We improved our wider product range during the year, including the launch of "You Choose Home Insurance" which allows our customers to personalise their level of cover according to their circumstances and needs. The popularity of this product was reflected in a significant increase in demand.

> **"During the course of the year I had the privilege of meeting hundreds of our members who took the time to discuss their concerns with me. Top of the list were: the poor service provided by many high-street banks, the low rates of interest available to savers, real anger at the banks and bankers who were at the centre of the financial crisis and were "bailed out" by the taxpayer, and an overall lack of trust in financial services institutions.**
>
> **The Yorkshire has itself been affected by the crisis, we have sought to learn the lessons of the past, and fundamentally sought to ensure that our business is centred on adopting the best principles which means putting members' interests at the heart of all of our decision making and to honour the trust that our members continue to put in us."**

YBS Share Plans. Over 170,000 members benefited from participation in Savings Related Share Options schemes. This is an arrangement that allows employees of a company to buy company shares with money they have contributed to a savings scheme. YBS Share Plans contributed positively to the Group's performance in 2010, and acquired 24 new clients in the year including Old Mutual plc, Friends Provident Holdings (UK) PLC, Topps Tiles PLC and Communisis plc.

Our commitment to communities. Good corporate citizenship sits at the heart of our approach to mutuality. The Group actively supports the communities in which we live and work through a number of practices including fundraising for charities and good causes, a staff volunteering programme and sound environmental policies. All of these will remain important elements of our mutual approach. A detailed review of these activities is set out in the Corporate responsibility report on pages 24 to 27.

Branch network. Whilst we have invested substantially in our internet and telephone operations, our branch network remains at the heart of our operations. Many people value the personal service and high-quality advice which is best provided in a branch. Our formula is a successful one which combines the community presence and personal service of our branches with joined up and innovative on-line service.

We opened 14 more high street agencies during 2010 and kept all of our branches open. This approach contrasts starkly with the high street banks which have reduced their network by approximately 20% since 1997. Over the same period, the Yorkshire increased its branch network by 34% by a combination of merger and branch openings. At the end of 2010, our network of branches and agencies was the 9th largest in the UK and comprised:

- 135 Yorkshire branches;
- 35 Chelsea branches;
- 8 Barnsley branches; and
- 82 Yorkshire agencies.

Our commitment to our branch network hit the headlines recently when the Yorkshire became the last financial mutual to operate in Whitby. We temporarily re-branded our Whitby branch "Whitby's Building Society" and publicised the benefits of mutuality and the personal service available to customers in branch. All of these steps resulted in an influx of new business, underlining once again the fact that our branches are firmly at the heart of our business.

We have always regarded the ultimate test of value delivery as being what our members think about us, and we go to great lengths to seek feedback and give members a genuine say in how we run the Society on their behalf. Examples include the Member Forum and Member Panel. Once again I am grateful to everyone who participated in these for the valuable feedback they have given us. I would like to pay particular tribute to Martin Hawkrigg, a member of the Member Forum since its inception, who sadly died during 2010.

Regular customer satisfaction surveys provide us with reassurance that we continue to provide members

We have also received a significant number of external accolades.

Our awards

- **Winner – Best National Building Society**
  What Mortgage Awards
- **Winner - Best Cash ISA Service Provider**
  Moneywise Customer Service Awards
- **Winner – Best Children's Savings Account (Chelsea's Ready, Steady Save account)**
  Moneywise Children's Savings Awards
- **Highly Commended – Best Children's Savings Account (Yorkshire's One Day account)**
  Moneywise Children's Savings Awards
- **Winner – Best Youth Savings Account (Yorkshire's Freedom account)**
  Moneywise Children's Savings Awards
- **Winner – Excellence in Treating Customers Fairly**
  Mortgage Finance Gazette Awards
- **Winner – Best Advisor-only Lender (Accord Mortgages)**
  Mortgage Finance Gazette Awards
- **Runner Up – Best National Building Society**
  Mortgage Finance Gazette Awards
- **Highly Commended – Innovator Award for Lenders (for the launch of Rollover Mortgage)**
  Mortgage Finance Gazette Awards
- **Winner – Best Overall Mortgage Provider**
  Moneynet Awards
- **Highly Commended – Best Current Account Offset Mortgage Provider**
  Moneyfacts Awards
- **Highly Commended – Best Longer Term Fixed Rate Mortgage Provider (Chelsea)**
  Moneyfacts Awards
- **Highly Commended – Best Building Society Mortgage Provider**
  Moneyfacts Awards
- **Commended – Best Internet Account Provider**
  Moneyfacts Awards
- **Commended – Best Children's Account Provider (Chelsea)**
  Moneyfacts Awards
- **Runner Up – Best Lender for Current Account Offset Mortgages**
  Moneywise Mortgage Awards
- **Runner Up – Best Lender for Remortgages**
  Moneywise Mortgage Awards
- **Shortlisted – Best Major Employer Website**
  National Online Recruitment Awards
- **6 winners for YBS Share Plans**
  ifsProShare Annual Awards

Chief Executive's report (continued)

with the outstanding level of service that they've come to expect. For example, in 2010, 9 out of 10 customers who responded to our surveys said they rated their satisfaction levels in dealing with us as either excellent or good.

An equally important but more technical measure of how strongly our customers recommend us is our net promoter score, which in 2010 we believe ranked at the top of the financial services industry benchmarks. Our net promoter score refers to the net percentage of customers who, when responding to the question "how likely is it that you would recommend us to a friend or colleague?" would either strongly recommend or strongly detract from the organisation. We closely monitor this measure as we feel that it provides one of the most reliable insights into how our customers perceive the products and service that they receive from us.

Just as important is how we respond when things go wrong. We do sometimes make mistakes, but when we do we take it seriously and try to respond appropriately and learn for the future. One measure of our success was when, in 2010, the Financial Ombudsman Service published its "complaint overturn rates" on qualifying firms in the financial services sector. The Yorkshire came joint top of the table, which is an excellent achievement and one which is widely regarded as a clear indicator of the fairness of a firm's approach to complaints handling.

Merger activity

Chelsea

As we reported in our interim management report for the six months ended 30 June 2010, we successfully completed our merger with Chelsea on 1 April 2010 after it was overwhelmingly approved by the members of both societies. The merger was a transformational development for the Group and we can report that realisation of the merger benefits has progressed very well during 2010.

Some of the merger highlights include:

- the integration process remained in line with our plans, with delivery of synergies on track for 2011/12;
- we extended the Yorkshire's internet savings capability to Chelsea, and attracted additional sustainably-priced retail funds offering long-term value and better service to members;
- we made substantial progress in addressing the key issues which the Chelsea had at the time of the merger, in particular we improved the funding position for the Chelsea's business as unsustainably-priced fixed rate savings product balances were managed onto more fairly priced products or moved elsewhere; and
- we retained all of the Chelsea branches.

Merger with the Chelsea has undoubtedly strengthened the Group's position giving us greater resilience for the future, broadening our reach to a greater number of members and strengthening our ability to deliver benefits to members.

Our position on merger activity

One of our strategic priorities is to look ahead and seize opportunities; this includes taking advantage of merger opportunities that may be presented to us, but we will only consider doing so where there is a clearly defined benefit to our members.

We believe mergers between building societies, where this is possible, are preferable to the alternative of combining with organisations from outside the mutual sector. We anticipate that attractive opportunities of this type will inevitably arise over the next few years and believe that the Yorkshire is well positioned to respond to them when they are in the interests of our current and future members.

Our people

I would like to thank my colleagues throughout the Society for their hard work and commitment over what has been a transformational year for the business. I have been hugely impressed by everything that my colleagues have achieved, but especially by the professionalism and resilience of our people based in Cheltenham who have dealt with the inevitable uncertainty, and in some cases sadly redundancies, necessitated by the Chelsea's merger with the Yorkshire.

Across the Group we achieved another good performance in our staff feedback surveys, supporting our view that our people are engaged in delivering our strategy and are committed to our future success. The surveys showed that the Yorkshire's performance against key indicators including overall satisfaction and leadership remained well above average compared to similar financial services organisations using externally benchmarked data.

Our vision for mutuality and future outlook

We believe that mutual organisations will play an increasingly important role in society, and welcome the coalition government's recognition of this.

Building societies play a critical role in the market, offering consumers real choice in retail financial services. On the one hand there is the plc model which prioritises profit, and on the other the mutual model which prioritises customers' interests.

We firmly believe that the Yorkshire's model represents one way in which successful mutual organisations will operate. The Group has demonstrated the ability to grow by successfully merging with other building societies in order to create a stronger institution delivering a broader range of benefits to a growing membership.

We continue to operate in a challenging economy which, despite no longer being in recession, includes a fragile housing market, high levels of unemployment, inflation running significantly above the Bank of England's 2% target and the base rate of interest remaining at a record-low level.

Against this environment the Group has a stable and well-balanced funding base, a robust capital position and is well placed to increase mortgage lending when the housing market recovers.

In summary, we look ahead with sensible optimism, conscious of the significant challenges the environment presents but encouraged by the opportunities we believe exist for the Yorkshire as a leading independent mutual building society.

Iain Cornish
Chief Executive

Business review

The following section provides a detailed review of the Group's performance in 2010, including both income statement and balance sheet analyses and looks at some of the key performance indicators (KPIs) that the Board uses to monitor and direct the Group's performance.

Vision and strategy

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

- providing members with financial security and long-term value; and
- delivering a strong customer service through engaged and motivated staff.

Fundamental to achieving our vision, is our commitment to remaining a mutual organisation, and specifically a leading independent building society providing competitive products and excellent service across multiple products, brands and distribution channels. All of this is done in order to meet the needs of our members and other customers.

Given our mutual nature, our financial strategy revolves around achieving a balance between value for members, profitability, growth and financial strength. Within this is our target to optimise rather than maximise profits. We look to price our products so that they deliver value to our members and, by being attractive to them, achieve growth for the Group whilst at the same time (since profits are our main source of capital) generating sufficient profits to maintain a strong capital position, and so provide financial security for our members.

This means that we look, as far as is sensible in a competitive marketplace, to provide savings and mortgage products that give long-term value to our members, rather than focus on "Best Buy" products to attract new customers at the expense of existing customers. At the same time we look to minimise our costs without impairing the service we provide to our members. For example, we could cut costs materially by reducing the number of branches and agencies but believe that maintaining a broad network is at the heart of the service we provide to our members.

The Risk management report (pages 35 to 42) sets out the main risks that the Group faces and how we look to manage them. Strategically, we continue to operate in an economy and core markets characterised by a range of short and long-term uncertainties. For example:

- the economic recovery remains fragile and the impact of the government deficit reduction measures is yet to be seen. In particular future developments for interest rates (which directly impact our mortgage and savings customers) and for the level of unemployment (with a direct link to arrears and loan losses) are both highly uncertain;
- the economic conditions, and general socio-economic trends, continue to promote an increasing level of financial crime that the whole industry is experiencing. This means there is a need for constant vigilance and evolution to keep pace with the perpetrators;
- housing and mortgage volumes remain subdued, and these combine with the wider economic conditions to create a real possibility of material future falls in house prices;
- the wholesale funding markets remain extremely sensitive and activity within them sporadic; against this background financial institutions in the UK face material re-financing deadlines in 2011 and 2012. This continues to put pressure on the retail savings market, with many pricing at what we believe are unsustainable levels (i.e. the price paid for savings cannot be fully re-couped from mortgage loans); and
- the fast pace of regulatory change continues, with a raft of new regulation due to come into effect in 2011 and 2012, along with further regulatory reviews to be completed that will deliver even more change. A fundamental change in UK regulatory structures is also imminent.

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

It is in this context that the Board assesses the Group's 2010 performance.

Income statement overview

This section looks at our profit before tax on both a statutory and a core operating basis, with commentary that explores the underlying drivers of the Group's performance.

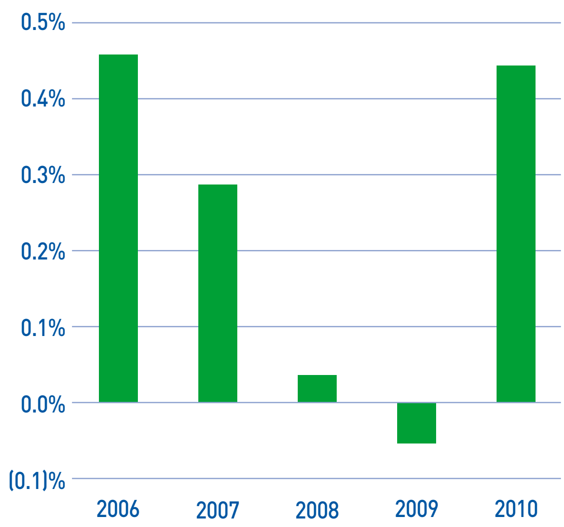
Under both measures 2010 has seen a strong return to profitability by the Group with figures of £115m and £128m respectively against a £12m statutory loss and £8m core operating profit in 2009.

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

Statutory profit before tax

	2006 £'m	2007 £'m	2008 £'m	2009 £'m	2010 £'m
Net interest income	165	188	165	148	273
Fair value movements	14	(43)	(29)	(10)	(10)
Profit from sale of assets	-	(2)	(1)	11	15
Other income	32	41	31	31	43
	211	184	166	180	321
Negative goodwill	-	-	3	-	17
	211	184	169	180	338
Management expenses	(117)	(120)	(122)	(131)	(173)
	94	64	47	49	165
Provisions	(16)	(9)	(39)	(61)	(50)
Profit before tax	**78**	**55**	**8**	**(12)**	**115**

Statutory profit before tax as % of mean assets



2010 has seen the Group return to levels of profitability more in line with those achieved before the financial crisis; this is demonstrated by the graph above which shows pre-tax profits measured against mean total assets.

In 2010 statutory pre-tax profits are up by almost £130m to £115m, driven by:

- the inclusion from 1 April 2010 of Chelsea Building Society which, for example, is the main reason why management expenses have risen £42m and other income has risen from £31m to £43m i.e. these increases reflect asset growth;
- a recovery in our net interest income, as some of the suppressing factors present in 2009 (discussed below) reverse out and our post merger management actions began to take effect;
- a one-off profit of £15m from the sale of some of our liquid assets, and a further one-off item (negative goodwill) arising on the merger with the Chelsea; and
- a reduction in our mortgage loss provisions charge of £18m partly offset by an increased provisions charge against other assets.

At the same time our core operating profits, discussed on page 15, rose from £8m to £128m.

The following pages look at each component in more detail.

Business review (continued)

Net interest income

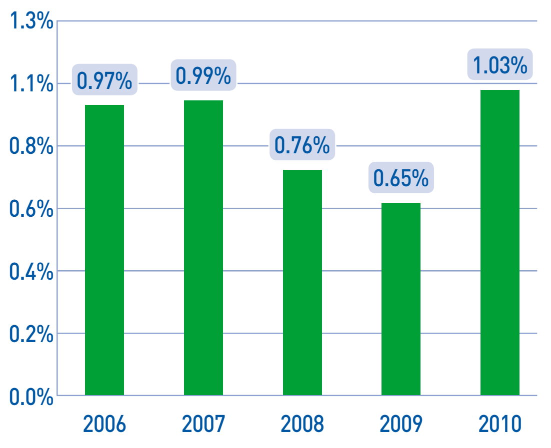
Key Performance Indicator explanation: The Board monitors the Group's net interest margin, a measure that calculates net interest income as a percentage of mean assets. This measure tracks how effective an institution is in earning income on its assets, and in managing the interest paid for its funding.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

The Group's net interest margin rose to 1.03% in 2010, up from 0.65% in 2009.

The 2009 margin was itself low because we:

- chose to hold abnormally high levels of very low earning liquid assets, which was prudent to ensure we could meet funding maturities in early 2010, and to position the Group for the merger with the Chelsea;
- decided not to pass on all of the bank base rate cuts in 2008-9 to savers, providing them with some protection in this low rate environment but thereby reducing our interest income; and
- focussed, in view of the uncertain economic conditions, on low-risk, low-margin lending, hence reducing earnings from this part of our business.

Net interest Margin
being net interest income as % of mean assets



In 2010 a key focus has been on managing material funding maturities against a background of a highly competitive retail (member) savings market and a wholesale (banks and companies) funding market that continues to be heavily constrained. This included a particular focus on the large portfolio of fixed rate savings products sold, pre-merger, by the Chelsea Building Society in late 2008 and early 2009 at what we consider to be unsustainably high rates of interest. Our policy on these balances has been to look to retain a material proportion at a more sustainable and equitable price level whilst accepting that the remaining balances would move to other institutions. This repositioning process has gone extremely well.

This all meant that:

- for some time we held extremely high levels of liquid assets so that we could be sure of meeting funding maturities (including preparing for managing the Chelsea's fixed-rate savings discussed above) even though this had a material negative impact on our net interest margin in 2009. Because of the progress made with these maturities we have been able to manage the Group's liquidity down from 31.9% as a proportion of liabilities at 31 December 2009 to 24.2% at 30 June 2010 and 21.1% at 31 December 2010. As discussed below this remains a very prudent level of liquidity under the new regime. Had we maintained the previous high level of liquidity we would now be holding, proportionately to our assets, £3.0bn more liquid assets earning very low rates; and
- we are now paying a fair and sustainable, albeit lower, price for the remaining Chelsea balances.

We have also, in common with other lenders, seen an increase in the number of borrowers choosing to remain on our standard variable rate for a period when their initial mortgage product matures, rather than moving immediately to a new product or lender. We expect this to be a temporary trend as borrowers consider their options in uncertain times, but it has provided a further transient boost to our mortgage earnings. At the same time, we increased our new lending in 2010 (from £936m in 2009) to £2,772m. Generally this lending is replacing older, maturing lending that was earning low interest margins (against the cost at which they have to be funded), having been advanced in the somewhat over-heated market conditions of 2006-7. Therefore whilst continuing to offer competitive mortgage products we have nevertheless seen an increase in the margins we earn on our overall mortgage book.

Fair value movements

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

In 2010 the Group's fair value movements were broadly level with 2009 at £10.5m against £10.3m in 2009, with both figures representing a marked reduction on the levels seen in earlier years. Because these figures represent timing differences the Group's aim is to minimise their year on year impact on our results, and so the 2010 result is considered to be at a comfortable level.

Profit from sale of assets

From time to time the Group will look to sell some of its non-mortgage assets because:

- we are required to periodically sell a proportion of our liquid assets to prove that they remain liquid i.e. can be readily sold on the open market. This is important because these assets are held in low-risk, low-earning investments principally to provide a ready source of funds should we experience an unusually high level of withdrawals from our savings accounts. In 2010 we sold a number of these investments at a profit of just over £15m; and
- in addition there is, from time to time an opportunity to realise an improvement in the underlying market value of an asset without impacting the core business.

By their nature these sources of income are highly variable - whilst the Board monitors and manages them, they are not considered part of our core performance.

Other income

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

- providing appropriate and competitively-priced products to our members through our partnerships with other financial institutions; and
- running our smaller business divisions.

In 2010 our other income increased from £31m to £43m, principally due to the inclusion from 1 April 2010 of such income earned by the Chelsea. After taking this into account, and excluding £9m of one-off profits from non-core items in 2007, our other income has been broadly stable over the last five years. In difficult and uncertain economic times the ability to source financial products that our members value, and hence wish to purchase because they meet their investment or insurance needs and all at the right price, is clearly more difficult. We are pleased that our performance has held up so well over the last few years. This is all the more notable given that a significant proportion of this income is linked indirectly to the mortgage market, which itself has shrunk materially in recent years. We remain focussed on sourcing the products that meet our members' needs and on monitoring this income figure, alongside the suitable performance of the products themselves, as evidence of our success in doing this.

Negative goodwill

This item reflects the difference between the deemed purchase price for Chelsea Building Society and the net value of its assets (after they have been adjusted to their "fair value" as discussed on page 16). Although there is no purchase consideration in the case of a merger, it is necessary under accounting rules to calculate one which is deemed to be the theoretical value of the business. The negative goodwill arising on the merger reflects the fact that this theoretical purchase price was lower (i.e. cheaper) than the value of the assets acquired as part of the merger. In accounting terms this item reduced the enlarged Group's opening reserves and then immediately reversed through the income statement, and so had no overall impact on the Group's reserves and its capital position. It does not reflect any element of underlying performance.

Management expenses

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

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

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

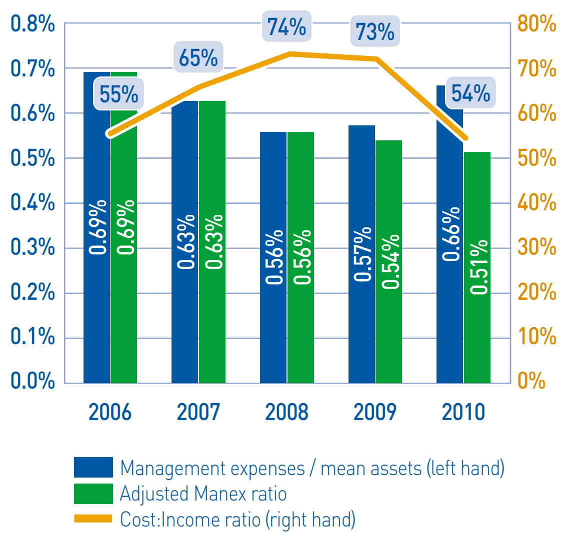
Business review (continued)

The management expenses ratio fell steadily to 2008 and then stabilised before rising sharply in 2010. This increase is due to two merger related factors, namely:

- in 2010 merger-related costs of £10.4m were incurred, including both costs of completing the deal and those incurred in realising the long-term cost savings arising from the merger, and which remain on track for delivery; and
- as the merger took place at 1 April 2010, nine months' worth of costs were incurred for the Chelsea but, being a simple average of the Group's total assets at 31 December 2009 and 2010 the mean asset figure only reflects the effect of six months worth of Chelsea assets.

If these two items are adjusted for (including a similar, merger cost item in the 2009 figures) then our underlying management expenses ratio has continued to improve in 2009 and 2010, ending at 0.51% by 31 December 2010. This reflects a strong underlying performance and the delivery of over £15m of merger related savings in 2010 alone.

Management Expenses and Cost:Income ratios



The Group's Cost:Income ratio (displayed as a line on the chart, and excluding non-core items) worsened in 2007/8/9 as the economic conditions, the low interest rate environment and management actions to protect the Group's members led to a decline in income levels. Underlying expenses rose, but only marginally. The improvement in overall income levels in 2010 has seen this key ratio return to pre-crisis levels.

Looking forwards, rising inflation and changes to the rate of value added tax combined with the current low-growth environment mean that, even with further merger-related savings due to be realised, maintaining the improvement in this area remains difficult. It remains a key area of focus.

Provisions

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

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

	2006 £'m	2007 £'m	2008 £'m	2009 £'m	2010 £'m
Provisions against loan portfolios	3.5	5.0	25.0	59.0	40.8
Provisions against impaired investments	-	6.9	-	0.9	5.1
Provisions for other items	12.5	(3.0)	(1.0)	(1.4)	-
Internally generated provisions	**16.0**	**8.9**	**24.0**	**58.5**	**45.9**
FSCS charges	-	-	14.7	2.7	3.6
Total provisions	**16.0**	**8.9**	**38.7**	**61.2**	**49.5**

The main provisions charge, against our residential loan portfolios, fell in 2010 to £41m from £59m in 2009. Whilst not in any way a return to pre-recession levels it is clearly a step in the right direction, and reflects our management of arrears during 2010 as well as wider movements in house prices. The economy and housing markets clearly remain stressed and many are forecasting increased unemployment and falling house prices in 2011, both of which could lead this figure to rise again even with continued firm management of arrears.

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

- impaired investments - as first reported in 2007, the value of our portfolio of structured credit investments was impacted badly by the financial downturn. This loss of value is partly reflected in the fair value movements noted above, and partly in the provisions charge. These provisions relate to historic investments that the Group is no longer active in, and where the remaining portfolio is being managed down, now standing at just £71m or 0.2% of our total assets;
- other items - these adjustments predominantly related to provisions made in 2006 and earlier against potential compensation payments to customers who bought

endowment policies via the Group in the 1990s. Later years have seen a reversal of what turned out to be an over-provision against these items. Again, they related to historic activities in which the Group has not been active for some time; and

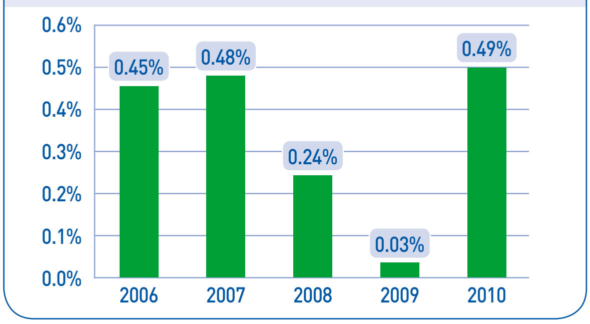
- Financial Services Compensation Scheme (FSCS) - since 2008 the Group, along with other building societies, has been paying a material contribution to the FSCS to fund the protection given to depositors in failed institutions (e.g. Bradford & Bingley plc and the Icelandic banks). We continue to believe that the approach to and scale of these charges (in drawing funding disproportionately from generally safer, more heavily retail-funded institutions) is wrong. Nonetheless it represents a real, and most likely ongoing, cost to the Group.

Core operating profit

Clearly a number of the components explored above do not reflect our core operating performance, which is monitored by the Board as shown below. The items reversed out to get to this view of our performance are removed because we do not believe that they reflect the ongoing, underlying performance of the Group. It is important for the Board to have clear sight of this level of performance ignoring shorter-term distortions, be they positive or negative:

	2006 £'m	2007 £'m	2008 £'m	2009 £'m	2010 £'m
Statutory profit before tax	**78**	**55**	**8**	**(12)**	**115**
Reverse out the following items:					
Fair value movements	(14)	43	29	10	10
Sale of assets/ other income	-	(11)	(2)	1	1
Non core provisions:					
• Structured credit	-	7	7	1	5
• FSCS	-	-	15	3	4
• Other liabilities	13	(3)	(1)	(2)	-
Negative goodwill	-	-	(3)	-	(17)
Merger costs	-	-	-	7	10
Core Operating Profit	**77**	**91**	**53**	**8**	**128**

Core operating profit as % of mean assets



In core operating profit terms the Group has returned to the levels of profitability seen before the start of the financial crisis in 2007.

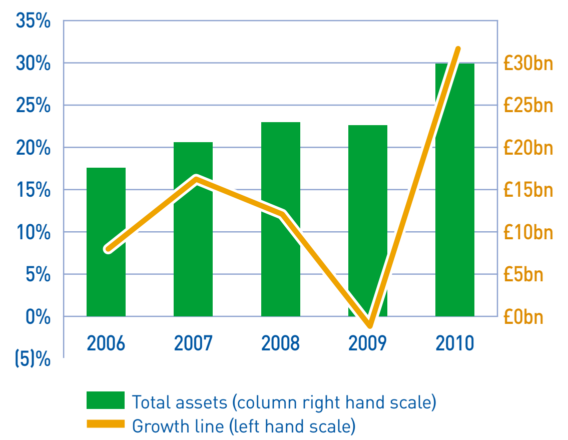
Balance sheet overview

Over the last five years the Group's business has grown materially, through a combination of controlled organic growth and mergers – we are now just over £30bn of assets, up 32% on 2009, and 70% on 2006.

Group Balance Sheet

	2006 £'bn	2007 £'bn	2008 £'bn	2009 £'bn	2010 £'bn
Liquid assets	4.1	4.7	5.3	6.7	5.9
Mortgage loans	13.3	15.4	16.3	15.0	23.4
Other assets	0.2	0.4	1.4	1.0	0.8
Total assets	**17.6**	**20.5**	**23.0**	**22.7**	**30.1**
Retail savings	11.3	12.4	13.7	13.8	21.4
Wholesale funding	4.9	6.6	7.3	7.2	6.3
Other liabilities	0.2	0.2	0.8	0.5	0.7
	16.4	19.2	21.8	21.5	28.4
Remunerated capital	0.3	0.3	0.3	0.3	0.4
Reserves	0.9	1.0	0.9	0.9	1.3
Total liabilities	**17.6**	**20.5**	**23.0**	**22.7**	**30.1**

Total assets (£'bn) and asset growth (%)



The Group grew strongly in 2006-8, with an equivalent annual rate of growth of 12% over these three years. In 2009 the balance sheet was shrunk as both funding and lending markets contracted and the Group looked to ensure that it did not over extend itself involatile markets.

2010 saw the Group's balance sheet grow by 32%, driven by the Chelsea merger. However, this figure covers a more complicated and carefully managed picture of merger-driven growth followed by careful contraction as unwanted assets and liabilities were shed. The assets actually brought onto the Group's balance sheet at the time of the merger, compared to the Group's balances at 31 December 2009 and 2010 and immediately before the merger (31 March 2010) were as follows:

Group Balance Sheet 2009 to 2010

	31/12 2009 £'bn	31/03 2010 £'bn	Chelsea assets added £'bn	01/04 2010 £'bn	31/12 2010 £'bn
Liquid assets	6.7	7.0	3.0	10.0	5.9
Mortgage loans	15.0	14.6	9.2	23.8	23.4
Other assets	1.0	1.2	0.2	1.4	0.8
Total assets	**22.7**	**22.8**	**12.4**	**35.2**	**30.1**
Retail savings	13.8	13.5	9.9	23.4	21.4
Wholesale funding	7.2	7.5	1.7	9.2	6.3
Other liabilities	0.5	0.6	0.4	1.0	0.7
	21.5	21.6	12.0	33.6	28.4
Remunerated capital	0.3	0.3	-	0.3	0.4
Reserves	0.9	0.9	0.4	1.3	1.3
Total liabilities	**22.7**	**22.8**	**12.4**	**35.2**	**30.1**

In the first three months of the year the Group's assets remained flat, albeit with:

- a reduction in mortgage assets as, not unexpectedly, the level of repayments by borrowers outweighed new mortgage lending in what is traditionally a quiet part of the year for new lending;
- a corresponding increase in liquidity as the cash released was retained for future lending; and
- a reduction of £0.3bn in retail savings balances, and a corresponding increase in wholesale funding.

As at 1 April 2010 the merged Group had total assets of £35bn. In the nine months following the merger the Group has focussed, as mentioned above, on managing:

- the large portfolio of fixed-rate savings products inherited from the Chelsea onto more sustainable interest rates and the accompanying, planned, outflow of funds. As a result, retail savings balances shrank by £2.0bn in net terms between the merger date and the end of the year to £21.4bn; and
- a number of wholesale funding maturities, partly offset by new issuance, resulting in a net reduction of £2.9bn in wholesale funding.

This outflow of funds was principally funded out of liquid assets that had been put in place for this reason – so that total liquid assets shrank from £10.0bn to £5.9bn between 1 April and 31 December.

The assets acquired with the Chelsea were subject to a number of significant adjustments to reflect their "fair value" rather than the value at which they were recorded in Chelsea's own records; i.e. as if they had been acquired, individually, by the Yorkshire in standalone transactions. The assets in question, the adjustments made and the fair value at which they came on to our balance sheet, are as follows (for more details see note 42 on pages 108 and 109):

Chelsea Fair Value adjustments

	Chelsea cessation accounts £'bn	Fair value adjustments £'bn	Take on balances £'bn
Liquid assets	3.0	-	3.0
Mortgage loans	9.4	(0.2)	9.2
Other assets	0.3	(0.1)	0.2
Total assets	**12.7**	**(0.3)**	**12.4**
Retail savings	10.0	(0.1)	9.9
Wholesale funding	1.7	-	1.7
Other liabilities	0.4	-	0.4
	12.1	(0.1)	12.0
Reserves	0.6	(0.2)	0.4
Total liabilities	**12.7**	**(0.3)**	**12.4**

The adjustments fall into a number of categories, including:

- those reflecting the difference between the actual interest rates in place on products or financial instruments (e.g. mortgages, savings and hedge instruments) and what we would have had to pay or could have earned if we were lending/raising money/hedging positions as at 1 April 2010. This price difference has to be shown as a positive or negative adjustment to the underlying mortgage, savings balance or derivative. These adjustments will reverse over time, through the income statement, as the underlying instruments mature;
- the write-off of assets that had no, or reduced, value to the combined group at 1 April 2010 e.g. Chelsea's computer software that was of no value to the combined group because we are integrating the Chelsea business onto the Yorkshire's bespoke

systems. These adjustments reduced reserves on 1 April 2010 but do not have any impact on the income statement thereafter; and

- an adjustment to reflect the amount that we expect to lose, at any point in the future, through borrower defaults. This approach is different to that for our existing mortgage assets where only currently impaired loans can be taken into account. The effect is, provided our estimate of future losses is accurate, that any future losses on these assets will not be reflected in our income statement – it is equivalent to bringing forward future loan loss provisions charges to 1 April 2010. The adjustment in relation to Chelsea mortgages was almost £175m. Although this adversely affects the capital position from 1 April 2010 it then protects the Group's future income statement. This adjustment is in addition to just over £53m of provisions already on the Chelsea's books at the time of the merger, giving a total of over £228m effective protection against future losses on these assets. In the nine months following the merger the actual amount written off against these loans was just £16m.

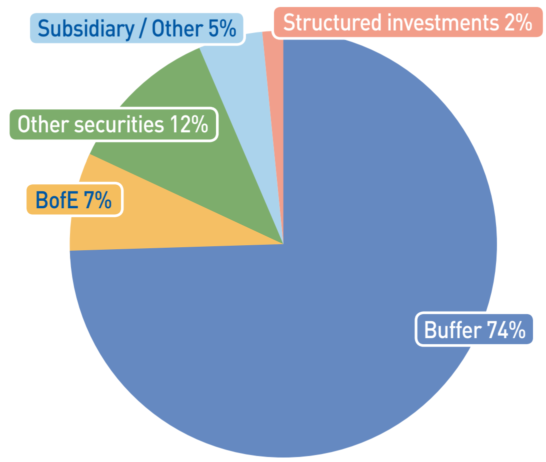
The following sections look in more detail at the principal balance sheet items:

Liquid assets

Key Performance Indicator explanation: The Board monitors the Group's liquidity position in a number of ways, including by continually running potential stress scenarios 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. The key measure, however, is to monitor the total level of "buffer liquidity" against our regulatory requirement (set by the FSA). Buffer liquidity constitutes cash and investments with the UK government (deposits with the Bank of England or holdings of UK Gilts and similar investments) and with supranational institutions. As such it represents the most liquid and safest form of holding. Our regulatory minimum is set by the FSA, who are currently in the process of reviewing our Internal Liquidity Adequacy Assessment in order to set an Individual Liquidity Guidance figure for the Group. In the meantime the Board is monitoring its liquidity against an interim Individual Liquidity Guidance Limit set by the FSA during 2010.

During 2010, in addition to the planned run down of balances already referred to, the Group continued its progress in moving more of its liquid assets into the highest quality investment categories, as required by the FSA's new liquidity regime. This move also reflects the shift in our funding profile with, in particular, far lower levels of short-dated funding that requires higher liquidity to be held against it. This all means that whilst a higher proportion of our liquid assets are held in these very low earning assets, we can also hold a lower overall level of liquidity. As shown in the table opposite, 75% of our total liquidity is now in this category.

Breakdown of liquid assets as at 31/12/2010



	2009 £bn	2010 £bn
Buffer liquidity	3.2	4.4
BoE Eligible securities	1.1	0.4
Other securities	1.9	0.7
Total core liquidity	**6.2**	**5.5**
Subsidiary / other liquidity	0.4	0.3
Structured investment	0.1	0.1
Total liquid assets	**6.7**	**5.9**

We continue to hold levels of liquidity that are significantly above our interim regulatory requirement.

As previously reported, some years ago the Group, in a controlled and deliberate return-seeking move, invested a small proportion of its liquidity in higher risk, higher yielding treasury investments ("structured investment"). These assets were always less than £200m in value, less than 3% of our total liquidity and less than 1% of total assets. Over the past few years they have been adversely affected by market conditions, resulting in a number of realised losses (i.e. where sold) and reductions in value (where still held). We continue to actively manage these assets and to seek to reduce our exposure, and as at 31 December 2010 this portfolio stands at just £71m or less than 0.25% of total assets.

The difficulties of a number of Eurozone countries have been well publicised in 2010, notably Greece, Ireland, Italy, Portugal and Spain, and in a number of cases rescue schemes have been put in place for these countries. This has raised concerns about the security, from a credit perspective, of loans to financial institutions that are guaranteed by those countries' governments (so-called sovereign risk). The Group has no exposure

Business review (continued)

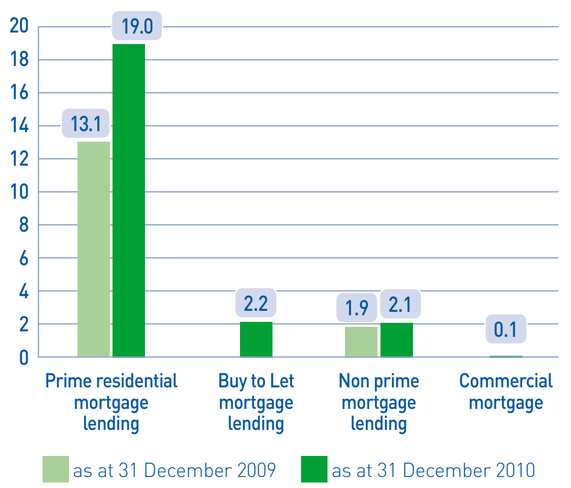
to investments issued directly by the governments of any of these countries. The only one of these countries where the Group has an exposure to government-owned or guaranteed institutions is Ireland – where at 31 December 2010 total balances of £216m were outstanding, although £42m of that has since been repaid on its due date. The Group continues to closely monitor these exposures, all of which are senior debt maturing over the next 18 months and which we believe are not impaired.

Mortgage assets and new mortgage lending

With the take-on of the Chelsea we saw a significant shift in the make-up of our mortgage assets since the Chelsea were active in a number of different markets to the Yorkshire Group:

	31 December 2009		31 December 2010	
	£'bn	%	£'bn	%
Prime mortgage lending	13.1	87%	19.0	81%
Buy to Let lending	-	-	2.2	9%
Non prime lending	1.9	13%	2.1	9%
Total residential	**15.0**	**100%**	**23.3**	**99%**
Commercial lending	-	-	0.1	<0.5%
Other lending	-	-	0.0	<0.1%
Total loans	**15.0**	**100%**	**23.4**	**100%**

Mortgage balances by loan type 2009 and 2010 (£'bn)



Our portfolio of prime residential mortgages grew by over £5bn as a result of the merger – and at the end of 2010 it stood at £19bn. As a percentage of our total mortgage loans this is 81%, which is down on 2009 because of the addition of just over £2bn of Chelsea originated Buy-to-Let mortgage loans – a market in which Yorkshire was not previously active, but where we are considering a limited re-entry into new high quality lending.

Meanwhile non prime lending grew with the take-on of Chelsea balances before shrinking back to £2.1bn by the year end, or just 9% of our total portfolio. This is principally lending to borrowers with adverse credit histories or self-certification lending where borrowers are not required to prove their income levels. Both are areas that were prevalent before the financial downturn, where both the Yorkshire and the Chelsea were active to relatively limited degrees and where the Group is completely inactive now. As a result these portfolios are being managed down.

With the merger we took on a small portfolio of commercial loans from the Chelsea, and by the year end had reduced this portfolio by almost 50% to just over £80m. We are not active in this market and do not intend becoming so.

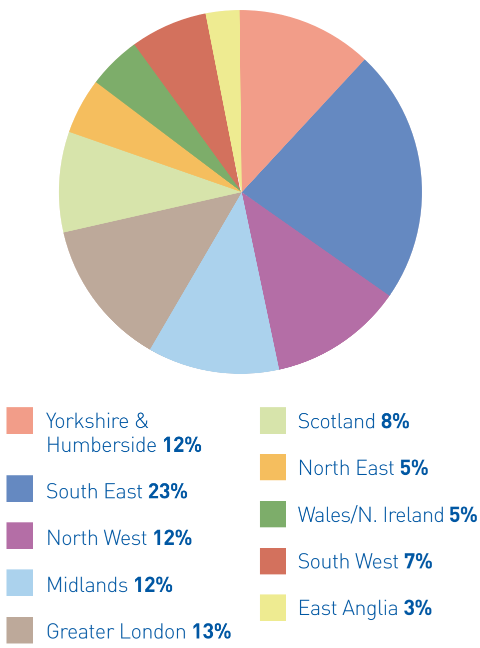
The make-up of our mortgage portfolio, and the potential risks that are contained within it, are monitored closely by the Group across a wide range of characteristics and analyses. These include, for example, considering the geographic profile of the portfolio, its indexed loan-to-value position and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

Taking these in turn:

- the UK economy and housing market is highly regional, and different regions are facing potentially very different economic and housing market conditions in 2011 and beyond. The merger with the Chelsea, as a more southern-focussed society, has meant a re-balancing of the Group's loan portfolios towards London and the South East of England, closer to the national split. Given the stronger performance (both to date and forecast by many commentators) of these regions' housing markets such a shift is likely to be helpful to the Group;

Geographic Distribution	2006	2007	2008	2009	2010
Yorkshire & Humberside	18%	17%	17%	17%	12%
South East	15%	15%	15%	15%	23%
North West	15%	14%	14%	14%	12%
Midlands	11%	11%	11%	12%	12%
Greater London	11%	11%	11%	11%	13%
Scotland	11%	12%	12%	11%	8%
North East	5%	6%	6%	6%	5%
Wales/N. Ireland	6%	6%	6%	6%	5%
South West	5%	5%	5%	5%	7%
East Anglia	3%	3%	3%	3%	3%
	100%	**100%**	**100%**	**100%**	**100%**

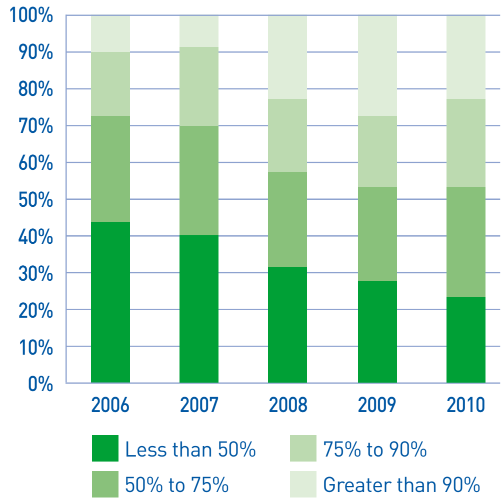
Mortgage assets by region at 31/12/2010



- an analysis of indexed loan-to-values for a mortgage portfolio provides a broad estimate of the current degree to which borrowers retain equity in their homes, and so how exposed a lender is to making a loss should borrowers default on their loans. The Group has a higher than average proportion of loans in the higher loan-to-value bands, reflecting its focus on the first-time-buyer market and our commitment to helping borrowers at all stages of their home-ownership journey. A combination of the merger with the Chelsea and house price movements during 2010 saw a general improvement in the Group's profile, with fewer borrowers in the highest bracket. This follows a number of years when falling house prices have, inevitably, increased the level of higher loan-to-value loans. The Board remains focussed on this characteristic of the mortgage portfolio through uncertain times.

Indexed loan to value	**2006**	**2007**	**2008**	**2009**	**2010**
Greater then 90%	10%	9%	23%	27%	23%
75% to 90%	17%	21%	19%	19%	23%
50% to 75%	29%	30%	27%	26%	30%
Less than 50%	44%	40%	31%	28%	24%
	100%	**100%**	**100%**	**100%**	**100%**

Indexed loan to value profile



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

Loans with payments more than 3 months in arrears as % of total loans

	2006	**2007**	**2008**	**2009**	**2010**
Number of accounts	0.72%	0.95%	1.59%	1.84%	1.84%
Balances outstanding on accounts	0.89%	1.04%	1.99%	2.46%	2.26%

The level of arrears for the Group's loan portfolios has, as previously reported, risen steadily over that last few years as the economic conditions have deteriorated and borrowers have struggled to keep up with their mortgage payments. However, the Group has maintained its arrears below the Council of Mortgage Lenders average for the country as a whole, and based on the latest publically available data (at 31 December 2010) this remains the case. The Group's arrears increased as a result of the merger with the Chelsea, whose equivalent arrears numbers at 31 December 2009 were 2.66% and 2.97%. This meant that as at 30 April 2010 the combined

Business review (continued)

group's arrears levels jumped but since then they have reduced to the levels shown above. Overall the 2010 performance has been good, but we remain cautious about the prospects for the UK as a whole in 2011 and beyond, and hence for our borrowers and our resulting arrears. We will continue to seek to balance the financial interests of the membership as a whole in minimising potential losses, and those of individual borrowers who find themselves in financial difficulties.

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

In terms of new lending, the Group increased its gross new mortgage lending in 2010 by just under 200% to £2.8bn, back above the level advanced in 2008 and achieving a market share of 2%. This reflects our commitment to be active in the mortgage market, as far as is prudent given the current economic and market conditions. Whilst still below the total levels achieved in 2006/7, for the last months of 2010 we were approaching similar levels of activity.

As mortgage redemptions (relative to the size of our total mortgage book) continued broadly in line with previous years, our net lending for the year improved from a net repayment of £1.2bn in 2009 to a net repayment of £0.8bn. Clearly the Group would like to be achieving positive net mortgage lending, but feels that it is more important to "fund first and lend second", and in raising its funding to ensure that the volume and pricing of that funding is equitable and sustainable. In today's volatile and competitive markets this needs to be managed carefully.

Retail and wholesale funding

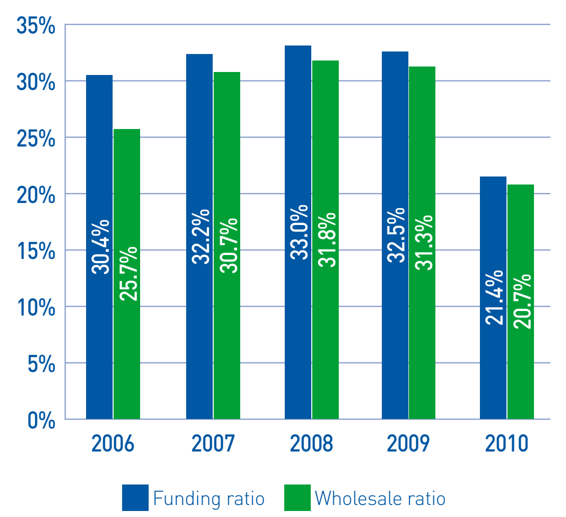
During the year the Group saw a material shift in the mix of its funding towards retail savings (i.e. through offering savings products to our members) and away from money raised on wholesale markets. This was a planned move, and the mix is now at a level that the Board feels appropriate in today's markets.

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

- Funding ratio – which calculates the proportion of total shares and borrowings (excluding offshore deposits held by individuals in Yorkshire Guernsey Limited) that are not in the form of shares. This is a statutory ratio and by law the group must maintain it below 50%; and
- Wholesale ratio – which calculates the proportion of our total funding that is from wholesale sources, in effect from banks and other financial or commercial institutions.

Wholesale funding provides valuable diversity in the Group's funding profile. However, as the events of 2007 and 2008 in particular showed, too great a reliance on these sources can leave institutions exposed to liquidity issues should wholesale markets suddenly contract. The Group's aim is to maintain a sustainable level of wholesale funding without becoming too reliant.

Wholesale funding ratios



	2006	2007	2008	2009	2010
Funding ratio	30.4%	32.2%	33.0%	32.5%	21.4%
Wholesale ratio	25.7%	30.7%	31.8%	31.3%	20.7%

Retail savings, that is money raised from our members, now constitutes 77% of our total funding. This is clearly sensible in a business whose principal purpose remains the provision of a safe home for members' savings and of residential mortgage loans. At 31 December 2010, 91% of our mortgages were funded from retail savings balances (2009: 92%).

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

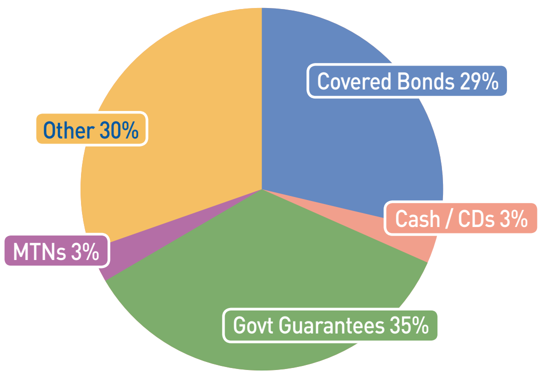
During 2010 the Group's main task was to manage the position inherited from the Chelsea, and in particular the large portfolio of highly priced fixed-rate bonds referred to above. This meant that for the Group as a whole:

- retail savings balances grew by over 54%, or £7.6bn, to £21.4bn in 2010;
- this growth included the addition of £9.9bn of savings balances on merger with the Chelsea;
- the Chelsea balances were managed down by £2.9bn during the last nine months of the year; and
- over the whole year the Yorkshire and Barnsley brands saw net inflow of £0.3bn.

Overall, in what continued to be a highly competitive market that saw a number of players continue to offer what we believe to be unsustainable pricing throughout the year, the Board is satisfied that the 2010 performance represents a prudent approach to managing the Group's funding position.

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

Wholesale funding portfolio



	2009 £bn	2010 £bn
Cash/CDs	0.4	0.2
Covered Bonds	2.7	1.8
Government guarantees	2.2	2.2
MTNs	0.5	0.2
Other	1.4	1.9
	7.2	**6.3**

The Group was pleased to achieve a successful re-entry into the Covered Bond market in September 2010. Looking forward, the Group has a number of significant maturities in 2011 and 2012, and hopes to continue to be active in the market for new issuance.

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

The Group's weighted average maturity at 31 December 2010 was 15.6 months. This figure has reduced in recent years as the availability of funding, and particularly longer-term funding, has contracted. However, the Group entered the current market conditions in a very good position and has managed to maintain its average funding maturity at a reasonably high level. As market conditions settle into a new norm we will look to extend this maturity further.

As discussed in previous years' reports, the Group chose to access the Credit Guarantee Scheme and other government funding initiatives available to institutions that satisfy the schemes' strict conditions. We chose to do this because the existence of these schemes itself caused further dislocation of the wholesale funding markets, further reducing the otherwise available funding, and because it provided longer-term funding at commercial rates (allowing us to reduce our levels of shorter-term funding). Not all institutions were able to access these schemes. The funding raised will begin to mature (and therefore need to be repaid) in 2011. The Board has been very careful to plan and manage the Group so as to be sure that these loans can be repaid when due.

Capital

The Group's capital ratios continue to reflect its core strengths, with the two key ratios improving in 2010 from what were already very strong and comparatively high positions.

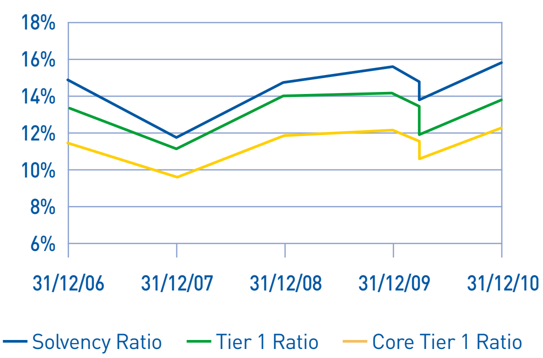
Key Performance Indicator explanation: The Board looks at two key measures to monitor the Group's capital strength, which is important since it represents the money held to protect investors against ever losing any of their money with the Group. The higher these ratios the more capital an institution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

Business review (continued)

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

The Group's capital resources and ratios are set out in detail in Note 30 to the accounts, but in summary are as follows:

	31/12 2006	31/12 2007	31/12 2008	31/12 2009	31/03 2010	01/04 2010	31/12 2010
Total Capital Resources	1,204	1,120	1,161	1,238	1,246	1,672	1,778
Tier 1 Capital Resources	1,288	1,062	1,104	1,123	1,127	1,451	1,562
Core Tier 1 Capital Resources	937	916	937	964	966	1,288	1,394
RWA	8,100	9,500	7,832	7,927	8,387	12,145	11,205
Tier 1 Ratio	13.5%	11.2%	14.0%	14.2%	13.4%	11.9%	13.9%
Core Tier 1 Ratio	11.6%	9.6%	12.0%	12.2%	11.5%	10.6%	12.4%



Note: The ratio at 31 December 2007 was impacted by the Group's move to the new Basel II regime, and a timing difference between the introduction of certain elements of this regime. In fact, one day later on 1 January 2008 our Solvency ratio was 14.4%, up 2.6%.

During 2010 the Group's capital was reduced, as planned and as indicated in the merger documentation, by the merger with the Chelsea – in effect the "price" that we paid for the merger was a reduction in our capital ratios on 1 April 2010 since the Chelsea's capital position was not as strong as the Yorkshire's. However, by the end of the year the Group has restored its key capital ratios to above those immediately pre-merger, and above the levels at 31 December 2009. This is ahead of our expectations and has been achieved through a combination of planned asset shrinkage post merger (reducing the amount of capital we need in place), and strong profitability which increased the absolute amount of capital we have in place.

Furthermore, our other key ratio, the Capital Excess, remains extremely healthy and ahead of plan. We have in place materially more capital than the FSA considers we need given our size and asset mix.

The Group remains committed to maintaining strong capital ratios as these fundamentally represent security for its membership.

Customer satisfaction measures

Delivering strong customer service is central to our vision and consequently the Board focusses on a number of detailed service measures. These include telephone answering times, ATM availability and general processing speed and accuracy. They provide invaluable feedback on how well we are meeting our members' product and service needs. At the highest level the Board focusses on customer satisfaction and complaints measures as the best reflection of overall service quality.

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

- Customer satisfaction – which shows the proportion of our customers who say that they are satisfied or more than satisfied with the service they received;
- Net promoter score – which shows the percentage of customers strongly prepared to recommend our products and services to others less those who are not prepared to do so and excluding those who are neutral towards us i.e. it is the net proportion of our customers with a positive perspective on us, and not just the gross number; and
- Complaints – a range of data is monitored including the number and type received, the speed with which complaints are resolved, the proportion that are accepted or rejected, how many are referred to the Financial Ombudsman Service and how many of those are found in our or the customer's favour. The Board also monitors the absolute level of complaints received.

Looking across the period our customer satisfaction measure shows the following picture – a score that is consistently at or above 90%:

As at the end of 2010 our net promoter score (which we have only recently introduced) is 44%, which is extremely pleasing and we believe is significantly better than most financial institutions.

Looking at complaints, the Board reviews an extensive array of data and trends. A key piece of data that started to be available in 2010 was the Financial Ombudsman Service (FOS) complaint overturn rates, which the FOS now publishes bi-annually. These tables show performance in terms of overturn rates relating to each qualifying firm in the finance sector – i.e. the percentage, per firm, of customer complaints sent to the FOS which were overturned in the customer's favour. The latest table - published in Q3 2010 and representing the period 1 January 2010 to 30 June 2010 - quoted the performance of the largest 160 qualifying firms. Yorkshire (including Chelsea) were joint top performers with an FOS overturn rate of only 14% during the reporting period. The Board views this as an excellent achievement - the data is widely recognised as a clear indicator of the fairness of a firm's complaints handling approach. The box below sets this achievement in context by showing a sample of other well-known institutions' results:

FOS Complaints overturn rates for a selection of providers
% of complaints referred to FOS then resolved in favour of consumers 1/1/2010 to 30/6/2010

Top 3 institutions	Clerical Medical Investment Group	14%
	Yorkshire Building Society	14%
	Northern Bank	17%
Other institutions included	Nationwide Building Society	18%
	Santander UK	19%
	Bank of Scotland plc	23%
	Northern Rock	31%
	National Westminster Bank	43%
	Sainsbury's Bank	43%
	Lloyds TSB	45%
	Direct Line Insurance	48%
	Royal Bank of Scotland	50%
	Barclays Bank	61%
	Tesco Personal Finance	65%
	Egg Banking	72%

Staff metrics

The Board places great importance on recruiting and retaining motivated people and recognises the key contribution they make to the Group's continued success.

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

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

	2006	2007	2008	2009	2010
Staff turnover	15.2%	18.9%	15.6%	10.7%	15.1%
Staff absenteeism	3.4%	3.1%	3.1%	3.2%	2.8%

In 2010 both measures remain below target i.e. are performing better than target.

Chelsea merger

The Group's merger with the Chelsea and subsequent work on integrating the two societies has been a major part of the Board's, and indeed the whole Group's, focus in 2010. Throughout the process, the Board has closely monitored both the financial impact (embedded in previous sections) and the operational progress of the merger. This includes a detailed integration project review on a monthly basis covering progress and issues on each major workstream, the key risks introduced by any such integration exercise and progress against the clear financial targets (costs and savings) set by the Board. As Iain notes on page 8, the integration is going according to plan and, whilst a material amount of work remains to be completed, is forecast to remain so in both operational and financial terms. The Board remains clearly focussed on monitoring progress in this vital area.

Other business review issues

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

- Corporate responsibility – pages 24 to 27
- Risk management report – pages 35 to 42
- Corporate governance report – pages 43 to 51

Robin Churchouse
Finance Director

Corporate responsibility

At the Yorkshire, playing an active role in our local communities is part of day to day life. Our corporate responsibility programme, "Societies Together", reflects the Society's values which are fun, fairness, passion and people working together.

Our corporate responsibility vision

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

Activity in 2010

2010 was an extremely busy year for our community team and this report provides an insight into some of our activities.

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

We are very proud of the success we have achieved through our community efforts during 2010, which is a result of the dedication and enthusiasm of our staff for getting involved and also the support of our members in identifying causes that are important to them and supporting our fundraising efforts.

Yorkshire Building Society Charitable Foundation

The Foundation supported around 2,000 charities and good causes in 2010 through donations totalling over £470,000. The Foundation's focus on providing grants to buy specific items means it is very clear to see how the money is helping local communities.

In addition to individual donations, there were two main campaigns supported by the Foundation in 2010.

Make a Difference Week

The fourth annual Make a Difference Week (MAD) which was held in June, encouraged members to nominate their own local causes to receive a small donation from the Foundation. With the assistance of our members we can help more local charities that are sometimes overlooked by large organisations and where a small donation will make a real difference to their activities. The 2010 Make a Difference Week was the most successful ever, with over 1,300 causes each receiving £100.

National Christmas Appeal

The 2010 charity, chosen as a result of member and staff feedback, was Teenage Cancer Trust. For five weeks over the Christmas period, staff and members got involved in fundraising activities which were matched pound for pound by the Foundation, to provide a fantastic donation to the charity of £100,000.

Our campaign was supported by actress Angela Griffin who, through local newspapers, encouraged people to

support the charity. As in previous years staff were very creative, with money raised from a variety of activities from a sponsored head shave to a team dressed up as reindeers selling reindeer food.

The donation to Teenage Cancer Trust will enable 400 teenagers suffering or recovering from cancer to get together later this year at Centre Parcs for a weekend of fun, enjoyment and education about their illness.

Pennies into Pounds

Small Change, Big Difference™ (SCBD) is our unique scheme where each year members who take part donate the pence of their interest to the Foundation. Whilst the average donation from each account is less than 50 pence a year, this scheme provides a large proportion of the Foundation's funding. Since 1999 SCBD has collected more than £1.9m. Members can join the scheme either at their local branch, online at www.ybs.co.uk/b1m or by calling us on 0845 1200 100.

Why not sign up for Small Change, Big Difference™, and nominate a charity to receive a donation from the Charitable Foundation. Log on to www.ybs.co.uk/b1m or visit your local branch.

"Staff Dress Down Days raised over £16,500, supporting Sport Relief, Jeans for Genes, Everyman Cancer and Children in Need".

The Ravenscliffe Community Association Hamper Project was supported by staff from our subsidiary company, Accord Mortgages Limited. In December two teams of volunteers wrapped, packed and delivered toys, hats, gloves and selection boxes for 450 children facing hardship in Bradford.

Anthony Waddington from Be Involved, who co-ordinated the activity through Bradford Chamber of Commerce, said "Yorkshire Building Society offers some of Bradford's most deprived communities their skills, knowledge and manpower through their community work, which would otherwise be out of reach for the community organisations. The projects staff from the Yorkshire support contribute to a long-term outcome for the community. These activities are often catalysts for either getting a project off the ground, helping to attract further funding, or increasing educational attainment".

Corporate responsibility (continued)

Actionteering – our staff volunteering programme

Over 1,700 volunteer hours were given by staff to local communities during the year. These were used on a wide variety of activities including creating outdoor classrooms at primary schools, brightening up community centres and working with local youth projects. In addition, a number of staff also got involved in their communities by being school governors, sports coaches and student mentors.

The Cornerstone Centre in Cheltenham receives regular support from Chelsea staff who give up their lunch hour to serve in the soup kitchen. The Society has also donated computer equipment that is no longer required by the Society to this charity.

Chelsea Building Society

Like the Yorkshire, community involvement and support was a key priority for Chelsea Building Society.

Their 2009 Staff Charity of the Year campaign was extended until March 2010. Many staff both at head office and in branches got involved in fundraising activities and their efforts, together with a donation from Chelsea Building Society Charitable Foundation, resulted in a donation of £30,000 to Sue Ryder Care.

Barnsley Building Society

Through the Barnsley's Saving Saves Lives affinity account, Yorkshire Air Ambulance received a donation of £129,000 bringing the total donation since 2007 to over £250,000.

Paul Gowland, Fundraising Director at the charity said, "At Yorkshire Air Ambulance we look at the crucial Golden Hour – if we can take a patient from accident to medical attention within an hour the chances of recovery are dramatically increased. The quarter of a million pound raised through the Saving Saves Lives account has covered the cost of over 150 Golden Hours, meaning Barnsley Building Society savers have helped us extend our golden lifeline to more than 150 individuals for which we are immensely grateful".

"Y Care International Emergency Appeal – Haiti Earthquake and Pakistan Flood appeals – collected over £40,000".

Environmental

We all have a responsibility to our environment and we are very aware of our individual impact both within the business and local communities. Our extensive recycling programme allows us to recycle up to 90% of Head Office waste and over 80% of our branch premises waste.

Our commitment to purchase electricity from renewable sources continues and has been extended to our Chelsea properties. By the consistent monitoring of our energy usage we are reducing and eliminating wastage wherever possible.

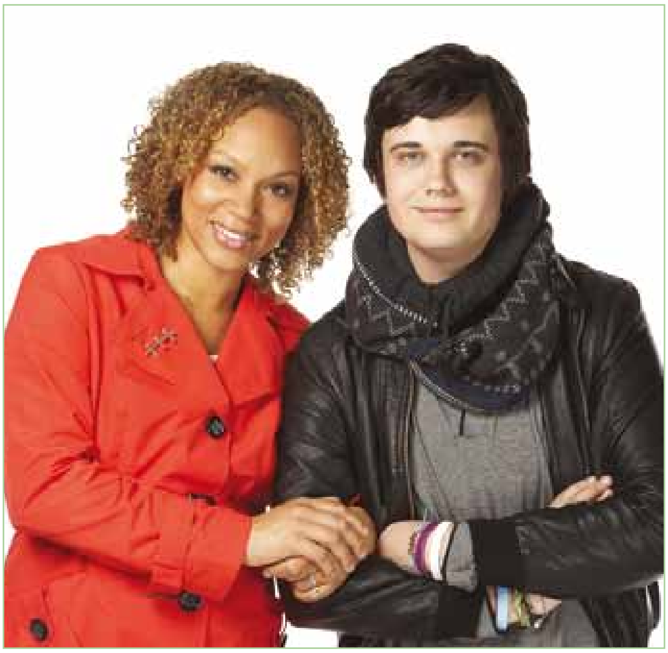
Through our support of Bike to Work week we encourage staff to leave their cars at home and cycle to work. One staff member who took up the challenge was Rob Savin who gave up his car for the whole week and cycled 80 miles each day between the office and home. As well as saving money on his travelling costs (and the benefits to his fitness) Rob was pleased that he had reduced his impact on the environment.

To make sure that Rob was "fuelled" for the day our Catering team kindly provided free breakfasts for all those who got on their bikes.

"Societies Together" – the way forward

In the second half of 2010 a review of the community practices of the Yorkshire, Barnsley and Chelsea was undertaken. The aim was to identify the best elements of each programme and design a new combined approach across all areas of the Society based on best practice.

Our new programme "Societies Together" will provide the platform for our activities moving forward, bringing to life our vision. We expect 2011 to be an exciting year for all our community activities and look forward to reporting on them in next year's report.



Non-executive directors

Ed Anderson, BSc CPFA (age 60)
Chairman

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

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

Kate Barker, CBE (age 53)
Non-executive Director

Kate Barker joined the Board on 5 November 2010 and is a member of the Group Risk Committee.

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, where she remained a committee member until May 2010. Prior to her appointment to the MPC, she was Chief Economic Adviser to the CBI. Kate is also a non-executive director of Electra Partners and a senior adviser to Credit Suisse.

She also has a background in housing as the author of major policy reviews for the previous government on housing supply and on planning. She is a former board member of the Homes and Communities Agency and in 2006 was awarded a CBE for services to social housing.

Roger Burden, PhD, FCIB, MBCS, FRSA (age 64)
Non-executive Director

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

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

Lynne Charlesworth, BA MBA (age 54)
Non-executive Director

Lynne Charlesworth joined the Board in December 2006 and is the Chairman of the Group Risk Committee and a Trustee of the Society's Pension Scheme. She also oversees the Group's policy on "Treating Customers Fairly" on behalf of the Board.

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

Richard Davey, BA (age 62)
Vice Chairman

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

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

Philip Johnson, FCA (age 64)
Non-executive Director

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

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

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

David Paige, BSc, FCA (age 59)
Non-executive Director

David Paige joined the Board in December 2006 and is a member of the Audit, Group Risk and Remuneration Committees.

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

David is also a non-executive director of several of Aegon's UK businesses.

Simon Turner, BSc (age 59)
Non-executive Director

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

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

Executive directors

Iain Cornish, BSc (age 50)
Chief Executive

Iain Cornish joined the Society in 1992 and has held a number of senior management positions with the Yorkshire prior to being appointed Chief Executive in July 2003. Iain is an economist and started his career in government followed by a move to the private sector.

Iain is a member of the Group Risk and Nominations Committees. He is a director of the Society's subsidiaries Accord Mortgages Ltd and Yorkshire Key Services Ltd. Iain is the Chairman of the Financial Services Practitioner Panel, which is a statutory body which represents the interests of the financial services industry in the UK regulatory framework. He is also a past Chairman of the Building Societies Association.

Robin Churchouse, MA ACA (age 45)
Finance Director

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

Ian Bullock, BSc FIA (age 50)
Sales and Marketing Director

Ian Bullock is a qualified actuary and joined the Society in February 2003 as Head of Insurance and Financial Services, soon acquiring responsibility for other functions. He was promoted to the General Management team in 2004 and became Sales & Marketing Director in April 2007. Ian has the responsibility for Product Development, Marketing and the Society's distribution network, including our branches, agencies and online business. He is also Chairman of Accord Mortgages Ltd, the Society's intermediary lending subsidiary.

Andy Caton, BA (age 47)
Corporate Development Director

Andy Caton joined the Society in 1991 as an economist and was appointed to the General Management team in 1998. On 1 July 2004, he was appointed Corporate Development Director and is responsible for the Treasury, Corporate Affairs, Legal & Secretarial and Corporate Development functions. Andy is also a director of Yorkshire Guernsey Ltd, the Group's offshore deposit taking subsidiary.

General managers

David Henderson, BSc (age 50)
General Manager Group Services and Chief Information Officer

David Henderson joined the Society in August 2007 as Chief Information Officer, and has responsibility for the Group's IT, Premises, Programme Delivery and Corporate Shareplan functions. He is also Chairman of the subsidiary Yorkshire Key Services Ltd which offers IT solutions and account administration services to other financial institutions. David continues to head the integration work following the merger with Chelsea Building Society in April 2010. He started his career in the building society sector and, prior to joining the Yorkshire, he held a range of senior IT positions within a major UK banking group.

Mark Jenkins, BA, FCA, DipL (age 48)
General Manager Commercial Development

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

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

Rachel Court, BA (age 44)
General Manager Human Resources & Customer Service

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

Richard Wells, FCIB (age 47)
General Manager Risk

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

The directors have pleasure in presenting their annual report, together with the Group Accounts and Annual Business Statement, for the year ended 31st December 2010.

Business objectives and activities

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

- providing members with financial security and long-term value; and
- delivering a strong customer service through engaged and motivated staff.

Further information on the Group's vision and strategy is given in the Business review on page 10.

Principal risks, uncertainties and going concern

The principal risks and uncertainties faced by the Group and our approach to managing them are set out in the Risk management report on pages 35 to 42.

As set out on page 59 the directors are required to prepare these financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Society will continue in business.

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

The future risks considered in the latest review, performed in February 2011, included uncertainty around recovery in both the UK housing market and the general economy, the potential for restricted access to funding, excessive demands on liquidity, the impact of sovereign failure and the impact of increasing levels of regulation.

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

The key risks associated with the merger with Chelsea Building Society have largely receded but are still monitored on a continuous basis.

As a result of the detailed assessment performed in February 2011 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 materially in excess of that required by the regulator.

Merger with Chelsea Building Society

During the year, the Society merged with Chelsea Building Society. Further details relating to the impact of this merger are given in the Business review on pages 10 to 23.

Business review and future developments

Key developments and the future outlook are reviewed by the Chairman and Chief Executive on pages 2 to 9 and in the Business review on pages 10 to 23. The Business review identifies and explains the Group's Key Performance Indicators and sets out how it has performed against each during 2010.

Profit and capital

Profit before tax for the year was £115.4m (2009 – £12.5m loss) and after tax the amount transferred to Group general reserves was £91.8m (2009 – £3.3m loss).

Total Group reserves at 31st December 2010 were £1,337.5m (2009 – £899.8m). Details of reserves movements are given in the Statements of changes in members' interest on page 64.

Gross capital at 31st December 2010 was £1,719.7m (2009 – £1,170.8m) including £214.9m (2009 – £111.7m) of subordinated debt and £167.3m (2009 – £159.3m) of subscribed capital. Expressed as a ratio to shares and deposits gross capital was 6.20% (2009 – 5.58%) and free capital was 5.69% (2009 – 5.13%). These ratios are explained on page 110.

One of the Group's principal measures, to monitor the level of capital within the business, is the solvency ratio, the calculation of which is in Note 30 on page 92. The Group's solvency ratio has increased to 15.9% (2009 – 15.6%).

Further information about the Group's capital strength is outlined in the Business review on pages 21 and 22.

Mortgage arrears

Details of the Group's mortgage accounts, including those in possession, which were 12 months or more in arrears at 31st December 2010 were as follows:

	2010	2009	2010 % of mortgage accounts/balances	2009 % of mortgage accounts/balances
Number of accounts	**920**	622	**0.38**	0.38
Balances outstanding on accounts	**£126.6m**	£87.7m	**0.54**	0.60
Amount of arrears included in balances	**£10.4m**	£6.8m	**0.04**	0.05

The increase in the absolute level of arrears results mainly from the merger with Chelsea Building Society. Arrears as a proportion of total loans have fallen. Further details of the Group's arrears position and the various provisions made against potential losses are set out in the Business review on pages 10 to 23.

Staff

Our staff are key to our operations.

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

An equal opportunities policy is followed and the Group gives full consideration to applicants and staff who are disabled. The Group has recently had its Investor in People accreditation reaffirmed and has been recognised as going beyond the required IIP standard to meet the higher "bronze" rating.

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

Directors

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

Andrew Gosling retired on 31st May 2010 and was succeeded as Finance Director by Robin Churchouse who was appointed on 1st June 2010 having been a member of the senior management team since 2004.

Indira Thambia stepped down from the board on 30th September 2010 following her appointment as executive Chairman of the Multiyork Group.

The board wishes to acknowledge the contribution of Andrew and of Indira to the continuing success of the Group.

Two non-executive directors were appointed during 2010. Roger Burden, formerly a non-executive director of Chelsea Building Society, was appointed on 1st April 2010 when the merger with the Chelsea took effect. Kate Barker was appointed to the board on 5th November 2010. Kate was previously a non-executive director of the Society until her appointment to the Bank of England's Monetary Policy

Committee (MPC) in 2001 and the board is delighted to welcome her back following the completion of her term of office with the MPC.

At the 2011 Annual General Meeting (AGM), Ian Bullock, Andy Caton and Philip Johnson retire as directors in accordance with the Society's rules and the Building Societies Act 1986 and, being eligible, offer themselves for re-election. Biographical details of all directors are outlined on pages 28 to 30.

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

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

Charitable donations

In 2010 Yorkshire Building Society's Charitable Foundation donated over £470,000 to some 2,000 causes, of which 83% were suggested by members, maintaining the Foundation Trustees' desire to support causes across the UK with the assistance of member nominations. The funds were primarily raised through the 'Small Change, Big Difference™' scheme. Further details can be found in the Corporate responsibility report on pages 24 to 27.

Supplier payment policy

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

The creditor days were five days at 31st December 2010.

Auditor

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

On behalf of the board

Ed Anderson
Chairman

23rd February 2011

Risk management report

Introduction

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

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

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

"The organisation will not take risk positions that threaten its ability to remain a sustainable and independent mutual organisation. Implicit within this is an assumption that we will not take positions that might result in a loss for the members themselves, or threaten the sustainability of our market position and ability to grow."

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 reflect leading practice, whilst remaining commensurate with the Group's strategic aims, its appetite for risk and the actual risks it faces at any time. The Group Risk function provides periodic independent reports on risk positions and risk management activities for consideration by the General Managers of the business, the Group Risk Committee, its sub-committees and the board. The General Manager, Risk provides a formal update to each board meeting covering all areas of risk management, including both routine reporting and ad hoc issues.

The board recognises that risk in various forms arises naturally from the Group's provision of various financial services to members and believes that its risk management philosophy should be based on:

- an awareness of all risk exposures and potential exposures;
- the formulation and quantification of views about the probable impact and likelihood of risk crystallising; and
- the development and implementation of strategies that mitigate those risks and contain them within the risk appetite of the Group.

The Group aims to identify the major sources of risk to its assets and operations and to deploy, in response to these, appropriate measures to control and monitor those risks. To this end, the Group has developed a map of the key risks that it believes it faces, being those that, in the view of the board and senior management, represent the greatest threat to the Group's sustainability in terms of combined impact and likelihood. At an operational level, these principal risks and uncertainties can be considered in a number of categories, around which the Group has constructed its systems of monitoring and control. The individual risks, and the Group's response to them, are considered in more detail below within the context of the sub-committees of the Group Risk Committee established to oversee them under delegated authority of the board. The categories are as follows:

- credit risk – this risk arises from the Group's retail lending and wholesale investment activities and is overseen by the Group Credit Committee. It is the risk that retail borrowers or wholesale counterparties fail to repay monies due to the Group;
- market risk – the Group's balance sheet and financial position is exposed to market risk through the normal course of the Group's business. Market risk arises from balance sheet positions that are exposed to changes in interest rates or similar indices. This risk is overseen by the Group Asset and Liability Committee;

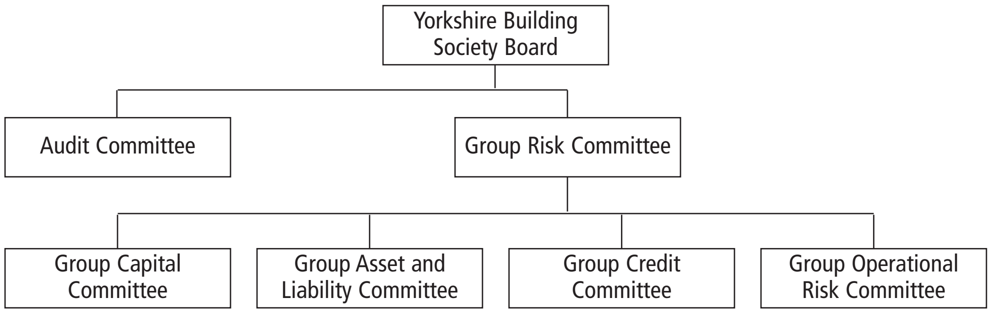
- liquidity risk – this is the risk that the Group does not hold sufficient liquidity, in terms of quantity and quality, to meet its liabilities as they fall due. This risk is overseen by the Group Asset and Liability Committee; and
- operational and regulatory risk – overseen by the Group Operational Risk Committee, this encompasses the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems, and from external events; it includes the risk of non-compliance with laws and regulation, and the risk of internal or external fraud.

The board reviews the Group Risk Map monthly. This map plots the impact and likelihood of the main individual risks faced by the Group crystallising, together with an assessment of whether each risk is outside or within the Group's risk appetite. Supporting each risk assessment is a risk dashboard that integrates all the relevant information about the risk including key risk indicators, control assessments, audit and compliance points, emerging issues, and actions being taken. The risk dashboards are updated monthly and reviewed by General Management in detail on a quarterly basis. The Group Risk Committee reviews the dashboards relating to the most significant risks on a quarterly basis.

At the end of 2010 and the beginning of 2011, the principal risks and uncertainties can be broadly summarised as follows:

- financial markets remain in a state of flux, and key credit concerns appear to have shifted from institutions to sovereign states; the Group has divested itself of its exposures to high risk countries wherever possible, and suspended limits relating to those countries. Large-scale refinancing for the market as a whole may bring new risks that are as yet unclear;
- although the UK economy is not currently in recession, the future is unclear although public sector job losses in the coming year are a certainty. The housing market may well suffer further decline and there remains uncertainty over the fiscal impacts of government policy. As a result, the Group's exposure to potential retail credit losses will persist, and must continue to be monitored, analysed and managed very intensively;
- the wholesale and retail savings markets in which the Group operates have continued to demonstrate uncertainty and volatility with access to wholesale funding sporadic and retail funding available but expensive. The way in which institutions decide to manage these conditions can bring with it reputational risks and doubts about the soundness and strength of an organisation. The Group has not been damaged in this way – but the environment does mean that we have to remain vigilant at all times, given our forthcoming wholesale funding refinance programme, to ensure that no doubt is cast on our strength and financial soundness in the eyes of our members and counterparties;
- there is further regulatory change in the offing over the next few years, not just with Basel III, the mortgage market review, and the retail distribution review, but with the regulatory regime itself where the FSA's responsibilities will be split between the Financial Policy Committee, the Prudential Regulation Authority, and the Financial Conduct Authority (FCA);
- future interest rate rises may have an adverse impact on the Group's lending book and this is the subject of close analysis and monitoring; the effect of such rises would be most evident in the variable rate book;
- on a wider level, the amount of fraud and other financial crime within the UK retail financial services markets remains high and the current economic situation is likely to increase the pressures in this area. Whilst the Group has not been directly exposed to what it considers to be the higher risk areas of the market, it nonetheless continues to maintain a strong focus on minimising the level of fraud and other financial crime to which it and its customers are exposed; and
- the merger with the Chelsea will be substantially completed during 2011; the key risks envisaged at the time of the merger have been managed successfully to date, and can be considered to have receded; the completion of full integration will allow the Group to resume business transformation activities.

Group Risk Committee (GRC)
The Group Risk Committee was established in 2006 by the board to oversee the Group's risk governance framework and to provide an entity-wide perspective on all risk matters. It comprises non-executive directors and senior executives and is chaired by a non-executive director. It is responsible for establishing appropriate risk management committees as detailed below and its broader terms of reference include establishing the Group's risk appetite, monitoring key risk indicators, setting the direction of risk management, and the improvement of the Group's risk management processes. Further details of the membership and responsibilities of the committee can be found on pages 48 and 49 of the Corporate Governance Report.



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

This includes:

- monitoring in detail the Group's overall capital position, current and forecast, including allocation of capital across activities. This includes responsibility for approving, reviewing and maintaining the central consolidated capital models used under Basel II to calculate the Group's overall capital requirements, as well as determining the future requirements and impacts of Basel III;
- reviewing the appropriateness of capital usage in the context of the risks inherent within different business lines and of the returns thereon;
- establishing target returns on capital across the Group, monitoring performance against those targets and making proposals to GRC for changes to capital usage; and
- monitoring and reviewing the development of the annual Internal Capital Assessment prior to approval of the GRC.

Capital and capital ratios are detailed in Note 30.

Group Asset and Liability Committee (GALCO)
This committee is responsible, under delegated authority of the board, for managing the Group's liquidity, market and currency risks.

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 FSA's new liquidity regime is now in place and the Group has produced its first Individual Liquidity Adequacy Assessment (ILAA) – the assessment of how much high quality liquidity the Group deems it necessary to hold. This has been reviewed by the FSA and the setting of YBS' Individual Liquidity Guidance will be received later in 2011. In the meantime, high quality buffer liquidity (government and supranational debt securities and cash) is held in excess of the FSA's Individual Liquidity Guidance for Backstop Purposes (ILG for BP). The 3-month forward projection of buffer liquidity versus the ILG for BP is reported and reviewed daily within the business. In addition, liquidity stress tests are run for the wider liquidity measure of marketable assets and cash – these are also reviewed daily. The weekly GALCO meeting reviews an extended projection of funding and liquidity against a longer-term forecast for the two measures mentioned above. All three reports are reported monthly to GALCO and to the board.

The Group continues to maintain a presence in the wholesale market and has demonstrated that it can issue successfully: a €600m covered bond issue in September 2010 was over-subscribed. In addition, a contingent convertible bond (CoCo) was issued to exchange the full outstanding principal amount of Chelsea's subordinated debt on merger; the bonds will convert into equity if the Group's core tier 1 ratio falls below 5%.

Detail of actual exposures is contained in Note 34.

Market risk

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

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

The Group's policies for the management of risks arising from movements in interest or currency exchange rates and the composition of the balance sheet provide the framework for the Group's Asset and Liability Management (ALM) and Treasury Risk Management activities. The primary purpose of the Group's ALM process is to ensure the accurate and timely identification, measurement and control of market 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 Group Risk function and both submit monthly reports to GALCO.

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

- Value at Risk provides a measure of the maximum likely loss that could be sustained over a specified time period at a stated level of confidence;
- basis point value sensitivity provides a measure of the sensitivity of the present value of the balance sheet to a one basis 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, in particular between LIBOR and other rates; and
- repricing gap analysis is used primarily for the identification of instrument repricing concentrations.

More details of these risk management measures can be found in Note 35.

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

- stress testing which is used to monitor the sensitivity of net interest income to extreme market conditions;
- Earnings at Risk which provides a measure of the potential variability in net interest income for a given business mix over a given time period at a stated level of confidence; and
- 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.

Detail of actual exposures is contained in Note 36.

Other risks

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

Group Credit Committee

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

Retail credit risk

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

The Group's mortgage lending has been conducted, and has hence been monitored and managed, within three key portfolios: two are 'prime' quality lending to borrowers with a good credit history (lent via branches, internet, or via financial intermediaries by the subsidiary company Accord Mortgages Ltd). The third portfolio is 'credit repair' lending (made via intermediaries and managed within Accord) to borrowers with poorer credit histories. As a result of the merger with Chelsea Building Society, the following books have been added to that portfolio: Chelsea Prime, Chelsea Non-Conforming Lending (akin to Accord credit repair), and Buy-to-Let. 81% of balances of the merged entity comprise prime lending, and 9% are represented by Buy-to-Let properties.

The Group is well aware of the risk disparity between the 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 Group Credit Committee. In particular the committee monitors arrears, loan-to-value ratios, expected losses and scorecard performance.

The monitoring of retail credit risk is tailored to our different loan portfolios and to the economic and housing market conditions that are in place at any given time. The current focus is strongly on the impact of the housing downturn on our borrowers' behaviour and therefore on identifying, and seeking to help, those borrowers where the exposure to such a downturn is greatest.

In accordance with the new Specialist Sourcebook for Building Societies (FSA Policy Statement 10/5), a clearer segregation of responsibilities has been implemented with Retail Credit Risk function undertaking policy setting, monitoring, and sampling the quality of underwriting.

Detail of actual retail credit exposures is contained in Note 38.

Wholesale credit risk

The Group Credit Committee also takes primary responsibility for the task of assessing and monitoring wholesale counterparty creditworthiness and conducting credit research and analysis. It does this by reviewing the Group's exposures and through setting limits to individual counterparties based on its internal ratings methodology. Limits are also set against the aggregate exposure to equally rated institutions and to all institutions based in any one country. Over the last two years, the Group has suspended a significant number of lines to other institutions, most recently to all institutions connected to Portugal, Ireland, Italy, Greece and Spain.

The investment of liquidity with institutional counterparties is however reducing. The new liquidity regime militates against anything other than the highest quality liquid assets by only permitting government or supranational debt securities and cash to be included in the liquidity buffer. It is the liquidity buffer that is measured against the individual liquidity guidance as the key regulatory metric over liquidity risk.

Prior to the financial crisis, the Group invested a limited amount of funds into higher yielding, and hence higher risk, structured credit instruments.

The events of the past three-and-a-half years have adversely impacted the value of these structured credit investments, principally through the illiquid state of the market but also, in a number of cases, through underlying credit issues. The Group's response to these events has been to further increase its levels of performance monitoring, including frequent liaison with investment managers. It has also looked at all alternatives for the future structure of individual investments and has adopted a prudent approach to their valuation and treatment within the Group's financial statements. For example, the synthetic investments have now moved to external valuation with a consequent hit to the income statement. The Group's stated wholesale credit risk appetite precludes any further investment in structured credit. Structured credit investments are currently valued at £71m. Details of all actual exposures are contained in Note 37.

The Group Credit Committee also reviews the risks related to commercial lending and loans to housing associations.

Group Operational Risk Committee

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

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

Risk management report

continued

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

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

The Group measures its operational risks based on both numerical and qualitative assessments of the risks it faces. These measures help to determine the level of control required to manage such risks within the overall risk profile of the organisation.

Risk management report

continued

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, or in the orderly and legitimate conduct of its business, by circumstances that may be reasonably foreseen. The focus is adapted to current conditions. For example, recent years have seen the development of more refined fraud and financial crime strategies and controls in response to increasing levels of such activity in the financial services market.

On behalf of the board

Lynne Charlesworth
Chairman of Group Risk Committee

23rd February 2011

Corporate governance report

In developing its approach to corporate governance, the board is mindful that:

- it is accountable to the Society's members for the conduct of the business and to ensure that it is run in the best interests of its members; and
- the effectiveness of the board is vital to the financial strength and future success of the Society.

To ensure that the board manages the Society in a prudent and effective manner and that it manages the risks that the Society faces, it is committed to complying with best practice in corporate governance.

This report provides members with information on the Society's corporate governance framework. It is based on the principles and provisions of the Combined Code 2008 (the Combined Code) issued by the Financial Reporting Council (the FRC), which applies to listed companies, to the extent that they are relevant to a building society.

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

The board considers that the Society has complied with the Building Societies Association's Guidance for Building Societies on the Combined Code throughout the year unless the contrary is stated within this report.

In May 2010 the FRC published the UK Corporate Governance Code (the New Code) which replaces the Combined Code. The New Code applies to accounting periods beginning on or after 29th June 2010. It will therefore apply to the Society (to the extent that the principles and provisions are relevant to a building society) with effect from the accounting year beginning 1st January 2011. Any changes introduced by the New Code are therefore not referred to in this report except as referred to below.

One change in the New Code which the board wishes to highlight is the requirement for the annual re-election of all directors at the Annual General Meeting (AGM) of FTSE 350 companies. Although the Society is not a FTSE 350 company, this is a provision that would apply to the Society on the basis set out above. The board has considered this provision in respect of the 2011 AGM and has agreed that this should not be brought in at that time. This will be covered in detail in the Corporate Governance Report for 2011. However, the board is 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

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

- the board held twelve board meetings in 2010. The attendance record of each director at those meetings and at relevant board committee meetings is set out on page 51;
- the non-executive directors are responsible for bringing independent judgement to board debate and decisions, and for constructively challenging the General Management team which is made up of the executive directors and other General Managers. Details of all the General Managers can be found on pages 30 and 31;
- the non-executive directors meet without the executive directors present at least twice a year;
- the board's principal role is to focus on the Group's strategy, to ensure that the necessary resources are in place for the Group to meet its objectives, and to ensure that financial and internal controls and systems of risk management are robust. In particular, its role is to provide general direction to the organisation and to safeguard the interests of members;
- the board maintains a schedule of reserved matters (which is reviewed at least annually) in order to ensure that it exercises control over the Group's affairs. These include the approval of the annual results and strategic aims of the Group as well as approval of policies and matters which must be approved by the board under legislation and the Society's Rules. The board is also responsible for the recruitment and terms of employment of the General Management team. Other matters are delegated to the General Management team or to other specified members of staff or committees, including the board committees referred to on pages 46 to 49;

- all directors have access to independent professional advice if required and have the benefit of appropriate liability insurance cover at the Society's expense; and
- the size and composition of the board is kept under constant review by the Chairman and is reviewed formally by the Nominations Committee at least annually. This is to ensure that there is adequate succession planning for executive and non-executive directors and that there is the optimum mix of skills and experience on the board for the direction of the Group's activities.

Appointments to the board and re-elections

The appointment of new directors is considered by the Nominations Committee (see page 48), which makes recommendations to the board. Under the Society's rules all directors are subject to election by members at the AGM following their appointment (or at the AGM in the following year if the director is appointed by the board in the period between the beginning of the year and the AGM). In addition, all directors must receive approval from the FSA as Approved Persons in order to fulfil their controlled function as a director.

In normal circumstances an external agency is engaged to assist in the recruitment of non-executive directors once a vacancy and the required skills and experience have been identified. Any such vacancy is advertised in national and the main local press to enable members to apply. In addition, the advertisement is made known to those members who have shown an interest in becoming a non-executive director.

During 2010 two new non-executive directors were appointed by the board, Roger Burden (appointed on 1st April 2010) and Kate Barker (appointed on 5th November 2010). These vacancies were not advertised by the board due to the specific circumstances leading to their respective appointments. Roger was appointed following the completion of the merger of Chelsea Building Society with the Yorkshire. We notified our members in the Merger Booklet (which was sent out to qualifying members at the end of 2009) that the Yorkshire board would consider the appointment of a Chelsea director, subject to the merger completing. Roger joined Chelsea Building Society's board on 1st November 2009 as a non-executive director, when merger discussions between the Yorkshire and Chelsea were already well advanced.

Kate was previously on the Society's board and stepped down part way through her term of office when she became a member of the Bank of England's Monetary Policy Committee (MPC) in 2001 until May 2010. The board was delighted to welcome Kate back onto the board when her term of office with the MPC finished.

Following the retirement of Andrew Gosling as Finance Director on 31st May 2010, Robin Churchouse was appointed as his successor with effect from 1st June 2010. Robin joined the Society in June 2004 and was previously General Manager, Risk & Planning.

All three of the above-mentioned directors will be put forward for election by members at the 2011 AGM.

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

At the 2011 AGM, members will be asked to re-elect Philip Johnson, non-executive director, Ian Bullock, Sales and Marketing Director, and Andy Caton, Corporate Development Director. The board has confirmed that the performance of these directors continues to be effective and that they continue to demonstrate the necessary commitment to their respective roles. The process to review the performance of the directors is set out on page 46.

Details of the above mentioned directors, together with those of all the other directors, are set out on pages 28 to 31.

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

Chairman and 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. The Chief Executive has overall responsibility for managing the Society and its subsidiaries and for implementing the strategies and policies agreed by the board.

Board balance and independence

As at the date of this report, the board consists of four executive directors and eight non-executive directors.

In the opinion of the board, each non-executive director, including the Chairman, is independent in character and judgement. The Vice Chairman is the Society's Senior Independent Director.

Information and professional development

The Chairman ensures that the directors receive accurate, timely and clear information to enable the board to carry out its responsibilities effectively. In December 2010 the Group Internal Audit function (GIA), together with external consultants, commenced a review of the information provided to the board to assess it against the above criteria. GIA and the consultants are due to report to the board on their findings at the end of February 2011.

The Chairman also ensures that, on appointment, non-executive directors receive a comprehensive tailored induction programme on the Group's business and regulatory environment. All non-executive directors update their skills, knowledge and familiarity with the Group through internal presentations by senior managers, relevant external and internal courses and through branch visits and attendance at member events referred to on page 50. Individual training requirements for non-executive directors are discussed during the performance evaluation process (see below). Non-executive directors are encouraged to contact individual members of the senior management team to discuss any queries that they may have.

All directors 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.

Performance evaluation

The board undertakes an annual evaluation of the performance and effectiveness of the board and the board committees together with an annual review of the performance of individual directors. Prior to 2010 these reviews have been undertaken internally. However, to comply with best practice and to ensure independence and objectivity, external consultants, Praesta Partners LLP, conducted a board effectiveness review and individual director reviews which commenced in November 2010 and were completed in January 2011. Details of the reviews are set out below.

(a) Board effectiveness

The process undertaken by Praesta included the use of questionnaires, two hour one-to-one meetings with each director and General Manager and the observation of a board meeting. The evaluation covered the following areas:

- the board's role and level of engagement in nine specific areas including strategic direction, risk strategy and financial management;
- the board's composition, structure and processes; and
- the leadership of the board including the specification of roles and responsibilities.

The evaluation process confirmed that the Society's board is highly effective and well placed on all key aspects of board performance. In particular the board's composition of skills and experience is highly rated by Praesta, as is the leadership of and the operating dynamic of the board, including its constructive and open approach with effective meetings focusing on the relevant issues. The review also confirmed the independence of the non-executive directors.

The process produced a small number of areas for consideration including a recommendation to review the management information referred to the board. This is also the subject of a separate independent review by GIA and external consultants.

In 2010 and early 2011 internal performance evaluations of the Audit Committee, the Remuneration Committee and the Group Risk Committee were carried out through the means of a questionnaire completed by all relevant committee members. The results were reviewed by the relevant committees and any appropriate improvements were identified for action.

(b) Individual evaluation

The process for the review of each of the non-executive directors' performance was based on oral feedback given to Praesta by all the other directors and General Managers. Feedback was then given to each non-executive director in a one-to-one meeting with Praesta which was then formally recorded in a personal letter. The Chairman received a copy of each non-executive director's letter and has discussed any individual development issues in subsequent one-to one meetings. The Vice Chairman received a copy of the Chairman's feedback letter and conducted the follow-up meeting with the Chairman. Kate Barker's performance was not reviewed as she only joined the board on 5th November 2010.

The process for the review of the performance of each executive director included the completion of an anonymous questionnaire on each executive director by the non-executive directors which was used as part of the annual performance appraisal by the Chief Executive whose own annual appraisal was, in turn, conducted by the Chairman. These appraisals also included assessment against pre-determined performance targets.

These procedures identify any individual and board training requirements and provide the evidence to the board as to whether to recommend to members that a director should be re-elected.

Board committees

The board has established a number of committees which have their own terms of reference. Details of the board committees are set out below. 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/committees.

The Chairman 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.

Audit Committee

The members of the committee are:

Richard Davey, Society Vice Chairman
Philip Johnson, non-executive director (committee Chairman)
David Paige, non-executive director
Simon Turner, non-executive director

All members of the committee have relevant audit committee experience and Richard Davey, Philip Johnson and David Paige have recent relevant financial experience.

The responsibilities of the committee are in line with the provisions of the FRC Guidance on Audit Committees (the "Smith Guidance"). They are in the process of being updated to ensure that they reflect the revised guidance issued in December 2010 by the FRC which will be adopted from 30th April 2011. The main function of the committee is to assist the board in fulfilling its oversight responsibilities, specifically the ongoing review, monitoring and assessment of:

- the integrity of the financial statements, any formal announcements relating to financial performance and significant financial reporting judgements contained in them;
- the effectiveness of the system of internal control processes;
- the internal and external audit processes;
- the Society's ethical and business standards;

- the appointment, re-appointment and removal of the external auditor and the periodic review of their performance and independence; and
- the policy on the use of the external auditor for non-audit work.

During 2010, the committee met five times in the execution of its responsibilities and, in particular, considered reports on the following matters which were reported on by the independent GIA function, the Group Finance function and the external auditor:

- the system of internal control. As well as regular reports from the internal and external auditors on control matters, the committee receives an annual paper from GIA which expresses their opinion on the effectiveness of the system of internal control and management's response to the observations. In light of the merger with Chelsea Building Society during the year, the committee specifically requested assurance on the effectiveness of internal controls in a number of areas including the generation of management information and maintenance of the general ledger;
- the integrity of financial statements. A detailed paper on going concern is prepared for the committee as a matter of routine by the Group Risk function. This provides an analysis of a range of potential future scenarios, considering the impact on capital, liquidity and profitability of the Group. Particular attention has been paid to the potential impact on the availability of funding in the market in general as a result of the future maturity of funding schemes provided to the financial sector by the government. In 2010 the Group published its first set of interim financial statements and obtained a formal report from the external auditor on this;
- new accounting policies and application of existing policies. In the current economic environment, particular attention has been paid to impairment provisions. Reports have been received from management and the external auditor on the appropriateness of the models used and the methodologies adopted to support the calculation of provisions. In terms of mortgage assets, the sensitivity of assumptions used on house price inflation, probability of default and emergence periods has been subject to scrutiny. The potential impairment of the Group's relatively small structured credit investment portfolio has also been considered in detail. Focus has been given in 2010 on the fair value accounting adopted for the merger with Chelsea Building Society and assurance sought from the external auditor on the calculations adopted and the appropriateness of any adjustments subsequently made;
- the activities of internal and external auditors. The committee receives regular reports from both Deloitte LLP and the GIA function and closely monitor all issues raised until they have been resolved satisfactorily by management. Both auditors have met in private session with the committee during the year. The committee appraised the resource available to internal audit in light of the merger and approved changes in headcount;
- the effectiveness of the GIA function. Effectiveness is reviewed on an annual basis by the audit function self assessing practices against published standards (including those published by the Chartered Institute of Internal Auditors) and collating performance feedback from management. This is supplemented by the committee obtaining the views of the external auditor. An independent assessment is performed every five years and is next scheduled in 2012. The review concluded that the GIA function operates effectively and exhibits many examples of leading practice;
- the performance of the external auditor. Feedback on performance was facilitated by GIA and comprised direct interviews with key stakeholders as well as questionnaires with personnel involved with the audit process. The committee is satisfied with the performance of Deloitte LLP and has recommended to the board and members that they should be re-appointed at the 2011 AGM. The committee believes that effective, independent challenge has been provided to management and the judgements made in the financial statements;
- the effectiveness of the committee. A self assessment exercise, co-ordinated by GIA, is performed each year to monitor the effectiveness of the committee. This is undertaken using questionnaires and interviews with members and attendees at committee meetings. The results are reported to the board. The 2010 review concluded that the committee has operated effectively during the year; and

- the level of non-audit fees paid to the external auditor. As noted on page 50, the committee has reviewed the level of non-audit fees paid to the external auditor throughout the year and believes that these have not impaired the independence and objectivity of Deloitte LLP.

The committee is aware of the close nature of its agenda and that of the Group Risk Committee and addresses the risk of overlap/omission through commonality of some of its members and the consideration of the minutes of meetings.

Audit Committee members are encouraged to obtain training relevant to this specific role. In Autumn 2010, a training session specifically for committee members (and also attended by the wider board) was held covering areas such as: governance developments, the regulatory landscape, accounting updates, trends in internal audit, key issues in managing liquidity and capital, and changes to the tax regime.

Chairman's Committee

The committee is made up of the Chairman, the Vice Chairman and the Chief Executive.

The committee's main function is to decide on any item that requires attention before the following board meeting except for specific issues that have to be determined by the full board.

Nominations Committee

The committee is made up of the Chairman, the Vice Chairman and the Chief Executive.

The committee is responsible for considering matters relating to the composition of the board, including nominating candidates for the position of non-executive director, taking into account the balance of skills, knowledge and experience of directors and making recommendations to the board as appropriate. It also reviews the succession planning for directors and other senior executives.

Remuneration Committee

The members of the committee (and dates of changes to the committee's membership in 2010) are:

Ed Anderson, Society Chairman
David Paige, non-executive director
Indira Thambiah, non-executive director (resigned 30th September 2010)
Simon Turner, non-executive director (committee Chairman)

The committee is responsible for considering and approving the remuneration of the executive directors and other General Managers as well as agreeing the remuneration policy for the whole organisation. Further details of the committee, the remuneration policy and directors' service contracts can be found in the Directors' remuneration report on pages 52 to 58.

Whilst the Combined Code states that the committee should set the remuneration of the Chairman, the board believes that it is more appropriate for the remuneration of the Chairman to be set and reviewed in the same manner as that used to determine the remuneration for all other non-executive directors. It is therefore dealt with by the board and not by the Remuneration Committee.

Group Risk Committee

The members of the committee (and dates of changes to the committee's membership in 2010) are:

Ed Anderson, Society Chairman
Kate Barker, non-executive director (appointed 16th December 2010)
Ian Bullock, Sales & Marketing Director (appointed 27th October 2010)
Roger Burden, non-executive director (appointed 1st April 2010)
Andy Caton, Corporate Development Director
Lynne Charlesworth, non-executive director (committee Chairman)
Robin Churchouse, Finance Director
Iain Cornish, Chief Executive
Rachel Court, General Manager, Human Resources and Customer Service
Richard Davey, Society Vice Chairman
Andrew Gosling, Finance Director (retired 31st May 2010)

Mark Jenkins, General Manager, Commercial Development (appointed 27th October 2010)
David Paige, non-executive director
Richard Wells, General Manager, Risk (appointed 29th November 2010)

The Group Risk Committee has delegated responsibility from the board for the more detailed ownership of the Group's risk appetite, risk monitoring and risk and capital management framework.

The committee's primary responsibilities are:

- oversight of the Group Risk Map and actions taken to manage key risks;
- establishing methods for measuring risk appetite and positions;
- recommending for board approval the Group risk management policies, standards and limits;
- monitoring on-going risk positions and issues, in particular for compliance with Group risk management policies, standards and limits;
- the annual review and approval of the Group's Individual Capital Adequacy Assessment on recommendation from the Group Capital Committee;
- approval of the Pillar 3 disclosure policy and annual review of Pillar 3 disclosures;
- the annual review and approval of the Group's Individual Liquidity Adequacy Assessment on recommendation from the Group Asset and Liability Committee;
- reviewing the Money Laundering Reporting Officer's annual report;
- reviewing the Group's current and proposed activities against its risk appetite and capital budgets;
- reviewing and approving the Group's compliance with the new liquidity regime;
- overseeing the scope and review of the due diligence process for major acquisitions; and
- establishing and monitoring appropriate sub-committees and associated governance structures.

The Group Risk Committee has established a number of sub-committees with day-to-day responsibility for risk management oversight. All of the sub-committees meet at least quarterly, are chaired by a senior manager with appropriate skills and are attended by a number of executive directors and General Managers as well as other senior managers and subject experts. At 31st December 2010 the sub-committees and frequency of meetings were as follows:

- Group Asset and Liability Committee – weekly;
- Group Credit Committee (comprising a retail credit committee and a wholesale credit committee) – monthly;
- Group Capital Committee – quarterly; and
- Group Operational Risk Committee – monthly.

Further details of the Group's approach to risk management can be found in the Risk management report on pages 35 to 42. During 2010 a Financial Management Committee was established to focus on key decisions surrounding growth, margin, risk appetite, capital, liquidity and overall Group profitability. This committee sits outside of the risk management structure and enables the risk sub-committees to concentrate on risk and control monitoring.

System of internal controls

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

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

The GIA function provided independent assurance to the board on the effectiveness of the internal control framework through the Audit Committee. The information received and considered by the committee provided reasonable assurance that during 2010 there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate internal control framework that met the principles of the Code and the supplementary Turnbull guidance.

Further details of actual risk management practices are provided in the Risk Management Report on pages 35 to 42.

Auditor

The Society has a policy on the use of the external auditor for non-audit work which is implemented by the Audit Committee. The purpose of this policy is to ensure the continued independence and objectivity of the external auditor. The policy sets out examples of services which the external auditor can and cannot perform. Fees for individual assignments which exceed pre-defined limits require prior notification to the Audit Committee Chairman who then decides if formal Audit Committee approval is needed. The level of fees incurred is regularly monitored. The external auditor, Deloitte LLP, undertook a number of non-audit related assignments for the Group during 2010. 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.

Deloitte LLP has received significant fees for this non-audit work in 2010. These have principally related to the merger with Chelsea Building Society, largely for due diligence services, tax structuring work and project management assistance for the integration of the business. The Audit Committee approved the appointment of Deloitte LLP for these roles and it actively monitors the scope of services provided and the level of fees incurred. The committee would normally expect due diligence services to be provided by the external auditor. The appointment for project management assistance was made following a separate competitive tender process.

Relations with members

The Society's members are made up of its investors (except deposit account holders) and borrowers. The majority of its customers are therefore its members and the Society encourages feedback from them on any aspect of the Society's activities.

This feedback takes various forms, including member 'Question Time' meetings and 'Meet the Chief Executive' events which give members the opportunity to meet and ask questions of the Chief Executive, the senior management team and local branch staff. The Members' Forum, currently made up of 18 members who are drawn from a cross section of the Society's membership, meets twice a year and the aim is to debate and obtain views on specific relevant issues.

The Society also operates a Member Panel, consisting of more than 9,500 members, who are invited to complete surveys on a variety of topical issues. In addition, a monthly customer satisfaction survey is undertaken, the results of which are a key performance indicator, which is monitored by the board on a monthly basis.

Annual General Meeting

At the AGM, the Chairman and Chief Executive give presentations on the previous financial year's performance and on future plans. The meeting also provides an opportunity for members to question the Chairman and Chief Executive 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 chairmen of all of the board committees.

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

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

Board and committee membership and attendance record 2010

Set out below are details of the directors during 2010 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 2010.

Director	Board Meetings	Board Committees: Audit	Chairman's	Nominations	Remuneration	Risk
Ed Anderson Chairman	12(12)	–	1(1)	1(1)	7(7)	6(6)
Kate Barker Non-executive director (appointed to the board 05.11.2010)	2(3)	–	–	–	–	–
Ian Bullock Sales & Marketing Director	10(12)	–	–	–	–	1(1)
Roger Burden Non-executive director (appointed to the board 01.04.2010)	7(9)	–	–	–	–	3(4)
Andy Caton Corporate Development Director	12(12)	–	–	–	–	5(6)
Lynne Charlesworth Non-executive director	12(12)	–	–	–	–	6(6)
Robin Churchouse Finance Director (appointed to the board 01.06.2010)	7(7)	–	–	–	–	3(3)
Iain Cornish Chief Executive	12(12)	–	1(1)	1(1)	–	6(6)
Richard Davey Vice Chairman	11(12)	5(5)	1(1)	1(1)	–	5(6)
Andrew Gosling Finance Director (retired as a director 31.05.2010)	5(5)	–	–	–	–	3(3)
Philip Johnson Non-executive director	10(12)	5(5)	–	–	–	–
David Paige Non-executive director	11(12)	5(5)	–	–	7(7)	6(6)
Indira Thambiah Non-executive director (resigned as a director 30.09.2010)	8(8)	–	–	–	4(4)	–
Simon Turner Non-executive director	10(12)	3(5)	–	–	7(7)	–

Notes:

In addition to the above, the written resolution procedure under the Society's Rules was used on one occasion by each of the board and the Remuneration Committee and on a further four occasions by the Chairman's Committee to conduct business.

On behalf of the board

Ed Anderson
Chairman

23rd February 2011

Directors' remuneration report

Introduction
This report:

- explains to members the policy for the remuneration of executive and non-executive directors;
- demonstrates how this policy complies with the Financial Services Authority's (FSA's) Remuneration Code, a revised version of which was implemented in December 2010;
- meets the additional requirements of the FSA's new rules regarding remuneration disclosure published in December 2010, in compliance with the Capital Requirements Directive (CRD3);
- voluntarily addresses the statutory disclosure requirements for listed companies in relation to directors' remuneration that are considered relevant to a building society; and
- includes a table showing each director's remuneration for the year ended 31st December 2010.

A summary of this report will be sent to all members eligible to vote at the 2011 Annual General Meeting and members will have the opportunity to vote on the report.

Relevant sections of this report have been audited in accordance with corporate governance best practice and legislation.

Remuneration Committee
The committee is responsible for determining, on behalf of the board, the overall remuneration policy for all staff and, in particular, the policy and the level of remuneration of the executive directors and other senior managers – in particular, those with a material impact on the Society's risk profile (known as 'Code Staff'). The full terms of reference of the committee can be found at www.ybs.co.uk/committees.

The committee normally meets five times a year with additional meetings if required. It takes independent external professional advice, as appropriate, and monitors comparative remuneration packages within the financial sector. During 2010, the committee commissioned a report from Towers Watson on the appropriateness and competitiveness of the Society's remuneration structures for senior managers and the results of this review are set out in more detail later in this report. Towers Watson also provide general salary benchmarking data to the Society and act as the Society's consultants on pension matters, as well as fulfilling the role of actuary to the Society's pension scheme.

The committee is made up of at least three non-executive directors. In 2010, they were Ed Anderson (Chairman of the Society), David Paige and Simon Turner (Chairman of the committee). Indira Thambiah resigned from the committee on 30th September 2010.

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

Remuneration policy for non-executive directors
The committee does not set the remuneration of the non-executive directors. Instead, their remuneration, including that of the Society's Chairman, is reviewed on an annual basis by the executive directors and the General Manager, Human Resources and Customer Service, using external benchmarking data.

A recommendation is made to the full board, which determines any change in the remuneration of non-executive directors, which takes effect from 1st July. In 2010, external benchmarking data provided by Hewitt New Bridge Street demonstrated that the fees paid to non-executive directors were lower than those paid by comparable organisations, and consequently, these were increased with effect from July 2010. The most significant increase was in respect of the Chairman's fee, which was found to be substantially out of line with the market.

Additional fees (details of which are given on pages 57 and 58) are paid to those non-executive directors who undertake additional duties and responsibilities, including membership of certain board committees. As a result of the increase in the Chairman's fee, he will no longer be paid additional fees for membership of board committees with effect from 1st July 2010.

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

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

The overall policy is that:

- the remuneration of executive directors and other Code Staff should comply with the FSA's Remuneration Code, with an appropriate balance being struck between financial performance and risk management;
- the remuneration of executive directors (together with that of other Code Staff) should be competitive with those of comparable organisations in the financial sector so as to attract and retain high calibre individuals with the relevant experience;
- a significant part of the remuneration of executive directors and other Code Staff should be variable based primarily on the Society's financial and service performance (in particular, customer satisfaction) and should also be based on individual performance, using pre-determined targets to motivate and reward success in the interests of current and future members. However, the proportion of variable pay is limited, to ensure that it is feasible for no bonus to be paid in years where business performance does not merit this;
- personal reviews of the executive directors and other Code Staff are carried out at least annually to assess their performance in meeting individual and strategic objectives. These reviews are reflected in pay reviews which take effect from 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; and
- no executive director or member of Code Staff is involved in deciding his or her own remuneration.

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

(a) Basic salary

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

The committee considers external data from independent national salary surveys of the financial sector and a comparator group of financial institutions to ensure salaries remain competitive. Independent reward specialists carry out an overall review of remuneration, generally once every three years. A recent review was undertaken in 2010 by Towers Watson. This review concluded that although salary arrangements for senior managers were broadly market competitive, total remuneration was lower due to the absence of any long-term incentive plans and that the roles of the executive directors (and other General Managers) were broader in scope than equivalent roles looked at in the comparator data. Futhermore, it found that a number of senior roles had increased in scale and complexity in 2010 following the completion of the merger with the Chelsea Building Society and as a result of that finding, increases in basic salary beyond the standard annual settlement were awarded in these cases – in particular to the Chief Executive, whose basic pay was found to be significantly below the market median for organisations of a similar scale and complexity. Increases in basic pay for other executive directors were awarded based on the Remuneration Committee's view of their broader accountabilities and of the marked increase in the scale and complexity of their roles following the merger. This view was clearly reinforced by external recruitment at senior level conducted during the course of the year. These increases were also felt to be appropriate given the observations made by Towers Watson noted below regarding the shortfall in variable pay.

(b) Variable pay

In 2010, the executive directors and other Code Staff participated in a non-pensionable performance incentive scheme, the elements of which reflected the Society's key measures of retail savings flow, gross mortgage lending, cost control, pre-tax profit and customer satisfaction. A scheme with similar characteristics is in place for all other staff. The scheme also contained threshold conditions regarding sustainable levels of capital and liquidity. In addition, executive directors (together with other Code Staff) had an element of their performance pay based on the achievement of personal objectives.

These measures were all set to provide challenging objectives, giving the executive directors an incentive to perform at the highest level in a manner consistent with the interests of members. The bonuses generated under the 2010 scheme reflect the strong overall financial performance of the Society in the year.

There was no minimum amount of variable pay and the maximum amount in the 2010 scheme, as a percentage of basic salary, was 65% for executive directors and general managers, 90% for the Chief Executive and up to 45% for other Code Staff.

As part of their review of senior management remuneration, Towers Watson noted that variable pay opportunity within the Society is generally lagging the financial services market as a whole, although it is broadly competitive against other building societies. This reflects the fact that the Society does not operate an additional long-term incentive plan. Nevertheless, the committee decided not to increase the earning potential for variable pay for 2011 by either increasing the 'on target' or maximum payments in the scheme for 2011, or by introducing a standalone long-term incentive scheme on top of the current annual scheme, since it believes that the current absolute amounts of and ratio between basic and variable pay achieve the optimum balance between incentivising financial performance and managing risk, as well as being in line with both the letter and spirit of regulation.

Instead, as explained in last year's Directors' Remuneration Report, in order to meet the Society's desire to reward performance over a longer time period, as well as to comply with the requirements of the FSA Remuneration Code, deferral was introduced into the annual incentive schemes for 2010 for executive directors and certain senior managers. For executive directors 60% of the total 2010 bonus payment will be deferred over a 3-year period. The undeferred amount is generally payable in March 2011 and is set out in the table on page 55. For executive directors and general managers the amount payable in 2010 will be in two instalments, 50% to be paid in March 2011 and the remaining 50% held in escrow by the Society until September 2011. The deferred amount is divided into three equal instalments, with payments to be made in March 2012, March 2013 and March 2014 respectively. These deferred payments are, however, conditional upon the achievement of future profit targets and risk thresholds in each of the subsequent years in question, as well as upon satisfactory individual performance. They may be reduced or withheld entirely if future performance does not meet the required standards. The risk thresholds are based on achievement of the Society's required levels of capital and liquidity under the relevant FSA processes for determining these, which take account of all the categories of risk to which the Society is exposed.

The FSA's Remuneration Code as revised in December 2010 now requires 50% of all variable pay (both undeferred and deferred) to be paid in shares or share equivalent instruments. As a mutual organisation, the Society does not have the facility to make payments in this way at present, since no such share equivalent instrument currently exists. Consequently, the undeferred element of the 2010 bonus payment will be paid entirely in cash in March 2011, as permitted by the transitional provisions of the FSA Code. The Society will work with the FSA over the course of the next 12 months to determine how the Society can comply with this requirement for payments made from 2012 onwards.

In summary, the Remuneration Committee can confirm that 2010 bonuses for executive directors and other Code Staff meet with the requirements of the FSA's Remuneration Code, and consider that they represent an appropriate and proportionate reward in relation to the Society's overall 2010 performance. The committee will continue to review the operation of the performance pay scheme in light of emerging best practice, taking into account the performance of the Society as a whole and the interests of members.

(c) Benefits

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

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

The executive directors are either members of the contributory defined benefit section or the defined contribution section of the Society's pension scheme. With effect from 1st April 2010, in keeping with changes made to the defined benefit section of the Society's pension scheme for all staff, future accrual for participating executive directors was changed to be on a career average revalued earnings basis rather than on a final salary basis.

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

Similar benefit structures exist for other Code Staff.

(d) Service contracts

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

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

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

Aggregate remuneration data

The Prudential Sourcebook for Banks, Building Societies and Investment Firms (Remuneration Disclosures) Instrument 2010 now requires the publication of aggregate remuneration data for the Society as a whole, and in summary form for senior managers and members of staff whose actions have a material impact on the risk profile of the firm (Code Staff). The total fixed pay to employees in 2010 was £68.4m, total undeferred variable pay was £8.6m. Details of remuneration paid to Code Staff are as follows:

Fixed and variable pay

	Fixed Pay £000	Variable pay (undeferred) £000	Proportion of variable pay as cash %	Deferred from previous years paid in 2010 £000	Outstanding deferred variable pay[2] £000	Number of beneficiaries
Code Staff[1]	**4,065**	**914**	**100**	**–**	**1,062**	**38**

Sign on and severance payments

	Sign on payments payments[3] £000	Number of beneficiaries	Severance payments £000	Number of beneficiaries	Highest individual severance payment £000
Code Staff[1]	**156**	**1**	**196**	**2**	**121**

Notes

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

[2] Outstanding deferred variable pay is 100% unvested and subject to future performance conditions.

[3] Paid to attract a key senior manager who lost substantial deferred bonus elements from a previous employer on joining the Society. The amount disclosed is the full amount although 60% has been deferred in line with the approach taken for senior management bonuses.

Directors' remuneration report

continued

Executive directors' remuneration

	Salary £000	Performance pay[1] £000	Taxable benefits[3] £000	Increase in accrued pension[4] £000	Society's contribution to pension scheme[5] £000	Total £000
Executive directors						
2010						
Ian Bullock	**245**	**64**	**11**	**–**	**39**	**359**
Andy Caton	**251**	**58**	**–**	**10**	**–**	**319**
Robin Churchouse (appointed 01.06.2010)	**157**	**39**	**–**	**–**	**24**	**220**
Iain Cornish	**378[2]**	**132[2]**	**15**	**–**	**36**	**561**
Andrew Gosling (retired 31.05.2010)	**105**	**25**	**–**	**8**	**–**	**138**
	1,136	**318**	**26**	**18**	**99**	**1,597**
2009						
Ian Bullock	221	56	11	–	35	323
Andy Caton	230	46	–	6	–	282
Iain Cornish	327	–	15	13	–	355
Andrew Gosling	250	51	–	10	–	311
	1,028	153	26	29	35	1,271

Notes

[1] 2010 figures are the undeferred elements only which are due for payment in 2011 – of this 50% will be paid in March 2011 and 50% held in escrow until September 2011.

[2] Iain Cornish donated his net performance pay for 2010 and also the net increase in his basic salary to the Society's Charitable Foundation.

[3] Mainly relates to the provision of company car. Executive Directors not in receipt of a company car receive a cash allowance instead, and this is included under Salary.

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

[5] Defined contribution section. The defined contribution section and the defined benefit section of the YBS pension scheme were converted to salary sacrifice during 2010. The employer contributions above do not reflect the increase in employer contributions following the salary sacrifice conversion as this is shown as part of the basic salary.

Directors' remuneration report

continued

Executive directors' pension benefits (defined benefit section) in 2010

	Contributions from directors[1] £000	Increase in accrued pension £000	Accrued pension as at 31st December 2010 £000	Transfer value of accrued benefits as at[2] 1st January 2010 £000	Transfer value of accrued benefits as at[2] 31st December 2010 £000	Movement in transfer value less directors' contributions £000
Andy Caton	**4**	**10**	**90**	**1,081**	**1,415**	**330**
Iain Cornish	**–**	**–**	**190**	**2,820**	**3,294**	**474**[3]
Andrew Gosling (retired 31.05.2010)	**5**	**8**	**78**	**1,392**	**1,808**	**411**
	9	**18**	**358**	**5,293**	**6,517**	**1,215**

Notes

[1] With effect from 1st April 2010, pension contributions formerly made by members of Yorkshire Building Society Pension Scheme are now made on their behalf by the Society, with members instead sacrificing the equivalent amount of their salary. The contributions shown above are up to 31st March 2010. In addition, the directors effectively made the following contributions via salary sacrifice: Andrew Gosling: £13,000; Andy Caton: £15,000.

[2] In light of changes in market conditions and actuarial advice, the Trustees of the Yorkshire Building Society Pension Scheme reviewed and amended the basis for the calculation of cash equivalent transfer values from March 2010. This has resulted in an increase in transfer values. For comparison, transfer values at 31st December 2009 recalculated on the new basis were: Iain Cornish: £3,091,000; Andrew Gosling: £1,447,000; Andy Caton: £1,202,000.

[3] Iain Cornish is an active member of the defined contribution section of the pension scheme. The figures shown above represent only the value of his deferred entitlement as a former member of the defined benefit section, with no additional contributions being paid during 2010.

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

Non-executive directors' fees

	Committee fees (notes 1 and 2)		Basic fees		Total	
	2010 £000	2009 £000	**2010 £000**	2009 £000	**2010 £000**	2009 £000
Ed Anderson (Chairman)	**5***	9	**104**	77	**109**	86
Kate Barker (appointed 05.11.2010)	**–**	–	**7**	–	**7**	–
Roger Burden (appointed 01.04.2010)	**5**	–	**30**	–	**35**	–
Lynne Charlesworth	**21**	16	**40**	37	**61**	53
Richard Davey (Vice Chairman)	**13**	12	**55**	50	**68**	62
Philip Johnson	**15**	14	**40**	37	**55**	51
David Paige	**16**	16	**40**	37	**56**	53
Indira Thambiah (resigned 30.09.2010)	**3**	2	**28**	37	**31**	39
Simon Turner	**13**	12	**40**	37	**53**	49
	91	81	**384**	312	**475**	393

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

Directors' remuneration report

continued

Notes:

1. 2010 committee fees for non-executive directors consist of:
   - member of the Audit Committee – £7,000 per annum (£6,000 per annum up to 30th June 2010);
   - member of the Group Risk Committee – £7,000 per annum (£6,000 per annum up to 30th June 2010);
   - member of the Remuneration Committee – £4,500 per annum (£3,500 per annum up to 30th June 2010);
   - Chair of the Audit Committee – £17,000 per annum (£13,500 per annum up to 30th June 2010);
   - Chair of the Group Risk Committee – £17,000 per annum (£13,500 per annum up to 30th June 2010);
   - Chair of the Remuneration Committee – £7,000 per annum (£6,000 per annum up to 30th June 2010); and
   - 'Treating Customers Fairly' oversight role – £7,000 per annum (£6,000 per annum up to 30th June 2010).
2. Membership of these committees is set out in the Corporate Governance Report on pages 43 to 51. Significant changes in 2010 were:
   - Roger Burden became a member of the Group Risk Committee on 1st April 2010;
   - Indira Thambiah resigned from the Remuneration Committee on 30th September 2010; and
   - Kate Barker became a member of the Group Risk Committee on 16th December 2010.

On behalf of the board

Simon Turner
Chairman of the Remuneration Committee

23rd February 2011

Statement of directors' responsibilities

The following statement, which should be read in conjunction with the statement of the Auditor's responsibilities on page 60, 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 these 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; and
- 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.

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; and
- take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000.

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

On behalf of the board

Ed Anderson
Chairman

23rd February 2011

Independent auditor's report

to the members of Yorkshire Building Society

We have audited the Group and Society financial statements of Yorkshire Building Society for the year ended 31st December 2010 which comprise the Group and Society Income statements, the Group and Society Statements of comprehensive income, the Group and Society Statements of financial position, the Group and Society Statements of changes in members' interests, the Group and Society Statements of cash flows and the related notes 1 to 42. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31st December 2010 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.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Building Societies Act 1986 requires us to report to you if, in our opinion:

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

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

23rd February 2011

Income statements

for the year ended 31st December 2010

	NOTES	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Interest receivable and similar income	3	**1,310.7**	1,050.8	**1,248.0**	993.1
Interest payable and similar charges	4	**(1,038.0)**	(903.0)	**(1,081.8)**	(958.8)
Net interest income		**272.7**	147.8	**166.2**	34.3
Fees and commissions receivable		**46.2**	33.9	**43.2**	31.2
Fees and commissions payable		**(9.0)**	(7.8)	**(8.6)**	(7.7)
Net fee and commission income		**37.2**	26.1	**34.6**	23.5
Income from investments in subsidiaries	10	**–**	–	**1.0**	133.0
Net (losses)/gains from fair value volatility on financial instruments	5	**(10.5)**	(10.3)	**(11.4)**	3.9
Net realised profits	6	**15.2**	11.5	**15.2**	10.8
Other operating income		**6.2**	4.6	**16.7**	16.8
Total income		**320.8**	179.7	**222.3**	222.3
Administrative expenses	7	**(147.8)**	(113.7)	**(147.6)**	(113.1)
Chelsea Building Society merger costs	7	**(10.4)**	(6.7)	**(10.4)**	(6.7)
Depreciation and amortisation		**(14.8)**	(10.6)	**(14.3)**	(10.0)
Operating profit before provisions		**147.8**	48.7	**50.0**	92.5
Impairment of loans and advances to customers	9	**(40.8)**	(59.0)	**(3.3)**	(7.0)
Impairment of debt securities	9	**(5.1)**	(0.9)	**(5.1)**	(0.9)
Provisions	27	**–**	1.4	**–**	1.4
Operating profit/(loss) before exceptional provisions		**101.9**	(9.8)	**41.6**	86.0
Financial Services Compensation Scheme levy	27	**(3.6)**	(2.7)	**(3.6)**	(2.7)
Operating profit/(loss)		**98.3**	(12.5)	**38.0**	83.3
Negative goodwill	42	**17.1**	–	**17.1**	–
Profit/(loss) before tax		**115.4**	(12.5)	**55.1**	83.3
Tax (expense)/credit	11	**(23.6)**	9.2	**(7.2)**	(16.6)
Net profit/(loss)		**91.8**	(3.3)	**47.9**	66.7

Net profit/(loss) arises from continuing operations and is attributable to members.

The notes on pages 66 to 109 form part of these accounts.

Statements of comprehensive income

for the year ended 31st December 2010

	NOTES	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Available for sale investments:					
Valuation gains taken to equity		**2.4**	46.9	**2.3**	46.7
Amounts transferred to income statement		**1.2**	(3.0)	**1.2**	(0.4)
Cash flow hedges:					
(Losses)/gains taken to equity		**(1.9)**	3.5	**(1.9)**	3.5
Amounts transferred to income statement		**7.2**	(9.9)	**7.2**	(9.9)
Actuarial gain/(loss) on retirement benefit obligations	25	**4.8**	(50.4)	**4.8**	(50.4)
Tax on items taken directly to or transferred from equity	11	**(7.6)**	6.7	**(7.6)**	6.1
Net income/(expense) not recognised directly in the income statement		**6.1**	(6.2)	**6.0**	(4.4)
Net profit/(loss)		**91.8**	(3.3)	**47.9**	66.7
Total comprehensive income/(losses) for the year		**97.9**	(9.5)	**53.9**	62.3

The notes on pages 66 to 109 form part of these accounts.

Statements of financial position

as at 31st December 2010

ASSETS	NOTES	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Liquid assets					
Cash in hand and balances with the Bank of England	12	**1,310.8**	1,149.8	**1,310.8**	1,149.8
Loans and advances to credit institutions	13	**935.8**	988.4	**725.4**	570.3
Debt securities	14	**3,615.2**	4,562.2	**3,506.6**	4,454.4
Loans and advances to customers					
Loans secured on residential property	15	**23,296.6**	14,975.4	**16,509.7**	8,840.3
Other loans	15	**74.1**	4.0	**74.1**	4.0
Derivative financial instruments	33	**579.8**	904.5	**297.8**	149.3
Investments	10	**2.1**	2.1	**10,488.1**	9,876.3
Intangible assets	16	**20.4**	10.6	**20.1**	10.2
Investment properties	17	**18.7**	6.7	**18.5**	6.5
Property, plant and equipment	18	**107.3**	80.6	**89.1**	62.1
Deferred tax assets	19	**107.8**	30.2	**96.4**	30.2
Other assets	20	**17.7**	7.5	**50.2**	40.3
Total assets		**30,086.3**	22,722.0	**33,186.8**	25,193.7
LIABILITIES					
Shares	21	**21,382.5**	13,793.4	**21,382.5**	13,793.4
Amounts owed to credit institutions	22	**926.4**	393.4	**1,716.8**	866.0
Other deposits	23	**1,061.9**	1,091.0	**3,562.6**	3,239.9
Debt securities in issue	24	**4,348.4**	5,698.7	**4,348.4**	5,698.7
Derivative financial instruments	33	**472.3**	468.1	**472.3**	468.1
Current tax liabilities		**22.6**	34.5	**8.7**	23.9
Deferred tax liabilities	19	**13.7**	4.8	**9.1**	3.5
Retirement benefit obligations	25	**14.2**	4.3	**14.2**	4.3
Other liabilities	26	**74.2**	50.4	**71.6**	48.5
Provisions	27	**50.4**	12.6	**50.4**	12.5
Subordinated liabilities	28	**214.9**	111.7	**214.9**	111.7
Subscribed capital	29	**167.3**	159.3	**167.3**	159.3
		28,748.8	21,822.2	**32,018.8**	24,429.8
Total equity attributable to members		**1,337.5**	899.8	**1,168.0**	763.9
Total liabilities		**30,086.3**	22,722.0	**33,186.8**	25,193.7

The accounts on pages 61 to 109 were approved by the board of directors on 23rd February 2011 and were signed on its behalf by:

Ed Anderson	Chairman
Richard Davey	Vice Chairman
Iain Cornish	Chief Executive

The notes on pages 66 to 109 form part of these accounts.

Statements of changes in members' interest

for the year ended 31st December 2010

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Group				
At 1st January 2010	**975.6**	**(36.0)**	**(39.8)**	**899.8**
Transfer of engagements*	**339.8**	**–**	**–**	**339.8**
Current year movement net of tax	**92.7**	**3.4**	**1.8**	**97.9**
At 31st December 2010	**1,408.1**	**(32.6)**	**(38.0)**	**1,337.5**
At 1st January 2009	1,042.3	(43.6)	(89.4)	909.3
Reallocation of tax**	(27.2)	–	27.2	–
Current year movement net of tax	(39.5)	7.6	22.4	(9.5)
At 31st December 2009	975.6	(36.0)	(39.8)	899.8

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Society				
At 1st January 2010	**839.8**	**(36.0)**	**(39.9)**	**763.9**
Transfer of engagements*	**350.2**	**–**	**–**	**350.2**
Current year movement net of tax	**48.8**	**3.4**	**1.7**	**53.9**
At 31st December 2010	**1,238.8**	**(32.6)**	**(38.2)**	**1,168.0**
At 1st January 2009	837.0	(43.6)	(91.8)	701.6
Reallocation of tax**	(27.8)	–	27.8	–
Current year movement net of tax	30.6	7.6	24.1	62.3
At 31st December 2009	839.8	(36.0)	(39.9)	763.9

* Merger with Chelsea Building Society, see Note 42.

** Taxation relating to the Available for sale reserve was reallocated to match the underlying transactions.

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 66 to 109 form part of these accounts.

Statements of cash flows

for the year ended 31st December 2010

	NOTES	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Cash flows from operating activities:					
Profit/(loss) before tax		**115.4**	(12.5)	**55.1**	83.3
Working capital adjustments	41	**52.7**	46.2	**121.7**	(10.5)
Net decrease in operating assets	41	**1,008.1**	1,050.4	**650.6**	1,239.1
Net decrease in operating liabilities	41	**(3,293.2)**	(1,257.8)	**(2,648.3)**	(1,619.7)
Net cash flows from operating activities		**(2,117.0)**	(173.7)	**(1,820.9)**	(307.8)
Cash flows from investing activities:					
Cash acquired on transfer of engagements		**1,227.4**	–	**1,127.4**	–
Purchase of property, plant and equipment and intangible assets		**(7.7)**	(10.8)	**(7.5)**	(10.6)
Proceeds from sale of property, plant and equipment		**0.2**	–	**0.2**	–
Purchase of debt securities		**(4,270.2)**	(10,293.7)	**(3,958.3)**	(9,777.2)
Proceeds from sale and redemption of debt securities		**6,881.7**	9,807.8	**6,561.1**	9,040.3
Net cash flows from investing activities		**3,831.4**	(496.7)	**3,722.9**	(747.5)
Cash flows from financing activities:					
Redemption of securities		**(2,278.6)**	(1,425.2)	**(2,278.6)**	(1,425.2)
Issue of securities		**723.7**	2,961.5	**723.7**	2,961.5
Interest paid on subordinated liabilities and subscribed capital		**(26.5)**	(16.2)	**(26.5)**	(16.2)
Net cash flows from financing activities		**(1,581.4)**	1,520.1	**(1,581.4)**	1,520.1
Taxation paid		**(20.9)**	(13.3)	**(10.2)**	(7.5)
Net increase in cash and cash equivalents		**112.1**	836.4	**310.4**	457.3
Opening balance		**2,223.6**	1,387.2	**1,706.3**	1,249.0
Total closing cash and cash equivalents		**2,335.7**	2,223.6	**2,016.7**	1,706.3
Cash and cash equivalents:					
Cash and balances with central banks		**1,285.8**	1,132.0	**1,285.8**	1,132.0
Loans and advances to banks	13	**935.8**	988.4	**725.4**	570.3
Debt securities		**114.1**	103.2	**5.5**	4.0
		2,335.7	2,223.6	**2,016.7**	1,706.3

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 comprises cash and other financial instruments with original maturities of less than three months.

The notes on pages 66 to 109 form part of these accounts.

Notes to the accounts

INTRODUCTION

Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) in issue that have been endorsed by the EU and are effective at 31st December 2010 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 32, under the heading, 'Principal risks, uncertainties and going concern'.

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

Accounting Developments

The following Accounting Standard amendments have been applied in 2010:

- 'IFRS 3 Business Combinations (Revised)' was endorsed by the EU in 2009. Its principles and methodology were applied when accounting for the transfer of engagements of Chelsea Building Society in 2010;
- amendments to 'IFRS 7 Financial Instruments Disclosures' extend the scope of IFRS 7 disclosures but does not change the recognition or measurement of transactions in the financial statements;
- amendments to IFRIC 9 and IAS 39 relating to the timing of recognition of embedded derivatives. The adoption of these amendments did not have a material impact on the financial statements; and
- 'Improvements to IFRSs' (April 2009): this pronouncement includes several small amendments which have had no material impact upon the financial statements.

The following Standards which have not been applied in these financial statements were in issue but not yet effective for the 2010 year end:

- amendments to 'IAS 32 Classification of Rights Issues': this amendment is not expected to have any impact on the financial statements;
- amendments to 'IFRIC 14 Prepayments of a Minimum Funding Requirement': the application of this amendment is not expected to have a material impact on the financial statements;
- 'IAS 24 Related Party Disclosures' (Revised): the application of this revised Standard is not expected to have a material impact on the financial statements; and
- 'IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments': this Standard is not expected to have a material impact on the financial statements

The following Standards have not been adopted by the European Union and hence have not been applied:

- The following amendments were made as part of 'Improvements to IFRSs (May 2010)': the amendments to 'IFRS 7 Financial Instruments: Disclosures' includes amendments to quantitative and credit risk disclosures. The overall amendments are intended to simplify the disclosures provided, especially by reducing disclosure requirements around collateral held and removing the requirement to specifically disclose financial assets renegotiated to avoid becoming past due or impaired. The application of this amendment is therefore expected to have a minor impact on the financial statements. The pronouncement includes several other small amendments which are not expected to have a material impact on the financial statements.

The following Standard is neither adopted by the European Union nor effective for the 2010 year end:

- 'IFRS 9 Financial Instruments' was issued in November 2009 and is effective for periods commencing on or after 1st January 2013. This Standard is concerned with the classification of financial assets and it is expected that its application will have a significant impact on the Group's financial statements because certain financial assets currently classified as held as available for sale may have to be reclassified as held at fair value, whereas some others will be reclassified as held at amortised book value.

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.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

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

Derivative financial instruments and hedge accounting

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

Embedded derivatives
Certain derivatives are embedded in other financial instruments. These are treated as separate derivatives where the economic characteristics and risks are not closely related to the host instrument and the host instrument is not measured at fair value. These embedded derivatives are measured at fair value with movements in value being recognised in the income statement. Where the Group is unable to value separately the embedded derivative 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 33. Hedge accounting is an optional treatment but the specific rules and conditions in IAS 39 have to be complied with before it can be applied. The Group has classified the majority of its derivatives as fair value and cash flow hedges in order to reduce volatility in the income statement.

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

Cash flow hedges
Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity and recycled to the income statement over the life of the forecasted 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. All other loans and advances are grouped according to their credit characteristics, and a collective review undertaken of any evidence of impairment. Future cash flows are estimated on grouped credit characteristics in all cases.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

Impairment losses on debt instruments

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

- significant financial difficulties of the issuer or obligor;
- any breach of contract or covenants;
- the granting of any concession or rearrangement of terms;
- the disappearance of an active market;
- any significant downgrade of ratings; and
- 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.

Business combinations between mutual organisations

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

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

Cash and cash equivalents

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

The statements of cash flows have been prepared using the indirect method.

Financial assets

The Group classifies its financial assets into the following categories:

Loans and receivables

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

Financial assets at fair value through the income statement

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

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Held to maturity

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

Available for sale financial assets

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

Financial liabilities

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

Joint ventures

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

Investment properties, property, plant and equipment

Investment properties

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

Property, plant and equipment

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

Subsequent costs

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

Depreciation

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

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

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

Intangible assets

Computer Software

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

Goodwill

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

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

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Other intangibles
Other intangibles, which largely represents 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.

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

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

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

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

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

The following temporary differences are not provided for:

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

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

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

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

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

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

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

Note 42 sets out the adjustments made in relation to the merger with Chelsea Building Society.

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

The fair value adjustment in relation to mortgage loans takes account of the differential between market and product interest rates as well as the level of credit risk. The principal area of uncertainty relates to the level of future losses that are expected to arise. A 10% increase in the overall level of expected losses would result in a £19m additional reduction in the fair value ascribed at the date of the merger – and vice versa.

Impairment of mortgage assets
The creation of impairment provisions for a portfolio of mortgage loans is inherently uncertain and requires the exercise of a significant degree of judgement. Provisions are calculated using historic default and loss experience but require judgement to be exercised in predicting future economic conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time before impairments are identified (emergence period). The most critical estimate is of the future level of house prices where a variance of 10% equates to £4.5m of provision. Other sensitivities include the emergence period, where a variance of three months equates to £13.6m, and the loss given default rate, where a 10% variance equates to £10.2m of provision.

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

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

Financial Services Compensation Scheme (FSCS)
The amount provided is the latest estimate of the contribution required for the three years to 31st March 2012 as advised by the FSCS. The Society is aware that further fees and exit fees are likely but has not made any provision for them as they cannot be reliably estimated. More detail of the FSCS and the Society's provision, including the fair value adjustments made as a result of the merger with Chelsea Building Society, are contained in Note 27.

Regulatory and other provisions
Note 27 provides details of Regulatory and other provisions which includes amounts provided in relation to customer redress claims totalling £6.5m. This has been calculated using information relating to claims received to date including uphold rates, the average amount of compensation paid and estimates of the population of potential future claims.

Pensions
The Group operates a defined benefit pension scheme. 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 25. The impact of a 0.1% increase in the rate used to discount the future value of the liabilities would be to reduce the present value of the liabilities by £9.6m. 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 £12.5m.

Notes to the accounts

continued

3. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
On assets held at amortised cost				
Loans fully secured on residential property	**1,006.0**	802.1	**644.0**	426.0
Connected undertakings	**–**	–	**366.1**	400.3
Other loans	**4.0**	0.3	**4.0**	0.3
Other liquid assets/cash and short-term funds	**11.6**	5.9	**10.5**	5.7
On available for sale securities	**47.1**	68.4	**46.4**	62.8
On held to maturity securities	**10.3**	12.5	**10.3**	12.5
On financial instruments held at fair value through the income statement				
Derivatives	**230.4**	159.3	**165.4**	83.2
Other assets	**1.3**	2.3	**1.3**	2.3
Total interest receivable	**1,310.7**	1,050.8	**1,248.0**	993.1

Included within interest receivable and similar income is interest earned on impaired loans: Group £37.2m, Society £15.6m (2009 – Group £24.8m, Society £2.4m), which, once included in the mortgage balance, is considered within the impairment calculation.

4. INTEREST PAYABLE AND SIMILAR CHARGES

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
On liabilities held at amortised cost				
Shares held by individuals	**475.0**	346.6	**475.0**	346.6
Deposits from banks	**3.3**	5.1	**3.3**	5.1
Deposits from other financial institutions	**0.7**	5.0	**0.7**	5.0
Deposits from connected undertakings	**–**	–	**36.4**	27.1
Other deposits	**21.4**	34.2	**2.9**	11.4
Certificates of deposit	**1.1**	7.1	**1.1**	7.1
Other debt securities	**157.5**	152.9	**157.5**	152.9
Subordinated liabilities	**17.9**	7.6	**17.9**	7.6
Subscribed capital	**8.6**	8.6	**8.6**	8.6
Other interest payable	**1.0**	0.8	**1.0**	0.7
On financial instruments held at fair value through the income statement				
Deposits from connected undertakings	**–**	–	**25.9**	51.6
Derivatives	**351.5**	335.1	**351.5**	335.1
Total interest payable	**1,038.0**	903.0	**1,081.8**	958.8

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

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Assets held at fair value	**1.1**	3.3	**1.1**	3.3
Embedded derivatives	**(5.9)**	4.5	**(5.9)**	4.5
Derivatives and hedging	**(5.7)**	(18.1)	**(6.6)**	(3.9)
Net (losses)/gains from fair value volatility on financial instruments	**(10.5)**	(10.3)	**(11.4)**	3.9

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. During the year the method of valuing these synthetic investments has been amended. Since the dislocation in the markets at the height of the financial crisis, and the associated unavailability of any external prices, an internal pricing model has been used that was based on externally verifiable market factors such as credit spreads and defaults in underlying instruments. However, as more stable market prices have returned during 2010, for the first time since 2008, the Group has reverted to an external pricing basis. Moving the valuation of all embedded derivatives back to external prices resulted in a fair value loss of £7.6m. For the majority of other instruments where an internal model is used, external prices are available and the difference is monitored to identify any material differences.

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

6. NET REALISED PROFITS

Net realised profits arose on debt securities.

7. ADMINISTRATIVE EXPENSES

	Group		Society	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Staff costs				
Salaries and wages	**80.5**	60.1	**79.7**	59.4
Social security costs	**7.8**	5.9	**7.7**	5.8
Pension costs – defined benefit plans	**2.4**	3.6	**2.4**	3.6
Pension costs – defined contribution plans	**2.5**	2.2	**2.5**	2.1
Other staff costs	**4.6**	2.1	**4.6**	2.1
Operating lease rentals	**6.4**	5.0	**8.7**	7.4
Other expenses	**54.0**	41.5	**52.4**	39.4
	158.2	120.4	**158.0**	119.8
Less: Chelsea Building Society merger costs	**(10.4)**	(6.7)	**(10.4)**	(6.7)
	147.8	113.7	**147.6**	113.1

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

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

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

Remuneration of the auditor and their associates	Group		Society	
	2010	2009	**2010**	2009
	£000	£000	**£000**	£000
Audit	**287**	162	**235**	115
Review of Interim Group Accounts	**70**	–	**70**	–
Tax advice	**39**	128	**39**	128
Information technology	**25**	26	**–**	–
Merger related costs – due diligence	**–**	460	**–**	460
Merger related costs – integration	**684**	423	**684**	423
All other services	**92**	25	**84**	20
	1,197	1,224	**1,112**	1,146

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 Corporate governance report on page 50.

Staff numbers

The average number of persons employed by the Group during the year (including executive directors) was as follows:	2010		2009	
	Full time	**Part time**	Full time	Part time
Building Society				
Central administration	**1,425**	**356**	1,086	295
Branches	**828**	**298**	710	272
Subsidiaries' offices	**14**	**1**	15	1
	2,267	**655**	1,811	568

Notes to the accounts

continued

8. REMUNERATION OF AND TRANSACTIONS WITH DIRECTORS

Total directors' remuneration amounted to £2,072,000 (2009 – £1,664,000).

Full details of directors' remuneration, bonuses and pensions are given in the Directors' remuneration report on pages 52 to 58. In addition, past directors' pensions in respect of services as directors (closed scheme) amounted to £31,000 (2009 – £41,000).

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 40.

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 2010 will be available for inspection at the Head Office for a period of fifteen days up to and including the Annual General Meeting.

9. IMPAIRMENT

Loans and advances to customers	**Group**		**Society**	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
At 1st January				
Collective	**3.7**	5.8	**0.1**	0.2
Individual	**47.0**	35.6	**2.1**	0.5
	50.7	41.4	**2.2**	0.7
Amounts written off during the year				
Collective	**–**	(0.1)	**–**	–
Individual	**(33.8)**	(49.6)	**(2.3)**	(5.5)
	(33.8)	(49.7)	**(2.3)**	(5.5)
Impairment adjustment for the year				
Collective	**0.8**	(2.0)	**0.1**	(0.1)
Individual	**40.8**	61.0	**3.2**	7.1
	41.6	59.0	**3.3**	7.0
At 31st December				
Collective	**4.5**	3.7	**0.2**	0.1
Individual	**54.0**	47.0	**3.0**	2.1
	58.5	50.7	**3.2**	2.2
The charge for the year comprises:				
Impairment adjustment for loans and advances	**41.6**	59.0	**3.3**	7.0
Recoveries relating to amounts previously written off loans and advances	**(0.8)**	–	**–**	–
Net provision charge for the year	**40.8**	59.0	**3.3**	7.0

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

Debt Securities	**Group**		**Society**	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
At 1st January	**7.8**	6.9	**7.8**	6.9
Impairment adjustment for the year	**5.1**	0.9	**5.1**	0.9
At 31st December	**12.9**	7.8	**12.9**	7.8

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

10. INVESTMENTS

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Equities	**2.0**	2.0	**2.0**	2.0
Joint ventures	**0.1**	0.1	**0.3**	0.3
Subsidiaries	**–**	–	**10,485.8**	9,874.0
	2.1	2.1	**10,488.1**	9,876.3

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

Investment in joint venture

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

	2010 £m	2009 £m
Share of joint ventures		
Gross assets	**0.3**	0.1
Gross liabilities	**(0.2)**	–
	0.1	0.1

Investment in subsidiaries

Society	Shares £m	Loans £m	Total £m
Cost			
At 1st January 2010	**212.4**	**9,662.1**	**9,874.5**
Acquired on transfer of engagement	**8.0**	**207.0**	**215.0**
Additions	**–**	**1,364.1**	**1,364.1**
Repayments	**–**	**(967.3)**	**(967.3)**
At 31st December 2010	**220.4**	**10,265.9**	**10,486.3**
Impairment losses			
At 1st January 2010	**(0.5)**	**–**	**(0.5)**
Provided in year	**–**	**–**	**–**
At 31st December 2010	**(0.5)**	**–**	**(0.5)**
Net book value			
At 31st December 2010	**219.9**	**10,265.9**	**10,485.8**
Cost			
At 1st January 2009	242.3	10,362.9	10,605.2
Additions	0.5	424.8	425.3
Repayments	(30.4)	(1,125.6)	(1,156.0)
At 31st December 2009	212.4	9,662.1	9,874.5
Impairment losses			
At 1st January 2009	(0.5)	–	(0.5)
Provided in year	–	–	–
At 31st December 2009	(0.5)	–	(0.5)
Net book value			
At 31st December 2009	211.9	9,662.1	9,874.0

Included within Shares is an investment of £7.7m (2009 – £7.7m) in Yorkshire Guernsey Ltd which is a credit institution.

Income from interest in subsidiaries
The Society has recognised dividend income of £1.0m (2009 – £133.0m) from its subsidiary Yorksafe Insurance Company Limited.

Notes to the accounts

continued

10. INVESTMENTS (continued)

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

	Principal activity
Accord Mortgages Ltd	Mortgage lending
Barnsley Property Services Ltd*	Non-trading
BCS Loans and Mortgages Ltd	Loan and mortgage broker
CBS Capital Ltd	Capital Exchange
CBS Nominees Ltd*	Capital Exchange
CBS Property Services Ltd*	Non-trading
Chelsea Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds
Chelsea Mortgage Services Ltd	Third party residential mortgage portfolios
Mortgage Loan Management Ltd*	Non-trading
Phillip Schofield & Company*	Non-trading
Phillip Schofield (Property Management)*	Non-trading
YBS Investments (No. 1) Ltd	Investments
YBS Investments (No. 2) Ltd	Investments
YBS Ltd*	Non-trading
YBS Properties (Edinburgh) Ltd	Property holding
YBS Properties (York) Ltd	Non-trading
YBS Properties Ltd	Property holding
Yorksafe Insurance Company Ltd	Insurance
Yorkshire Building Society Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds
Yorkshire Building Society Estate Agents Ltd	Non-trading
Yorkshire Computer Services Ltd*	Non-trading
Yorkshire Direct Ltd*	Non-trading
Yorkshire Estate Agents Ltd*	Non-trading
Yorkshire Guernsey Ltd	Deposit taking
Yorkshire Insurance Services Ltd*	Non-trading
Yorkshire Investment Services Ltd	Investments
Yorkshire Key Services (No. 2) Ltd*	Non-trading
Yorkshire Key Services Ltd	Computer services
Yorkshire Life Assurance Services Ltd*	Non-trading
Yorkshire Mortgage Services Ltd*	Non-trading
Yorkshire Personal Financial Services Ltd*	Non-trading
Yorkshire Property Services Ltd*	Non-trading
Yorkshire Services Ltd*	Non-trading
Yorkshire Syndications Ltd*	Non-trading

* Dormant subsidiaries.

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

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

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

All the companies are wholly owned except for Yorksafe Insurance Company Ltd, Yorkshire Building Society Covered Bonds LLP and Chelsea Covered Bonds LLP. The Society's interests in these companies 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/(CREDIT)

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Current tax:				
UK corporation tax at 28%	**27.7**	14.4	**12.2**	3.8
Corporation tax – adjustment in respect of prior periods	**(5.3)**	5.3	**(5.3)**	5.3
Overseas tax	**(0.2)**	0.2	**–**	–
Total Current tax	**22.2**	19.9	**6.9**	9.1
Deferred tax (Note 19):				
Current year	**0.7**	(33.3)	**(0.4)**	3.3
Adjustment in respect of prior periods	**0.7**	4.2	**0.7**	4.2
Total tax expense/(credit) in income statement	**23.6**	(9.2)	**7.2**	16.6

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

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Profit/(loss) before tax	**115.4**	(12.5)	**55.1**	83.3
Tax calculated at a tax rate of 28%	**32.3**	(3.5)	**15.4**	23.3
Effects of:				
Lower tax rate on overseas earnings	**(0.7)**	(0.7)	**–**	–
Income not subject to tax	**(5.1)**	(16.2)	**(5.1)**	(17.8)
Expenses not deductible for tax purposes	**1.4**	1.7	**1.5**	1.6
Adjustment to tax charge in respect of previous periods	**(4.5)**	9.5	**(4.5)**	9.5
Change in tax rate	**0.2**	-	**(0.1)**	-
Total tax expense/(credit) in income statement	**23.6**	(9.2)	**7.2**	16.6
Tax expense/(credit) recognised directly in equity:				
Tax on available for sale securities	**1.0**	12.4	**1.0**	13.0
Tax on pension costs	**1.3**	(14.1)	**1.3**	(14.1)
Deferred tax on cash flow hedges	**1.5**	(14.0)	**1.5**	(14.0)
Utilisation of tax losses recognised in previous periods on available for sale securities	**–**	9.0	**–**	9.0
Adjustment to tax in respect of previous periods	**0.5**	–	**0.5**	–
Change in tax rate	**3.3**	–	**3.3**	–
	7.6	(6.7)	**7.6**	(6.1)

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

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Cash in hand	**14.2**	12.6	**14.2**	12.6
Cash ratio deposit with the Bank of England	**25.0**	17.8	**25.0**	17.8
Other deposits with the Bank of England	**1,271.6**	1,119.4	**1,271.6**	1,119.4
	1,310.8	1,149.8	**1,310.8**	1,149.8

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

Notes to the accounts

continued

13. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	Group		Society	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Loans and advances to banks	**935.8**	708.3	**725.4**	290.2
Loans and advances to other credit institutions	**–**	280.1	**–**	280.1
	935.8	988.4	**725.4**	570.3

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

14. DEBT SECURITIES

	Group		Society	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Debt securities issued by:				
Public bodies	**1,007.3**	1,421.6	**1,007.3**	1,421.6
Other borrowers	**2,607.9**	3,140.6	**2,499.3**	3,032.8
	3,615.2	4,562.2	**3,506.6**	4,454.4
Analysis by type:				
Listed on a recognised investment exchange	**3,501.1**	3,589.6	**3,501.1**	3,581.0
Unlisted	**114.1**	972.6	**5.5**	873.4
	3,615.2	4,562.2	**3,506.6**	4,454.4

Debt securities of £2.3bn (2009 – £2.7bn) are due in over one year.

Group	Held at fair value through the income statement £m	Embedded Derivative £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1st January 2010	**17.1**	**(41.0)**	**3,874.2**	**711.9**	**4,562.2**
Acquired on transfer of engagements	**–**	**–**	**1,492.7**	**147.2**	**1,639.9**
Additions	**–**	**–**	**4,384.3**	**–**	**4,384.3**
Disposals and repayments	**–**	**18.0**	**(6,892.7)**	**(69.3)**	**(6,944.0)**
Exchange translation	**(0.5)**	**–**	**(13.7)**	**8.8**	**(5.4)**
Other changes in value	**0.9**	**(4.2)**	**(24.4)**	**5.9**	**(21.8)**
At 31st December 2010	**17.5**	**(27.2)**	**2,820.4**	**804.5**	**3,615.2**
Movements in debt securities during the year were:					
At 1st January 2009	15.6	(45.5)	3,730.8	792.9	4,493.8
Additions	–	–	10,396.9	–	10,396.9
Disposals and repayments	–	–	(10,220.2)	(57.6)	(10,277.8)
Exchange translation	(1.5)	–	(61.8)	(23.8)	(87.1)
Other changes in value	3.0	4.5	28.5	0.4	36.4
At 31st December 2009	17.1	(41.0)	3,874.2	711.9	4,562.2

14. DEBT SECURITIES (continued)

Society	Held at fair value through the income statement £m	Embedded Derivative £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1st January 2010	**17.1**	**(41.0)**	**3,766.4**	**711.9**	**4,454.4**
Acquired on transfer of engagements	**–**	**–**	**1,492.7**	**147.2**	**1,639.9**
Additions	**–**	**–**	**3,963.8**	**–**	**3,963.8**
Disposals and repayments	**–**	**18.0**	**(6,472.9)**	**(69.3)**	**(6,524.2)**
Exchange translation	**(0.5)**	**–**	**(13.7)**	**8.8**	**(5.4)**
Other changes in value	**0.9**	**(4.2)**	**(24.5)**	**5.9**	**(21.9)**
At 31st December 2010	**17.5**	**(27.2)**	**2,711.8**	**804.5**	**3,506.6**
Movements in debt securities during the year were:					
At 1st January 2009	15.6	(45.5)	3,386.3	792.9	4,149.3
Additions	–	–	9,781.2	–	9,781.2
Disposals and repayments	–	–	(9,377.3)	(57.6)	(9,434.9)
Exchange translation	(1.5)	–	(61.8)	(23.8)	(87.1)
Other changes in value	3.0	4.5	38.0	0.4	45.9
At 31st December 2009	17.1	(41.0)	3,766.4	711.9	4,454.4

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

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

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

15. LOANS AND ADVANCES TO CUSTOMERS

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Loans and advances to customers comprise:				
Loans fully secured on residential property	**23,103.3**	14,700.3	**16,316.2**	8,550.7
Other loans secured on residential property	**52.8**	51.1	**22.1**	17.3
Fair value hedging adjustments	**199.0**	274.7	**174.6**	274.5
Allowances for impairment	**(58.5)**	(50.7)	**(3.2)**	(2.2)
Loans secured on residential property	**23,296.6**	14,975.4	**16,509.7**	8,840.3
Loans fully secured on land	**74.1**	4.0	**74.1**	4.0

Loans and advances to customers are held at amortised cost, with interest and associated costs being recognised in the interest receivable and similar income line of the income statement on an effective interest rate basis. Amounts totalling £22.7bn (2009 – £14.3bn) are due in over one year.

Fair value hedging adjustments of £199.0m (2009 – £274.7m) have been made to certain fixed rate mortgages that are in fair value hedging relationships.

Covered Bonds

Loans and advances to customers include £3.4bn (2009 – £5.1bn) for both the Group and Society which have been transferred from the Society to Yorkshire Building Society Covered Bonds LLP, a Limited Liability Partnership which is consolidated by the Group. The loans secure £1.8bn (2009 – £2.8bn) of covered bonds issued by the Society. The covered bonds are included in debt securities in issue (see Note 24). The loans are retained on the Society's statement of financial position as the Society substantially retains the associated risks and rewards.

16. INTANGIBLE ASSETS

	Goodwill £m	Software £m	Other £m	Total £m
Group				
Cost				
At 1st January 2010	**–**	**46.7**	**2.1**	**48.8**
Additions	**(17.1)**	**4.8**	**–**	**(12.3)**
Acquired on transfer of engagements	**–**	**0.1**	**12.2**	**12.3**
Written off in the year	**17.1**	**–**	**–**	**17.1**
Disposals	**–**	**(0.8)**	**–**	**(0.8)**
At 31st December 2010	**–**	**50.8**	**14.3**	**65.1**
Depreciation				
At 1st January 2010	**–**	**37.0**	**1.2**	**38.2**
Charged in year	**–**	**3.6**	**3.7**	**7.3**
Disposals	**–**	**(0.8)**	**–**	**(0.8)**
At 31st December 2010	**–**	**39.8**	**4.9**	**44.7**
Net book value				
At 31st December 2010	**–**	**11.0**	**9.4**	**20.4**
Cost				
At 1st January 2009	–	41.1	2.1	43.2
Additions	–	5.8	–	5.8
Disposals	–	(0.3)	–	(0.3)
Transfers	–	0.1	–	0.1
At 31st December 2009	–	46.7	2.1	48.8
Depreciation				
At 1st January 2009	–	34.0	0.6	34.6
Charged in year	–	3.3	0.6	3.9
Disposals	–	(0.3)	–	(0.3)
At 31st December 2009	–	37.0	1.2	38.2
Net book value				
At 31st December 2009	–	9.7	0.9	10.6

Transfers relate to the reclassification of assets from construction in progress, as the assets are completed and put into service.

Other intangible assets includes the intrinsic value of the Chelsea retail savings book and brand, the intrinsic value of the Barnsley retail savings book and income streams from renewable contracts (primarily property insurance) and an amount paid for the transfer of a number of employee sharesave schemes to the Society.

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

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

16. INTANGIBLE ASSETS (continued)

	Goodwill £m	Software £m	Other £m	Total £m
Society				
Cost				
At 1st January 2010	**–**	**36.2**	**2.1**	**38.3**
Additions	**(17.1)**	**4.8**	**–**	**(12.3)**
Acquired on transfer of engagements	**–**	**0.1**	**12.2**	**12.3**
Written off in the year	**17.1**	**–**	**–**	**17.1**
Disposals	**–**	**(0.8)**	**–**	**(0.8)**
At 31st December 2010	**–**	**40.3**	**14.3**	**54.6**
Depreciation				
At 1st January 2010	**–**	**26.9**	**1.2**	**28.1**
Charged in year	**–**	**3.5**	**3.7**	**7.2**
Disposals	**–**	**(0.8)**	**–**	**(0.8)**
At 31st December 2010	**–**	**29.6**	**4.9**	**34.5**
Net book value				
At 31st December 2010	**–**	**10.7**	**9.4**	**20.1**
Cost				
At 1st January 2009	–	30.6	2.1	32.7
Additions	–	5.8	–	5.8
Disposals	–	(0.3)	–	(0.3)
Transfers	–	0.1	–	0.1
At 31st December 2009	–	36.2	2.1	38.3
Depreciation				
At 1st January 2009	–	24.0	0.6	24.6
Charged in year	–	3.2	0.6	3.8
Disposals	–	(0.3)	–	(0.3)
At 31st December 2009	–	26.9	1.2	28.1
Net book value				
At 31st December 2009	–	9.3	0.9	10.2

Transfers relate to the reclassification of assets from construction in progress, as the assets are completed and put into service.

17. INVESTMENT PROPERTIES

	Group		Society	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Cost				
At 1st January	**9.7**	9.7	**9.5**	9.5
Additions	**–**	–	**–**	–
Acquired on transfer of engagements	**11.8**	–	**11.8**	–
Disposals	**–**	–	**–**	–
Transfers	**1.4**	–	**1.4**	–
At 31st December	**22.9**	9.7	**22.7**	9.5
Depreciation				
At 1st January	**3.0**	2.5	**3.0**	2.5
Charged in year	**0.3**	0.1	**0.3**	0.1
Impairment	**0.6**	0.4	**0.6**	0.4
Disposals	**–**	–	**–**	–
Transfers	**0.3**	–	**0.3**	–
At 31st December	**4.2**	3.0	**4.2**	3.0
Net book value				
At 31st December	**18.7**	6.7	**18.5**	6.5
Fair value				
At 31st December	**22.8**	10.0	**22.4**	9.6

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

Investment properties are generally flats and offices, ancillary to branch premises and not used by the Group.

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 2010 has been arrived at on the basis of a valuation carried out by the Group's Estates Manager.

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

18. 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 2010	**–**	**84.5**	**80.5**	**165.0**
Additions	**0.2**	**0.3**	**2.4**	**2.9**
Acquired on transfer of engagements	**–**	**30.8**	**1.6**	**32.4**
Disposals	**–**	**(0.1)**	**(0.6)**	**(0.7)**
Transfers	**(0.2)**	**(1.2)**	**–**	**(1.4)**
At 31st December 2010	**–**	**114.3**	**83.9**	**198.2**
Depreciation				
At 1st January 2010	**–**	**18.5**	**65.9**	**84.4**
Charged in year	**–**	**2.2**	**5.1**	**7.3**
Impairment	**–**	**–**	**–**	**–**
Disposals	**–**	**(0.1)**	**(0.4)**	**(0.5)**
Transfers	**–**	**(0.3)**	**–**	**(0.3)**
At 31st December 2010	**–**	**20.3**	**70.6**	**90.9**
Net book value				
At 31st December 2010	**–**	**94.0**	**13.3**	**107.3**
Cost				
At 1st January 2009	2.4	81.7	76.5	160.6
Additions	2.6	0.5	1.9	5.0
Disposals	–	–	(0.5)	(0.5)
Transfers	(5.0)	2.3	2.6	(0.1)
At 31st December 2009	–	84.5	80.5	165.0
Depreciation				
At 1st January 2009	–	16.5	61.4	77.9
Charged in year	–	1.8	5.0	6.8
Impairment	–	0.2	–	0.2
Disposals	–	–	(0.5)	(0.5)
Transfers	–	–	–	–
At 31st December 2009	–	18.5	65.9	84.4
Net book value				
At 31st December 2009	–	66.0	14.6	80.6

Transfers relate to the reclassification of assets from construction in progress to land and buildings, equipment, fixtures, fittings and vehicles and intangible assets, as the assets are completed and put into service.

Notes to the accounts

continued

18. 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 2010	**–**	**62.2**	**35.3**	**97.5**
Additions	**0.2**	**0.3**	**2.2**	**2.7**
Acquired on transfer of engagements	**–**	**30.8**	**1.6**	**32.4**
Disposals	**–**	**(0.1)**	**(0.6)**	**(0.7)**
Transfers	**(0.2)**	**(1.2)**	**–**	**(1.4)**
At 31st December 2010	**–**	**92.0**	**38.5**	**130.5**
Depreciation				
At 1st January 2010	**–**	**14.7**	**20.7**	**35.4**
Charged in year	**–**	**1.8**	**5.0**	**6.8**
Impairment	**–**	**–**	**–**	**–**
Disposals	**–**	**(0.1)**	**(0.4)**	**(0.5)**
Transfers	**–**	**(0.3)**	**–**	**(0.3)**
At 31st December 2010	**–**	**16.1**	**25.3**	**41.4**
Net book value				
At 31st December 2010	**–**	**75.9**	**13.2**	**89.1**
Cost				
At 1st January 2009	2.4	59.6	31.3	93.3
Additions	2.6	0.3	1.9	4.8
Disposals	–	–	(0.5)	(0.5)
Transfers	(5.0)	2.3	2.6	(0.1)
At 31st December 2009	–	62.2	35.3	97.5
Depreciation				
At 1st January 2009	–	13.1	16.5	29.6
Charged in year	–	1.4	4.7	6.1
Impairment	–	0.2	–	0.2
Disposals	–	–	(0.5)	(0.5)
Transfers	–	–	–	–
At 31st December 2009	–	14.7	20.7	35.4
Net book value				
At 31st December 2009	–	47.5	14.6	62.1

Transfers relate to the reclassification of assets from construction in progress to land and buildings, equipment, fixtures, fittings and vehicles and intangible assets, as the assets are completed and put into service.

Notes to the accounts

continued

19. DEFERRED TAX ASSETS AND LIABILITIES

	Group		Society	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
The movement on the deferred tax asset/(liability) is as follows:				
At 1st January	**25.4**	(21.6)	**26.7**	17.2
Acquired on transfer of engagements	**88.0**	–	**78.8**	–
Income statement (charge)/credit	**(1.4)**	29.1	**(0.3)**	(7.5)
Tax (expense)/credit recognised directly in equity	**(17.9)**	17.9	**(17.9)**	17.0
At 31st December	**94.1**	25.4	**87.3**	26.7
Deferred tax assets and liabilities are attributable to the following items:				
Deferred tax assets				
Provision for loan impairment	**0.8**	1.0	**0.6**	0.7
Other provisions	**1.8**	0.8	**1.8**	0.8
Other temporary differences	**0.1**	0.1	**0.1**	0.1
Accelerated tax depreciation	**3.2**	0.5	**3.2**	0.8
Tax value of losses carried forward	**8.5**	10.2	**8.5**	10.2
Pensions and other post retirement benefits	**5.4**	3.6	**5.4**	3.6
Implementation of IAS 39 – mortgages and hedging	**1.9**	–	**1.4**	–
Cash flow hedging	**12.0**	14.0	**12.0**	14.0
Transfer of engagements – fair value adjustments	**74.1**	–	**63.4**	–
	107.8	30.2	**96.4**	30.2
Deferred tax liabilities				
Accelerated tax depreciation	**0.3**	–	**–**	–
Implementation of IAS 39 – mortgages and hedging	**7.2**	3.8	**6.1**	2.9
Overseas operations	**0.1**	0.3	**–**	–
Other temporary differences	**1.9**	0.7	**1.8**	0.6
Transfer of engagements – fair value adjustments	**4.2**	–	**1.2**	–
	13.7	4.8	**9.1**	3.5

The deferred tax asset (which has not been discounted) on the tax value of losses carried forward has arisen on trading losses and on fair value adjustments, including available for sale securities in reserves. It is anticipated that the asset will be recoverable against future taxable profits including the reversal of fair value adjustments.

The deferred tax charge/(credit) in the income statement comprises the following temporary differences:

	Group		Society	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Accelerated tax depreciation	**0.6**	(0.3)	**0.6**	(0.3)
Tax value of losses carried forward	**–**	11.1	**–**	11.1
Pensions and other post retirement benefits	**0.8**	0.6	**0.8**	0.6
Other provisions	**0.1**	8.4	**–**	1.7
Overseas operations	**(0.3)**	(42.3)	**–**	–
Other temporary differences	**(1.3)**	(6.6)	**(1.1)**	(5.6)
Release of fair value adjustments on merger	**1.5**	–	**–**	–
	1.4	(29.1)	**0.3**	7.5

Notes to the accounts

continued

20. OTHER ASSETS

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Prepayments and accrued income	**12.3**	4.8	**12.0**	4.8
Due from subsidiary undertakings	**–**	–	**35.3**	34.1
Other assets	**5.4**	2.7	**2.9**	1.4
	17.7	7.5	**50.2**	40.3

21. SHARES

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Shares comprising balances held by individuals	**21,457.7**	13,794.9	**21,457.7**	13,794.9
Fair value adjustments	**(75.2)**	(1.5)	**(75.2)**	(1.5)
	21,382.5	13,793.4	**21,382.5**	13,793.4

22. AMOUNTS OWED TO CREDIT INSTITUTIONS

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Amounts owed to:				
Banks	**920.4**	377.3	**920.4**	103.4
Group companies	**–**	–	**790.4**	746.5
Other credit institutions	**6.0**	16.1	**6.0**	16.1
	926.4	393.4	**1,716.8**	866.0

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

23. OTHER DEPOSITS

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Amounts owed to:				
Group companies	**–**	–	**3,378.3**	2,955.1
Other customers	**1,061.9**	1,091.0	**184.3**	284.8
	1,061.9	1,091.0	**3,562.6**	3,239.9

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

24. DEBT SECURITIES IN ISSUE

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Certificates of deposit	**25.8**	132.3	**25.8**	132.3
Fixed rate notes	**3,943.6**	4,738.7	**3,943.6**	4,738.7
Floating rate notes	**350.1**	757.7	**350.1**	757.7
Fair value hedging adjustment	**28.9**	70.0	**28.9**	70.0
	4,348.4	5,698.7	**4,348.4**	5,698.7

Debt securities in issue include €2.1bn (2009 – €3.0bn), for both Group and Society, of covered bonds secured on certain loans and advances to customers. The Sterling equivalent value of these bonds is £1.8bn (2009 – £2.8bn).

25. 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 31st December 2008, the Society also operated an additional defined benefit employee benefit scheme (the Barnsley Scheme) in relation to the Society's transfer of engagements of Barnsley Building Society. This scheme was merged with the main scheme during 2010.

With effect from 1st April 2010, the Society operates a further additional defined benefit employee benefit scheme (the Chelsea Scheme) and contributes to a group personal pension arrangement, both in relation to the Society's transfer of engagements of Chelsea Building Society.

The assumptions and figures below include the Barnsley Scheme and Chelsea Scheme where appropriate.

In addition, the Group operates unfunded defined benefit pension schemes for certain current and former members of staff. The present value at 31 December 2010 of the defined benefit obligation in relation to these schemes was £4.4m (2009 – £5.3m) 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. As noted above, the Group also contributes to a group personal pension arrangement in relation to the Society's transfer of engagements of Chelsea Building Society. The total expense recognised for these defined contribution benefits is £3.5m (2009 – £2.2m).

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 Group's policy for recognising actuarial gains and losses is to recognise them immediately on the statement of financial position through the Statement of comprehensive income.

Summary of assumptions	**31st Dec 2010 %**	31st Dec 2009 %	31st Dec 2008 %	31st Dec 2007 %	31st Dec 2006 %
Retail Prices index (RPI) Inflation	**3.8**	3.8	3.2	3.4	3.0
Consumer price index (CPI) inflation	**3.1**	n/a	n/a	n/a	n/a
Discount rate	**5.5**	5.7	6.4	5.8	5.1
Expected return on assets	**6.3**	6.3	5.9	6.4	7.0
Rate of increase in pay	**5.3**	5.3	4.7	4.9	4.5
Rate of increase of pensions in payment*					
subject to a min of 3% and a max of 5%	**4.0**	4.0	3.4	3.6	3.7
subject to a min of 0% and a max of 5%	**3.8**	3.8	3.2	3.4	3.0
subject to a min of 0% and a max of 2.5%	**2.4**	2.4	n/a	n/a	n/a
Rate of increase for deferred pensions*					
subject to a min of 0% and a max of 5%	**3.1**	3.8	3.1	3.4	3.0
subject to a min of 0% and a max of 2.5%	**2.3**	n/a	n/a	n/a	n/a

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

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

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:

	2010 Years	2009 Years
For a current 60 year old male	**26.3**	26.2
For a current 60 year old female	**27.6**	27.5
For a current 45 year old male	**27.9**	27.8
For a current 45 year old female	**28.6**	28.5

Notes to the accounts

continued

25. RETIREMENT BENEFIT OBLIGATIONS (continued)

Categories of assets	**31st Dec 2010 %**	31st Dec 2009 %	31st Dec 2008 %	31st Dec 2007 %	31st Dec 2006 %
Equities	**32**	44	42	44	66
Bonds	**56**	55	17	50	30
Cash and other	**12**	1	41	6	4
	100	100	100	100	100

Reconciliation of funded status	**31st Dec 2010 £m**	31st Dec 2009 £m	31st Dec 2008 £m	31st Dec 2007 £m	31st Dec 2006 £m
Present value of defined benefit obligation	**(456.7)**	(317.3)	(231.1)	(262.7)	(286.3)
Assets at fair value	**442.5**	313.0	259.9	270.7	255.6
Funded status/Defined benefit (liability)/asset	**(14.2)**	(4.3)	28.8	8.0	(30.7)

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

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

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

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

Statement of comprehensive income (SCI)	**2010 £m**	2009 £m	2008 £m	2007 £m	2006 £m
Actuarial gain/(loss) recognised in SCI	**4.8**	(50.4)	17.8	33.8	22.0
Cumulative actuarial (losses)/gains recognised at 1st January	**(2.7)**	47.7	29.9	(3.9)	(25.9)
Cumulative actuarial gains/(losses) recognised at 31st December	**2.1**	(2.7)	47.7	29.9	(3.9)
Experience gain and losses					
(Loss)/gain on change of assumptions	**(5.9)**	(80.0)	45.2	37.0	15.3
Gain/(loss) on other experience	**0.5**	4.0	8.6	1.0	(0.7)
Experience gain/(loss) on assets	**10.2**	25.6	(36.0)	(4.2)	7.4
Actuarial gain/(loss) recognised in SCI	**4.8**	(50.4)	17.8	33.8	22.0

Components of pension expense as shown in the income statement	**2010 £m**	2009 £m
Service cost	**5.1**	4.5
Interest cost	**22.7**	14.5
Expected return on assets	**(24.4)**	(15.4)
Total pension expense	**3.4**	3.6

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

25. RETIREMENT BENEFIT OBLIGATIONS (continued)

Reconciliation of present value of defined benefit obligation	**2010 £m**	2009 £m
Present value of defined benefit obligation at 1st January	**317.3**	231.1
Acquired on transfer of engagements	**119.2**	-
Defined benefit service cost	**5.1**	4.5
Interest cost	**22.7**	14.5
Defined benefit employee contributions	**0.4**	1.5
Actuarial loss	**5.4**	76.0
Defined benefit actual benefits paid	**(13.4)**	(10.3)
Present value of defined benefit obligation at 31st December	**456.7**	317.3

Movement in defined benefit fair value of assets		
Fair value of assets at 1st January	**313.0**	259.9
Acquired on transfer of engagements	**102.8**	-
Expected return on assets	**24.4**	15.4
Actuarial gain on assets	**10.2**	25.6
Defined benefit actual company contributions	**5.1**	20.9
Defined benefit employee contributions	**0.4**	1.5
Defined benefit actual benefits paid	**(13.4)**	(10.3)
Fair value of plan assets at 31st December	**442.5**	313.0

None of the assets were invested in the Group's own financial instruments (2009 – £nil) or property (2009 – £nil).

Estimated contributions in 2011	2011 £m
Society contributions	**6.7**
Employee contributions	**0.2**
Total contributions	**6.9**

Society contributions include £2.0m 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. OTHER LIABILITIES

	Group		**Society**	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Accruals and deferred income	**28.1**	27.5	**26.4**	27.0
Income tax deducted at source	**37.4**	18.9	**37.0**	17.5
Other	**8.7**	4.0	**8.2**	4.0
	74.2	50.4	**71.6**	48.5

Notes to the accounts

continued

27. PROVISIONS

Movements in provisions during the year were as follows:

Group	FSCS Levy £m	Regulatory and other £m	Total £m
At 1st January 2010	**12.1**	**0.5**	**12.6**
Acquired on transfer of engagements	**33.7**	**9.3**	**43.0**
Amounts utilised during the year	**(8.6)**	**(0.2)**	**(8.8)**
Provision charge during the year	**3.6**	**–**	**3.6**
At 31st December 2010	**40.8**	**9.6**	**50.4**
At 1st January 2009	14.8	2.3	17.1
Amounts utilised during the year	(5.4)	(0.4)	(5.8)
Provision charge/(release) during the year	2.7	(1.4)	1.3
At 31st December 2009	12.1	0.5	12.6
Society			
At 1st January 2010	**12.1**	**0.4**	**12.5**
Acquired on transfer of engagements	**33.7**	**9.3**	**43.0**
Amounts utilised during the year	**(8.6)**	**(0.1)**	**(8.7)**
Provision charge during the year	**3.6**	**–**	**3.6**
At 31st December 2010	**40.8**	**9.6**	**50.4**
At 1st January 2009	14.8	2.2	17.0
Amounts utilised during the year	(5.4)	(0.4)	(5.8)
Provision charge/(release) during the year	2.7	(1.4)	1.3
At 31st December 2009	12.1	0.4	12.5

Financial Services Compensation Scheme

During 2008 and 2009 the Financial Services Compensation Scheme (FSCS) was instrumental in safeguarding depositors' money following the failures of Bradford and Bingley plc, Kaupthing Singer & Friedlander Limited, Heritable Bank Plc, Landsbanki Islands hf, London Scottish Bank Plc and Dunfermline Building Society.

The FSCS has borrowings of c. £20bn in the form of loans from HM Treasury. The FSCS is liable to pay interest on these loans for the first three years, the principal of the loans becoming due in April 2012 by which time it is hoped that there will have been substantial recoveries from the assets of the failed institutions. Any amounts outstanding will need to be met by FSCS levies on the industry (including the Yorkshire).

As a result of notifications received from the FSCS, the Society has recognised in this year's results a provision for a levy of £5.9m for the scheme year 2011/12, calculated with reference to the protected deposits it held at 31st December 2010, and a release of £2.3m for the scheme year 2009/10 due to interest rates being lower than anticipated.

The amounts above have been recognised in the Income statement and do not take account of any compensation levies which may arise if the recoveries of the assets of the failed institutions are insufficient to repay the HM Treasury loan. However, on merger with the Chelsea Building Society, in accordance with 'International Financial Reporting Standard 3 Business Combinations (Revised)', a fair value adjustment in respect of the savings balances acquired has been made to provide for that eventuality. In addition, a further fair value adjustment has been made to provide for future interest costs on the HM Treasury loan on the assumption that not all of it will have been repaid by April 2012.

Regulatory and other

Other provisions have been made in respect of various customer claims, including claims in relation to previous sales of payment protection insurance. It is expected that the liability will predominantly crystallise over the next six to nine months.

28. SUBORDINATED LIABILITIES

Group and Society	2010 £m	2009 £m
6% Subordinated Bonds 2019	**25.8**	25.8
11⅜% Subordinated Bonds 2022	**25.3**	25.3
6⅜% Subordinated Bonds 2024	**51.6**	51.6
13½% Convertible Tier 2 Capital Notes 2025	**99.8**	-
Fair value hedging adjustments	**12.4**	9.0
	214.9	111.7

All subordinated liabilities are denominated in sterling. The following notes are repayable at the dates stated or earlier at the option of the Society and with the prior consent of the Financial Services Authority under the following conditions:

- redemption of all (but not some only) of the 6% Notes at par on 7th May 2014 after giving not less than fifteen nor more than thirty days' notice to the holders. In the event the Society does not redeem the notes on 7th May 2014 the fixed rate of interest will become the aggregate of 2.03% and the then current five year benchmark Gilt rate; and
- 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 sixty 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.

During 2010, the Society issued £100m nominal value of 13½% Convertible Tier 2 Capital Notes. The redemption of these notes will occur on 1st April 2025 unless the notes are converted to Profit Participating Deferred Shares (PPDS) under the following condition:

- the "Conversion Trigger" shall occur if on any Calculation Date the Society's Consolidated Tier 1 Capital Ratio, as confirmed in a report of the auditor to the Society and addressed to the board of directors of the Society, is less than 5%.

The rights of repayment of the holders of subordinated debt are subordinated to the claims of all depositors, creditors and members holding shares in the Society, as regards the principal of their shares and interest due on them.

Should the Conversion Trigger occur on the 13½% Convertible Notes and these notes convert into PPDS, the PPDS will be perpetual in nature, ranking *pari passu* with the currently issued Subscribed Capital (detailed in Note 29).

29. SUBSCRIBED CAPITAL

Group and Society	2010 £m	2009 £m
5.649% Permanent Interest Bearing Shares	**151.2**	151.1
Fair value hedging adjustments	**16.1**	8.2
	167.3	159.3

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 Financial Services Authority. If the PIBS are not repaid on a call date the interest rate is reset at a margin to the then prevailing LIBOR rate. They are deferred shares of the Society and the rights of repayment of the holders of PIBS are subordinated to the claims of all depositors, creditors, members holding shares in the Society and holders of subordinated debt, as regards the principal of their shares and interest due on them. The interest rate risk arising from the issuance of fixed rate PIBS has been mitigated through the use of interest rate swaps.

30. CAPITAL MANAGEMENT

More detail of capital management strategies can be found in the Risk management report on page 37.

	Group	
	2010	2009
	£m	£m
Tier 1		
General reserve	**1,408.1**	975.6
Subscribed capital	**167.3**	159.3
Pension fund adjustments*	**8.6**	(0.6)
Intangible fixed assets	**(20.4)**	(10.6)
Deductions from Tier 1 capital	**(1.8)**	(0.5)
	1,561.8	1,123.2
Tier 2		
Subordinated liabilities	**214.9**	111.7
Collective allowances for impairment	**4.5**	3.7
Deductions from Tier 2 capital	**(1.8)**	(0.5)
	217.6	114.9
Other items excluded	**(1.2)**	(0.2)
Total capital	**1,778.2**	1,237.9
Risk weighted assets	**11,205.2**	7,926.6
Core Tier 1 ratio (%)	**12.4%**	12.2%
Tier 1 ratio (%)	**13.9%**	14.2%
Solvency ratio (%)	**15.9%**	15.6%

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

The above ratios, deductions and definitions are in accordance with Financial Services Authority (FSA) guidelines.

Throughout the year the Group Capital Committee has kept the Group's capital position under review as well as considering the current market conditions for capital issuance.

31. FINANCIAL COMMITMENTS

	Group and Society	
	2010	2009
	£m	£m
Committed undrawn standby facilities	**96.2**	33.2

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 2010, but for which no provision has been made in the accounts, amounted to £0.5m (Society £0.4m), (2009 – Group £0.2m and Society £0.2m).

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

Group	**2010**		2009	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Within one year	**4.7**	**0.4**	3.7	0.8
Between one and five years	**14.6**	**0.4**	12.4	0.5
Over five years	**15.7**	**–**	14.9	-
	35.0	**0.8**	31.0	1.3

The Group is not in default on any of its financial liabilities or commitments.

Notes to the accounts

continued

32. 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 14
Loans fully secured on residential property	Loan period is typically up to 25 years A variety of mortgage products offering fixed and variable interest rates	Amortised cost*
Derivative financial instruments	Primarily medium-term Value derived from underlying price, rate or index	Fair value through income statement
Intercompany deposit from Covered Bond Limited Liability Partnerships	Long-term Fixed and variable interest rates	Fair value through income statement
Investments	Investment in subsidiary companies	Amortised cost
Shares	Deposits made by individuals Varying withdrawal notice periods Fixed and variable interest rates	Amortised cost*
Amounts owed to credit institutions and other customers	Primarily short-term Time Deposits Fixed and variable interest rates	Amortised cost*
Debt securities in issue	Short-term and medium-term Fixed and variable interest rates	Amortised cost*
Subordinated liabilities	Long-term Fixed and variable interest rates	Amortised cost*
Subscribed capital	Long-term Fixed interest rates	Amortised cost*

* Except where hedge accounting allows a fair value adjustment to be made for interest rate risk.

33. DERIVATIVE FINANCIAL INSTRUMENTS

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

Derivatives are only used by the Group in accordance with the Building Societies Act 1986. This means that such instruments are not used in trading activity or for speculative purposes and accordingly they are only used to reduce the risk of loss on core assets or liabilities arising from changes in interest rates, currency rates or other factors of a prescribed description.

The principal derivatives used in balance sheet risk management are interest rate swaps, interest rate options, cross-currency interest rate swaps, forward rate agreements, futures contracts and foreign exchange contracts. These are used to hedge Group exposures arising from fixed rate mortgage lending and savings products, funding and investment activities.

The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the type of derivatives which are typically used in managing such risks. Such risks may alternatively be managed using "on-balance sheet" instruments as part of the Group's integrated approach to risk management.

Activity	Risk	Type of hedge
Management of the investment of reserves and other net non-interest bearing liabilities	Sensitivity to changes in interest rates	Interest rate swaps
Fixed rate savings products and options, forward fixed rate funding	Sensitivity to changes in interest rates	Interest rate swaps, forward rate agreements and futures
Fixed rate mortgage lending and options, forward fixed rate investments	Sensitivity to changes in interest rates	Interest rate swaps, forward rate agreements and futures
Management of the interest basis risk arising from differences in the underlying pricing basis of assets and liabilities	Sensitivity to changes in relationships between interest rate bases	Interest rate swaps where one leg is referenced to LIBOR and the other to bank base rate
Equity linked investment products	Sensitivity to changes in equity indices	Equity linked interest rate swaps
Investment and funding in rate swaps and foreign currencies	Sensitivity to changes in foreign exchange rates	Cross-currency interest rate swaps and foreign exchange contracts

The Group's objective is to manage risk within its risk tolerance, irrespective of the accounting treatment.

Those derivative products which are combinations of more basic derivatives are used only in circumstances where the underlying position being hedged contains the same risk features. In such cases the derivatives used will be designed to match the risks of the underlying asset or liability and therefore to hedge the associated market risk.

Certain financial instruments (including some retail products) contain features that are similar to derivatives. In the majority of such cases, the Group manages the associated risks by entering into derivative contracts that match these features.

Whilst all derivatives have been entered into for hedging purposes, only certain ones have been designated as such for accounting purposes. In some cases a natural offset can be achieved without applying the requirements of IAS 39. The Group only designates hedges where a high degree of effectiveness can be achieved.

Fair value hedges are designated where interest rate swaps are used to minimise the variability in the fair value of fixed interest financial instruments (mainly fixed rate mortgages).

Cash flow hedges are designated where interest rate swaps are used to convert the interest rate variability on short-term financial instruments into fixed rates.

33. 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

At 31st December 2010	Contract/notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Interest rate swaps designated as fair value hedges	**8,367.3**	**113.6**	**332.6**
Interest rate swaps designated as cash flow hedges	**1,393.7**	**34.0**	**39.5**
Cross-currency interest swaps designated as fair value hedges	**1,808.1**	**328.6**	**–**
Derivatives not designated as hedges:			
Interest rate swaps	**8,385.6**	**51.5**	**91.1**
Cross-currency interest rate swaps	**146.3**	**47.2**	**–**
Equity linked interest rate swaps	**151.3**	**1.8**	**5.3**
Forward foreign exchange	**250.9**	**2.7**	**3.2**
Interest rate options	**202.0**	**0.4**	**–**
Interest rate futures	**50.0**	**–**	**0.6**
Forward rate agreements	**–**	**–**	**–**
Total derivatives held for hedging	**20,755.2**	**579.8**	**472.3**

Society

At 31st December 2010	Contract/notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Interest rate swaps designated as fair value hedges	**8,367.3**	**113.6**	**332.6**
Interest rate swaps designated as cash flow hedges	**1,393.7**	**34.0**	**39.5**
Derivatives not designated as hedges:			
Interest rate swaps	**8,583.6**	**98.1**	**91.1**
Cross-currency interest rate swaps	**146.3**	**47.2**	**–**
Equity linked interest rate swaps	**151.3**	**1.8**	**5.3**
Forward foreign exchange	**250.9**	**2.7**	**3.2**
Interest rate options	**202.0**	**0.4**	**–**
Interest rate futures	**50.0**	**–**	**0.6**
Forward rate agreements	**–**	**–**	**–**
Total derivatives held for hedging	**19,145.1**	**297.8**	**472.3**

33. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Group
At 31st December 2009

	Contract/notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Interest rate swaps designated as fair value hedges	6,515.5	25.4	307.9
Interest rate swaps designated as cash flow hedges	572.4	7.2	15.3
Cross-currency interest swaps designated as fair value hedges	2,664.9	755.2	–
Derivatives not designated as hedges:			
Interest rate swaps	8,367.8	69.9	95.0
Cross-currency interest rate swaps	530.2	9.0	11.1
Equity linked interest rate swaps	36.0	–	1.4
Forward foreign exchange	1,681.1	35.7	30.7
Interest rate options	213.0	2.0	–
Interest rate futures	750.0	–	6.7
Forward rate agreements	630.0	0.1	–
Total derivatives held for hedging	21,960.9	904.5	468.1

Society
At 31st December 2009

	Contract/notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Interest rate swaps designated as fair value hedges	6,515.5	25.4	307.9
Interest rate swaps designated as cash flow hedges	572.4	7.2	15.3
Derivatives not designated as hedges:			
Interest rate swaps	8,367.8	69.9	95.0
Cross-currency interest rate swaps	530.2	9.0	11.1
Equity linked interest rate swaps	36.0	–	1.4
Forward foreign exchange	1,681.1	35.7	30.7
Interest rate options	213.0	2.0	–
Interest rate futures	750.0	–	6.7
Forward rate agreements	630.0	0.1	–
Total derivatives held for hedging	19,296.0	149.3	468.1

Notes to the accounts

continued

34. LIQUIDITY RISK

Liquidity risk is an intrinsic part of the Group's business as long-term mortgages are funded by short-term retail customer balances. Most mortgages have a contractual maturity date of around 25 years but in practice are frequently repaid early; currently the estimated average life of a mortgage is approximately five years. Conversely, experience shows that retail deposits, nominally repayable on demand or with short notice periods, actually remain with the Society for relatively long periods. It is this inherent mismatch in the maturity profiles of retail assets and liabilities that creates liquidity risk.

The Group's liquidity management policy is designed to ensure maintenance of adequate investments in liquid assets to cover statutory, regulatory and operational requirements. The primary function of liquidity is the provision of sufficient assets in realisable form to ensure the Group is able to meet its liabilities as they arise and to absorb potential cash flow requirements created by the maturity mismatches referred to above or by a liquidity stress scenario. The policy is further designed to delegate liquidity management, within limits and a structure established by the board, as well as to monitor the composition of liquidity in line with risk management objectives.

The Group's liquidity management comprise the following key areas:

- limits are established by the board that govern the quantity, quality and marketability of and returns from the Group's portfolio of liquidity investments. The portfolio is managed by the Treasury function, monitored by the Risk function and overseen by the Group Asset and Liability Committee (GALCO) under a series of delegated authorities;
- the Group conducts a series of daily stress tests that are designed to ensure that its liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include ones caused by both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding. They are constructed on various timescales as far out as six months; and
- during 2010 the Group implemented the FSA's new liquidity regime. This has introduced two new measures of liquidity, i) where the Group is required to hold highly liquid collateral (government and supranational debt securities and cash) in excess of the FSA's Individual Liquidity Guidance for Backstop Purposes (ILG for BP) and ii) the wholesale refinancing gap. These new measures replace Society prudential liquidity and Group 8-day liquidity measures that had previously been used by the Group.

There are three key measures that the Group considers key to monitoring its liquidity position:

- buffer liquidity – which analyses daily the amount of high quality liquidity that it is deemed necessary to hold in a liquidity buffer, to absorb the worst-case stress scenario over the ensuing three months;
- wholesale refinancing gap – which sets a maximum permitted net wholesale outflow limit over the following two weeks; and
- 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.

All liquidity risk in subsidiary companies, with the exception of other deposits, is eliminated by the use of appropriate inter-company loans and deposits. The tables below show contractual cash flows for all financial liabilities including interest payments. Further details of liquidity management are contained within the Risk management report on pages 37 and 38.

Notes to the accounts

continued

34. LIQUIDITY RISK (continued)

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 2010				
Shares	**17,494.0**	**5,090.0**	**35.8**	**22,619.8**
Amounts owed to credit institutions	**733.2**	**162.0**	**33.2**	**928.4**
Other deposits				
Society	**180.7**	**4.8**	**–**	**185.5**
Subsidiaries	**822.8**	**63.7**	**–**	**886.5**
	1,003.5	**68.5**	**–**	**1,072.0**
Debt securities in issue	**2,289.3**	**2,204.8**	**–**	**4,494.1**
Subordinated liabilities	**14.3**	**57.1**	**322.1**	**393.5**
Subscribed capital*	**8.5**	**33.9**	**42.4**	**84.8**
Operating lease payments	**5.1**	**15.0**	**15.7**	**35.8**
Derivative financial liabilities	**265.0**	**362.9**	**350.7**	**978.6**
Total	**21,812.9**	**7,994.2**	**799.9**	**30,607.0**
Group				
As at 31st December 2009				
Shares	11,613.7	2,064.8	469.5	14,148.0
Amounts owed to credit institutions	313.5	78.6	3.2	395.3
Other deposits				
Society	283.2	2.1	–	285.3
Subsidiaries	733.4	78.7	–	812.1
	1,016.6	80.8	–	1,097.4
Debt securities in issue	2,123.4	3,705.9	–	5,829.3
Subordinated liabilities	7.5	30.1	162.1	199.7
Subscribed capital*	8.5	33.9	42.4	84.8
Operating lease payments	4.5	12.9	14.9	32.3
Derivative financial liabilities	340.6	327.9	72.0	740.5
Total	15,428.3	6,334.9	764.1	22,527.3

* Interest payments on subscribed capital are £8.5m per year. The liquidity table includes these for ten years.

35. 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; and
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

VaR measures below are based upon full balance sheet positions excluding the investment of the Group's free reserves.

Structural risk analysis (Basis risk)

An analysis of interest bearing items by rate type is performed to illustrate key areas of structural mismatch. It identifies mismatches between administered rates, fixed rates and other rates including those linked to Bank Base Rate and LIBOR. The effect of LIBOR mismatches within the statement of financial position is measured as the impact on net interest income (for a 12 month rolling period) of an isolated increase in LIBOR of one basis point (0.01%).

Basis point value (BP) sensitivity

This measure calculates the change in value of the assets and liabilities resulting from a one basis point parallel shift in interest rates. Within the Treasury portfolio this is calculated and reported on a daily basis separately for each currency and at the full statement of financial position level on a monthly basis.

Repricing gap analysis

Repricing dates are analysed, primarily to avoid repricing risk concentrations – the situation where too great a proportion of the Group's assets and liabilities see the interest rates earned or charged on them resetting within a given time period. The aim is to prevent excessive volatility in the net interest margin that could arise if rates shifted adversely within a given time period, and since the Group cannot dictate interest rate movements themselves, the best approach is to limit the amount of assets or liabilities that are exposed in this way. The analysis identifies the net asset/liability repricing position across a series of time intervals. Positions are calculated using nominal amounts and exclude interest flows. General reserves, fixed assets and other liabilities are classified as having 'non-specific' repricing characteristics with a zero rate of interest. The measure is calculated as a reverse cumulative gap.

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.

2010	**Year-end £000**	**Average £000**	**Maximum £000**	**Minimum £000**
VaR	**6,346**	**3,806**	**6,346**	**1,062**
Basis risk	**(8)**	**(27)**	**67**	**(116)**
BP sensitivity	**(149)**	**(15)**	**222**	**(149)**

	Greater than one year £m	**Greater than five years £m**	**Greater than 10 years £m**
Repricing gap	**577**	**(8)**	**–**

35. MARKET RISK (continued)

2009	Year-end £000	Average £000	Maximum £000	Minimum £000
VaR restated*	2,263	3,162	7,081	1,299
Basis risk	75	266	439	75
BP sensitivity	(6)	34	230	(58)

	Greater than one year £m	Greater than five years £m	Greater than 10 years £m
Repricing gap	516	(94)	(25)

* Restated for prior year to exclude the Group's free reserves.

Detail of how the Group manages its interest rate risk is included in the Risk management report on pages 38 and 39.

36. 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 39. Actual exposures were:

	2010 £m	2009 £m
Year-end	**0.5**	0.1
Maximum	**1.6**	1.0

37. WHOLESALE CREDIT RISK

The Group's wholesale credit risk arises principally from assets held for liquidity purposes. The risk is that counterparties with whom the Group invests liquid assets fail to repay those investments when they fall due. The Group, through the Group Risk function, undertakes its own internal rating of all its counterparties and sets individual limits accordingly. These limits are reviewed at least annually, with revocation or suspension taking place where considered appropriate. The ratings are compared with those produced by external rating agencies at least annually. Whilst recognising that exposures will be maintained across a spectrum of counterparties, and that it is not commercially feasible to limit exposure to the highest (i.e. best) rated organisations, the board has established a risk averse policy. Individual exposure limits are set according to the credit rating applied to a given institution, i.e. lower limits for lower rated institutions. Limits are in place governing the types of instrument in which the Group will invest, as well as geographic and sector limits designed to prevent over-exposure to a given country or business type. The following table breaks down exposures using Basel exposure methodology and composite external ratings.

	2010	2009
AAA	**69%**	51%
AA+ to AA-	**17%**	34%
A+ to A-	**9%**	8%
Other	**5%**	7%
	100%	100%

The maximum gross exposure to any one country (other than the UK), excluding structured credit and money market fund exposures is £229m (2009 – £231m restated*). The largest exposure is to France.

99% of all wholesale exposures are to major industrial countries. The largest gross exposure to a single institution (other than the UK Government) is £513m (2009 – £740m), which is to a UK clearing bank.

None of these exposures was either past due or impaired and there are no assets that would otherwise be past due or impaired whose terms have been renegotiated. The Group has a £216m exposure to a number of Irish banks, £42m of which was repaid in January 2011 with the remainder being due for repayment between November 2011 and July 2012. These currently benefit from a guarantee under the Irish Government Eligible Liabilities Guarantee Scheme until the end of June 2011. This scheme is approved by the European Commission under EC Treaty state aid rules and can be extended on a six monthly basis with their approval. The recent agreement between the Irish government, the European Union and International Monetary Fund (IMF) for a restructuring plan in November 2010 contained guarantees for the full repayment of its senior unsecured bonds. In light of the agreement, this exposure is considered not impaired.

The Society uses an internal credit ratings model to help identify potential risks and this has resulted in the avoidance of direct exposure to counterparties such as Greece and Portugal.

* The 2009 figure has been restated to exclude structured credit and money market fund exposures.

37. WHOLESALE CREDIT RISK (continued)

Wholesale credit risk is recorded in the following statement of financial position captions:

	2010 £m	2009 £m
Cash in hand and balances with the Bank of England	**1,310.8**	1,149.8
Loans and advances to credit institutions	**935.8**	988.4
Debt securities	**3,615.2**	4,562.2
Derivative financial instruments	**579.8**	904.5
Investments (note a)	**2.1**	2.1
Total wholesale credit risk	**6,443.7**	7,607.0

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

	2010 £m	2009 £m
UK Government securities	**1,007.3**	1,421.6
Medium-term notes issued by financial institutions	**1,620.8**	1,389.2
Certificates of deposit	**114.1**	972.6
Mortgage backed securities (note b)	**801.6**	705.6
Combination note (note c)	**10.9**	10.9
Synthetic collateralised debt obligations (note d)	**31.9**	32.3
Cash collateralised debt obligations (note e)	**28.6**	30.0
	3,615.2	4,562.2

(a) Principally the equity investment in VocaLink Holdings Limited which is associated with the Group's operation of cash machines.

(b) Mortgage backed securities are all backed by AAA rated UK prime residential mortgages.

(c) The combination note is structured to pay a return over and above its regular coupon.

(d) There are five holdings in synthetic credit investments. These contain embedded derivatives that have been separated with changes in fair value being taken directly to the income statement.

(e) There are investments in five cash based collateralised debt obligations, each of which continues to perform and there is no evidence of any impairment. These investments have been classified as available for sale.

The maximum exposure to wholesale credit risk at 31st December 2010 is as reported in the statement of financial position.

38. RETAIL CREDIT RISK

Following the merger with Chelsea Building Society on 1st April 2010, the Group's exposure to retail credit risk increased to £23.3bn (2009 – £15.0bn). Work prior to the merger ensured that Chelsea's lending policies were, from the merger date, aligned with those of the wider Group, and that analysis and control of Chelsea's mortgage portfolio were integrated within the Group's credit risk governance practices.

Across the Group, automated credit scoring tools are deployed to support sound credit decision-making within mortgage lending activities. A proactive approach to the identification and control of changing risk profiles and loan impairment is maintained in the Group Risk function, with challenge and oversight provided by the Group Credit Committee. This committee receives regular reports from Retail Credit Risk and the Retail Credit Committee on the risk profile of the Group portfolio by defined key risk indicators, to ensure the business profile remains within risk appetite.

The measures considered 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, behavioural scores) as well as monitoring of the overall characteristics of the loan portfolios (e.g. geographic, behavioural credit score, indexed loan-to-value concentrations, income multiples). In addition, the Group undertakes a number of stress tests that subject the 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.

Geographic distribution of mortgage balances	2010 %	2009 %
Scotland	**8**	11
North East	**5**	6
Yorkshire & Humberside	**12**	17
North West	**12**	14
Midlands	**12**	12
East Anglia	**3**	3
South West	**7**	5
Greater London	**13**	11
South East	**23**	15
Wales & Northern Ireland	**5**	6
	100	100

Loan-to-value distribution	Book		New Lending	
	2010	2009	2010	2009
Loan-to-value	%	%	%	%
Greater than 90%	**23**	27	**–**	–
75% to 90%	**23**	19	**32**	25
50% to 75%	**30**	26	**56**	56
Less than 50%	**24**	28	**12**	19
	100	100	**100**	100

The Group's average indexed loan-to-value is 56% (2009 – 52%). The proportion of the Group's loan books that are over 90% loan-to-value has fallen to 23% as at 31st December 2010 (2009 – 27%). At the same time the Group has continued to restrict the loan-to-values permitted on new lending.

Customer type	Book		New Lending	
	2010 %	2009 %	2010 %	2009 %
First time buyer	**16**	19	**26**	9
Other buyers, i.e. movers	**41**	47	**51**	51
Remortgage	**32**	34	**23**	40
Buy-to-Let	**10**	–	**–**	–
Other	**1**	–	**–**	–
	100	100	**100**	100

38. RETAIL CREDIT RISK (continued)

Arrears statistics

Arrears outstanding as a percentage of debt	Group 2010 %	Group 2009 %	Society 2010 %	Society 2009 %
No arrears	**91.91**	92.95	**93.86**	97.53
Less than three months	**5.38**	4.16	**4.49**	1.75
Three to six months	**1.37**	1.50	**0.82**	0.45
Six to 12 months	**0.72**	0.79	**0.41**	0.17
Over 12 months	**0.24**	0.22	**0.16**	0.03
Property in possession	**0.38**	0.38	**0.26**	0.07
	100.00	100.00	**100.00**	100.00
Number of properties in possession at the year end	**629**	380	**332**	52

The percentage of loans with arrears of three months or more has fallen during 2010 despite the challenging economic environment. Possessions expressed as a percentage of the total mortgage book have remained flat at 0.38%, despite the increase in the absolute number which reflects the inclusion of Chelsea possession cases. The Group's arrears ratios remain comparable to industry standards, and where they relate to higher risk lending the Group's pricing approach looks to ensure that the Group is adequately rewarded for the additional risks taken. Arrears on more recent lending are minimal, reflecting the de-risking measures undertaken from 2008 onwards.

Loans and advances

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Not impaired:				
Neither past due nor impaired	**21,458.2**	13,665.8	**15,535.8**	8,350.3
Past due but not impaired	**940.7**	420.6	**592.4**	115.3
Impaired	**1,043.7**	669.0	**493.1**	106.4
Total loans and advances	**23,442.6**	14,755.4	**16,621.3**	8,572.0

Loans acquired from the Chelsea have been fair valued on a basis which makes allowances for anticipated losses over the remaining life of the loans. Impaired loans totalling £403m in the above analysis for 31st December 2010 have thus been fair valued and are therefore unlikely to contribute any significant further losses to the Group.

Group	Loans and advances 2010 £m	Loans and advances 2009 £m	Collateral 2010 £m	Collateral 2009 £m
Neither past due nor impaired	**21,458.2**	13,665.8	**21,342.0**	13,549.2
Past due not impaired	**940.7**	420.6	**927.4**	411.4
Impaired	**1,043.7**	669.0	**1,010.9**	644.9
	23,442.6	14,755.4	**23,280.3**	14,605.5
Society				
Neither past due nor impaired	**15,535.8**	8,350.3	**15,473.9**	8,324.0
Past due not impaired	**592.4**	115.3	**584.8**	113.9
Impaired	**493.1**	106.4	**481.1**	104.4
	16,621.3	8,572.0	**16,539.8**	8,542.3

Impairment is assessed based on the arrears status of each mortage. Where mortgages are more than two months in arrears they are individually assessed for impairment. All mortgages that are past due but not impaired are less than two months in arrears. Where mortgages are less than two months in arrears they are assessed for collective impairment.

The Group continues to invest in developing and enhancing its arrears management strategies and solutions to minimise credit risk losses whilst ensuring customers are treated compassionately and fairly. These forbearance arrangements include term extension, conversion to interest only, payment holidays and other special arrangements agreed on a case by case basis. Following a clear demonstration of rehabilitation, capitalisation of arrears can also be considered for these customers.

Less than 3% of total loans outstanding that are currently Neither past due nor impaired have ever had any arrears capitalised. In the last 12 months loans to the value of £70m or 0.3% of total loans have had arrears capitalised. It should also be noted that a collective provision is carried against loans which are Neither past due nor impaired.

Substantially, all loans and advances are secured on property. Collateral is measured as the lower of the balance outstanding and the estimated current value of the property.

39. 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.

	2010		2009	
	Book Value	**Fair Value**	Book Value	Fair Value
Group	**£m**	**£m**	£m	£m
Assets				
Cash in hand and balances with the Bank of England	**1,310.8**	**1,310.8**	1,149.8	1,149.8
Loans and advances to credit institutions	**935.8**	**935.8**	988.4	988.4
Debt securities – fair value	**17.5**	**17.5**	17.1	17.1
Debt securities – embedded derivative	**(27.2)**	**(27.2)**	(41.0)	(41.0)
Debt securities – available for sale	**2,820.4**	**2,820.4**	3,874.2	3,874.2
Debt securities – held to maturity	**804.5**	**787.6**	711.9	670.8
Loans and advances to customers	**23,370.7**	**23,652.7**	14,979.4	15,160.2
Investments	**2.1**	**2.1**	2.1	2.1
Liabilities				
Shares	**21,382.5**	**21,382.5**	13,793.4	13,793.4
Amounts due to credit institutions	**926.4**	**926.4**	393.4	393.4
Other deposits	**1,061.9**	**1,061.9**	1,091.0	1,091.0
Debt securities in issue	**4,348.4**	**4,343.6**	5,698.7	5,650.8
Subordinated liabilities	**214.9**	**208.5**	111.7	95.9
Subscribed capital	**167.3**	**109.3**	159.3	85.2
Society				
Assets				
Cash in hand and balances with the Bank of England	**1,310.8**	**1,310.8**	1,149.8	1,149.8
Loans and advances to credit institutions	**725.4**	**725.4**	570.3	570.3
Debt securities – fair value	**17.5**	**17.5**	17.1	17.1
Debt securities – embedded derivative	**(27.2)**	**(27.2)**	(41.0)	(41.0)
Debt securities – available for sale	**2,711.8**	**2,711.8**	3,766.4	3,766.4
Debt securities – held to maturity	**804.5**	**787.6**	711.9	670.8
Loans and advances to customers	**16,583.8**	**16,761.0**	8,844.3	8,838.9
Investments	**10,488.1**	**10,488.1**	9,876.3	9,876.3
Liabilities				
Shares	**21,382.5**	**21,382.5**	13,793.4	13,793.4
Amounts due to credit institutions	**1,716.8**	**1,716.8**	866.0	866.0
Other deposits	**3,562.6**	**3,562.6**	3,239.9	3,239.9
Debt securities in issue	**4,348.4**	**4,343.6**	5,698.7	5,650.8
Subordinated liabilities	**214.9**	**208.5**	111.7	95.9
Subscribed capital	**167.3**	**109.3**	159.3	85.2

39. FAIR VALUES (continued)

Fair values of derivative financial instruments are shown in Note 33.

The fair values of all cash in hand, balances with the Bank of England and loans and advances to credit institutions have been recorded at par as they are all due in under one year and there is no impairment.

The fair values of debt securities are determined wherever possible from external market prices. Where reliable prices are not available valuations are determined using models and externally verifiable market factors. The main inputs used in these models are underlying asset credit ratings, credit spreads, defaults in underlying instruments and credit enhancement or subordination factors.

The fair value of loans and advances to customers has been calculated on an individual loan basis taking into account factors such as impairment and interest rates. It is not considered appropriate to value them collectively as a portfolio sale.

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 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 2010				
Debt Securities – fair value	**6.7**	**10.8**	**–**	**17.5**
Embedded derivatives	**–**	**(27.2)**	**–**	**(27.2)**
Debt Securities – available for sale	**2,642.1**	**178.3**	**–**	**2,820.4**
Investments	**–**	**–**	**2.1**	**2.1**
Derivative assets	**–**	**579.8**	**–**	**579.8**
Derivative liabilities	**–**	**(472.3)**	**–**	**(472.3)**
	2,648.8	**269.4**	**2.1**	**2,920.3**

40. 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 £8.6m to the pension scheme (2009 – £23.0m).

Key management compensation
The key management personnel compensations are as follows:

	No. of key management personnel	**2010 £000**	No. of key management personnel	2009 £000
Short-term employee benefits		**1,996**		1,600
Post employment benefits		**99**		64
Total key management personnel compensation	**14**	**2,095**	11	1,664

40. RELATED PARTIES (continued)

Transactions with key management personnel

Key management personnel and their close family members have undertaken the following transactions with the Society under normal business terms.

	No. of key management personnel 2010	**Amounts in respect of key management personnel and their close family members 2010 £000**	No. of key management personnel 2009	Amounts in respect of key management personnel and their close family members 2009 £000
Mortgage loans				
At 1st January		**551**		627
Net movements in the year		**207**		(76)
At 31st December	**3**	**758**	2	551
Deposit accounts and investments				
At 1st January		**1,367**		1,193
Net movements in the year		**(571)**		174
At 31st December	**12**	**796**	11	1,367

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 £880,691.

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 £30,764 (2009 – £17,901), received interest totalling £14,765 (2009 – £64,635), 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.

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:

	2010 £m	2009 £m
Shares in subsidiaries		
At 1st January	**211.9**	241.8
Acquired on transfer of engagements	**8.0**	–
Net movements	**–**	(29.9)
At 31st December	**219.9**	211.9
Loans to subsidiaries		
At 1st January	**9,662.1**	10,362.9
Acquired on transfer of engagements	**207.0**	–
Net movements	**396.8**	(700.8)
At 31st December	**10,265.9**	9,662.1
Deposits from subsidiaries		
At 1st January	**3,705.9**	3,798.1
Net movements	**466.5**	(92.2)
At 31st December	**4,172.4**	3,705.9
Interest receivable on loans	**366.1**	400.3
Interest payable on deposits	**(62.3)**	(78.7)
Fees and expenses receivable	**13.6**	15.0
Fees and expenses payable	**(2.6)**	(2.6)

40. RELATED PARTIES (continued)

Transactions with joint ventures

The Society holds 50% of the share capital of MutualPlus Ltd, a branch sharing company. The outstanding balances at 31st December 2010 and 31st December 2009 are less than £0.1m.

Chelsea Building Society

On 2nd February 2010, £520m was advanced to Chelsea Building Society, on commercial terms, as a reverse repo transaction secured by a covered bond issued by that society. Subsequent to the merger this arrangement was extinguished on the combination of the two legal entities.

41. CASH FLOWS FROM OTHER OPERATING ACTIVITIES

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Working capital adjustments:				
Depreciation and amortisation	**15.5**	11.4	**14.9**	10.6
Interest on subordinated liabilities and subscribed capital	**26.5**	16.2	**26.5**	16.2
Provisions	**49.5**	61.2	**12.0**	9.2
Gain attributable to transfer of engagements	**(17.1)**	–	**(17.1)**	–
Fair value of subordinated liabilities and subscribed capital	**111.2**	(9.1)	**111.2**	(9.1)
Profit on realisation of debt securities	**(15.2)**	(11.5)	**(15.2)**	(10.8)
Increase in other assets	**(13.9)**	(10.4)	**(6.2)**	(18.9)
Decrease in other liabilities	**(103.8)**	(11.6)	**(4.4)**	(7.7)
Working capital adjustments	**52.7**	46.2	**121.7**	(10.5)
Decrease/(increase) in operating assets:				
Loans and advances to credit institutions	**101.1**	–	**100.2**	–
Loans and advances to customers	**789.6**	1,253.4	**1,264.2**	918.7
Investments	**–**	–	**(396.8)**	730.7
Derivative financial instruments	**117.4**	(203.0)	**(317.0)**	(410.3)
Net decrease in operating assets	**1,008.1**	1,050.4	**650.6**	1,239.1
(Decrease)/increase in operating liabilities:				
Shares	**(2,362.0)**	110.3	**(2,362.0)**	110.3
Amounts owed to credit institutions	**(726.7)**	(697.1)	**(433.6)**	(964.6)
Other deposits	**(204.5)**	(671.0)	**147.3**	(765.4)
Net decrease in operating liabilities	**(3,293.2)**	(1,257.8)	**(2,648.3)**	(1,619.7)

42. TRANSFER OF ENGAGEMENTS

On 1st April 2010, the Society acquired the business of the Chelsea Building Society ("the Chelsea") following the approval of the shareholding and borrowing members of both societies.

Since the onset of the financial crisis the Chelsea had experienced a period of disappointing financial performance arising from a range of factors including: significant losses on investments with Icelandic Banks; the need to raise large amounts of expensive retail funds due to the Chelsea's difficulty in accessing wholesale markets; further exacerbation of these funding issues by a severe credit rating downgrade; and fraud in its buy-to-let mortgage book. These factors contributed to the Chelsea recording significant losses in both 2008 and 2009.

The assets and liabilities acquired and the associated accounting adjustments are set out below:

	Notes	Cessation Accounts £m	Reclassi-fications £m	Adjustments £m	Take on balances £m
Assets					
Cash in hand and balances with the Bank of England		1,227.4	–	–	**1,227.4**
Loans and advances to credit institutions		101.1	–	–	**101.1**
Debt securities	e	1,642.3	1.2	(3.6)	**1,639.9**
Derivative financial instruments		84.3	–	1.1	**85.4**
Fair value adjustment for portfolio hedged risk		169.4	–	(169.4)	**–**
Loans and advances to customers	c	9,407.8	–	(186.1)	**9,221.7**
Investment securities	e	1.2	(1.2)	–	**–**
Intangible assets	d	1.8	–	10.5	**12.3**
Property, plant and equipment	e	62.8	(10.8)	(19.6)	**32.4**
Investment properties	e	1.8	10.8	(0.8)	**11.8**
Other assets and prepayments		13.9	–	(10.4)	**3.5**
Current tax		0.4	–	2.5	**2.9**
Deferred tax		2.8	–	85.2	**88.0**
Total assets		12,717.0	–	(290.6)	**12,426.4**
Liabilities					
Shares		10,039.0	–	(87.9)	**9,951.1**
Deposits from banks and credit institutions		1,259.7	–	–	**1,259.7**
Due to customers		175.4	–	–	**175.4**
Derivative financial instruments		195.3	–	–	**195.3**
Fair value adjustment for portfolio hedged risk		10.7	–	(10.7)	**–**
Debt securities in issue		302.9	–	8.6	**311.5**
Other liabilities	e	123.0	(9.3)	–	**113.7**
Provision for liabilities and charges	e	0.8	9.3	32.9	**43.0**
Accruals and deferred income		3.4	–	–	**3.4**
Retirement benefit obligations		16.4	–	–	**16.4**
Reserves		590.4	–	(233.5)	**356.9**
Total liabilities		12,717.0	–	(290.6)	**12,426.4**
Goodwill					
Fair value of net assets					**356.9**
Less: deemed purchase consideration	f				**339.8**
Negative goodwill	g				**17.1**

This information has been updated since the provisional adjustments published in the Interim Group Accounts for the six months to 30th June 2010. IFRS requires that valuations are finalised within a period of 12 months from the date of the merger. As a result, final valuations and adjustments will be disclosed in the Interim Group Accounts for the six months to 30th June 2011.

42. TRANSFER OF ENGAGEMENTS (continued)

Notes and adjustments

a The Income and expenditure account for the Chelsea for the period to 31st March 2010 is reported in the table below for information only and these amounts have not been included in the Income statements of the Society or the Group. Following the transfer of engagements, the Chelsea ceased to exist, being subsumed by Yorkshire Building Society. It is thus not possible to separate its results from 1st April 2010.

b The cessation accounts of the Chelsea have been prepared in accordance with IFRS. Certain reclassifications have been made and balances have been adjusted in accordance with 'IFRS 3 Business Combinations'.

c A fair value adjustment to reflect estimated future losses has been made. In addition, mortgage balances have been adjusted to fair value by comparing them with the Society's current product range.

d Identifiable intangible assets relate to the intrinsic value of a retail savings book and the Chelsea brand. They will be amortised over their useful lives of between one and ten years

e Investment securities have been reclassified to Debt securities, certain properties ancillary to branches and not used by the business have been reclassified from Property, plant and equipment to Investment properties and provisions relating to the FSCS scheme have been reclassified from Other liabilities to Provision for liabilities and charges.

f The combination of the two societies did not result in any transfer of consideration. The deemed purchase price has been calculated by measuring the fair value of the Chelsea business. This calculation has been based on a forward projection of cash flows generated by the business assuming modest growth in business assets and a saving in management expenses due to synergies. These projections have been discounted at a rate of 6.4% which approximates to the estimated long-term cost of capital.

g Negative goodwill results from the transaction and has been recognised in the Income statement.

Income and expenditure account of the Chelsea Building Society
For the period 1st January 2010 to 31st March 2010

	£m
Net interest income	**5.9**
Net fee and commission income	**3.2**
Administrative expenses	**(17.4)**
Depreciation	**(2.1)**
Impairment losses on loans and advances	**(0.5)**
Icelandic investments release	**0.3**
Provision for FSCS	**(0.4)**
Operating loss before capital restructuring	**(11.0)**
Gains on cancellation of subordinated debt prior to merger	**121.0**
Operating profit	**110.0**
Taxation	**(4.0)**
Net profit for the period*	**106.0**

* The above income and expenditure relates to the cessation accounts of the Chelsea Building Society and these amounts have not been included in the Income statements of Yorkshire Building Society or the Group. They are reported here for information only. It is not felt to be practicable to disclose what the results for the enlarged Society would have been for the period to 31st March 2010 if the merger had taken place on 1st January 2010.

Annual business statement

1. STATUTORY PERCENTAGES

	2010 %	Statutory Limit %
Lending limit	**3.5**	25.0
Funding limit	**21.4**	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

	2010 %	2009 %
As a percentage of shares and borrowings:		
Gross capital	**6.20**	5.58
Free capital	**5.69**	5.13
Liquid assets	**21.15**	31.94
Profit for the financial year as a percentage of mean total assets	**0.35**	(0.01)
Management expenses as a percentage of mean total assets	**0.66**	0.57
Management expenses as a percentage of mean total assets adjusted for the effects of the merger	**0.51**	0.54

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; and
- 'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

Annual business statement

continued

3. INFORMATION RELATING TO THE DIRECTORS AND OTHER OFFICERS AT 31ST DECEMBER 2010

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 Leeds Trinity University College Mid Yorkshire Hospitals NHS Trust St. Gemma's Hospice University of Leeds
Ms K. M. Barker, CBE 29th November 1957	Economist	5th November 2010	Electra Private Equity Plc The Homes and Communities Agency The National Institute of Economic and Social Research
I. J. Bullock, BSc, FIA 7th November 1960	Building Society Sales and Marketing Director	12th April 2007	Accord Mortgages Ltd MutualPlus Ltd
R. F. Burden 3rd June 1946	Company Director	1st April 2010	Football Association Ltd Gloucester Football Association Ltd The Football Foundation The Football Stadia Improvement Fund Ltd
A. M. Caton, BA 27th July 1963	Building Society Corporate Development Director	1st July 2004	CBS Capital Ltd CBS Nominees Ltd Chelsea Building Society Charitable Foundation Chelsea Mortgage Services Ltd YBS Investments (No. 1) Ltd YBS Investments (No. 2) Ltd Yorkshire Building Society Charitable Foundation Yorksafe Insurance Company Ltd Yorkshire Guernsey Ltd Yorkshire Investment Services 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 YBS Investments (No.1) Ltd YBS Investments (No.2) Ltd Yorkshire Building Society Estate Agents Ltd Yorkshire Investment Services Ltd
I. C. A. Cornish, BSc 11th November 1960	Building Society Chief Executive	1st July 2003	Accord Mortgages Ltd Yorkshire Investment Services Ltd Yorkshire Key Services Ltd Yorkshire Key Services (No. 2) Ltd
R. H. Davey, BA 22nd July 1948	Company Director	27th September 2005	Amlin Plc London Capital Group Holdings Plc Severn Trent Plc Severn Trent Water Ltd
P. R. Johnson, FCA 12th October 1946	Chartered Accountant	1st June 2007	Cheadle Hulme School Member of the board of Addleshaw Goddard LLP

Annual business statement

continued

3. INFORMATION RELATING TO THE DIRECTORS AND OTHER OFFICERS AT 31ST DECEMBER 2010 (continued)

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
D. V. Paige, BSc, FCA 3rd July 1951	Company Director	31st December 2006	Aegon Direct Marketing Services Europe Ltd Cornerstone International Holdings Ltd Edgecumbe Consulting Group Ltd Guardian Assurance Plc Guardian Linked Life Assurance Ltd Guardian Pensions Management Ltd Scottish Equitable Plc Scottish Equitable (Managed Funds) Ltd Stonebridge International Insurance Ltd
S. Turner, BSc 29th November 1951	Company Director	13th October 2005	Identive Group Inc Netretail Holding BV TradeDoubler AB

Mr A. M. Caton, Mr I. C.A. Cornish and Mr I. J. Bullock entered into renegotiated contracts during 2009, which are terminable by the Society or the director on one year's notice.

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.

Officer	Business Occupation	Directorships
Mrs R. D. Court, BA	General Manager, Human Resources and Customer Service	Yorkshire Guernsey Ltd
Mrs A. L. FitzPatrick, LLB	Group Secretary and Head of Legal	Mortgage Loan Management Ltd Phillip Schofield & Company Phillip Schofield (Property Management) YBS Ltd Yorkshire Direct Ltd Yorkshire Estate Agents Ltd Yorkshire Insurance Services Ltd Yorkshire Life Assurance Services Ltd Yorkshire Mortgage Services Ltd Yorkshire Personal Financial Services Ltd Yorkshire Property Services Ltd Yorkshire Services Ltd Yorkshire Syndications Ltd
D. N. Henderson, BSc	General Manager, Group Services and Chief Information Officer	Barnsley Property Services Ltd CBS Property Services Ltd YBS Properties Ltd YBS Properties (Edinburgh) Ltd YBS Properties (York) Ltd Yorkshire Computer Services Ltd Yorkshire Key Services Ltd Yorkshire Key Services (No 2) Ltd
M. R. Jenkins, BA, FCA, DipL	General Manager, Commercial Development	BCS Loans and Mortgages Ltd
R. S. Wells, FCIB	General Manager, Risk	None

Principal Office:
Yorkshire House, Yorkshire Drive, Bradford BD5 8LJ.   www.ybs.co.uk

Auditors:
Deloitte LLP, 1 City Square, Leeds LS1 2AL.

REPORT & ACCOUNTS 2010

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Head Office: Yorkshire Building Society, Yorkshire House, Yorkshire Drive, Bradford BD5 8LJ.

Barnsley Building Society and the Barnsley are trading names of Yorkshire Building Society.

Chelsea Building Society and the Chelsea are trading names of Yorkshire Building Society.

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Yorkshire BUILDING SOCIETY

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