Skipton Building Society

Annual Report & Accounts

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SKIPTON BUILDING SOCIETY

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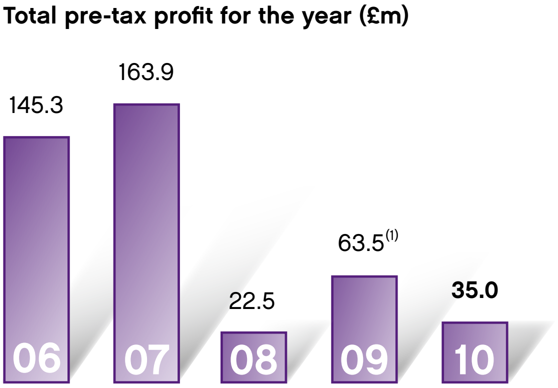
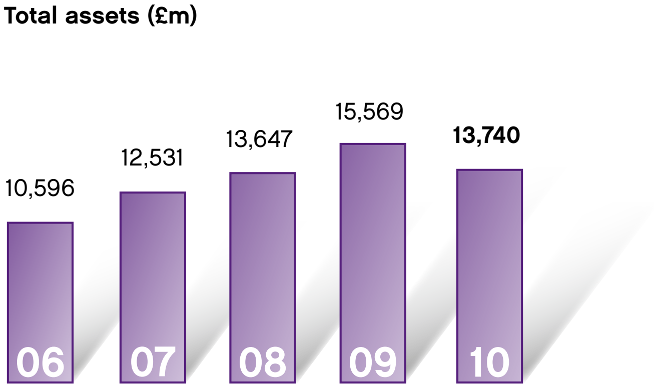
- Group profit before tax from continuing operations **up 94% to £35.0m (2009: £18.0m)**
- Core Tier One capital ratio **up 18% to 11.1% (2009: 9.4%)**
- Solvency ratio **up 14% to 16.6% (2009: 14.5%)**
- Group retail funding as a percentage of total funding **82% (2009: 79%)**
- Improved quality of liquid assets – Core liquidity buffer eligible assets as a percentage of total liquid assets **56% (2009: 37%)**

“…Skipton Building Society further improved its financial strength during 2010 by both substantially increasing the Group’s trading profits and improving its Core Tier One capital ratio.”

D J Cutter
Group Chief Executive

Five Year Summary





The Group's capital resources profile

	2006	2007	2008	2009	**2010**
Core Tier 1 ratio (%)	8.64	8.67	8.61	9.37	**11.06**
Total capital ratio (%)	12.88	12.30	12.28	14.48	**16.60**
Tier 1 ratio (%)	9.14	9.09	9.03	10.77	**12.64**
Tier 1 capital (before deductions[2]) (£m)	647	771	780	873	**910**
Tier 1 capital (after deductions) (£m)	463	541	537	691	**719**
Gross capital (£m)	813	935	918	1,063	**1,120**
Free capital (£m)	557	631	606	811	**854**

Notes
1. Includes profits of £45.5m from discontinued operations.
2. Intangible assets.

Group Income Statements

	2006 £m	2007 £m	2008 £m	2009 £m	**2010 £m**
Net interest receivable	98.8	110.7	87.5	53.3	**54.9**
Other income	415.8	433.1	351.7	386.5	**387.0**
Share of profits from joint ventures and associates	1.0	3.7	3.9	0.2	**0.3**
Profit on disposals of subsidiary undertakings and associates	15.7	36.0	31.4	-	**1.2**
Total income	531.3	583.5	474.5	440.0	**443.4**
Administrative expenses	(376.8)	(416.2)	(389.7)	(383.7)	**(395.5)**
Negative goodwill arising on merger	-	-	-	-	**3.1**
Impairment losses on loans and advances	(5.6)	(5.4)	(34.6)	(43.6)	**(14.8)**
Impairment (losses) / recoveries on debt securities	-	-	(11.5)	1.3	**(0.1)**
Provisions for liabilities	(1.6)	(0.8)	(20.8)	4.0	**(1.1)**
Profit before tax from continuing operations	147.3	161.1	17.9	18.0	**35.0**
Tax (expense) / income	(32.6)	(36.3)	2.8	(4.3)	**(9.8)**
Profit from continuing operations	114.7	124.8	20.7	13.7	**25.2**
Operating profit / (loss) from discontinued operation (net of tax)	(1.6)	1.8	3.1	4.2	**-**
Profit on disposal of discontinued operation	-	-	-	39.7	**-**
Profit for the financial year	113.1	126.6	23.8	57.6	**25.2**
Attributable to:					
Members of Skipton Building Society	111.7	125.5	22.8	57.4	**25.5**
Non-controlling interests	1.4	1.1	1.0	0.2	**(0.3)**
	113.1	126.6	23.8	57.6	**25.2**
As at 31 December					
Total assets	10,596	12,531	13,647	15,569	**13,740**

	2009 £m	**2010 £m**
Profit before tax from continuing operations	18.0	**35.0**
Profit before tax from discontinued operations	5.8	**-**
Profit on sale of discontinued operations	39.7	**-**
Group profit before tax	63.5	**35.0**

The past year has been characterised by continued external challenges such as fiscal tightening measures initiated by the Government – the full impact of which remains, as yet, unclear – and the Europe wide ripple effects of the implementation of sovereign debt rescue packages. These measures, coupled with the effects of growing unemployment; regulatory changes which threaten further to restrict access to mortgage finance; and the imminent withdrawal of support measures such as government funding for financial institutions, mean that caution will remain key to our effective management of the business for the foreseeable future.

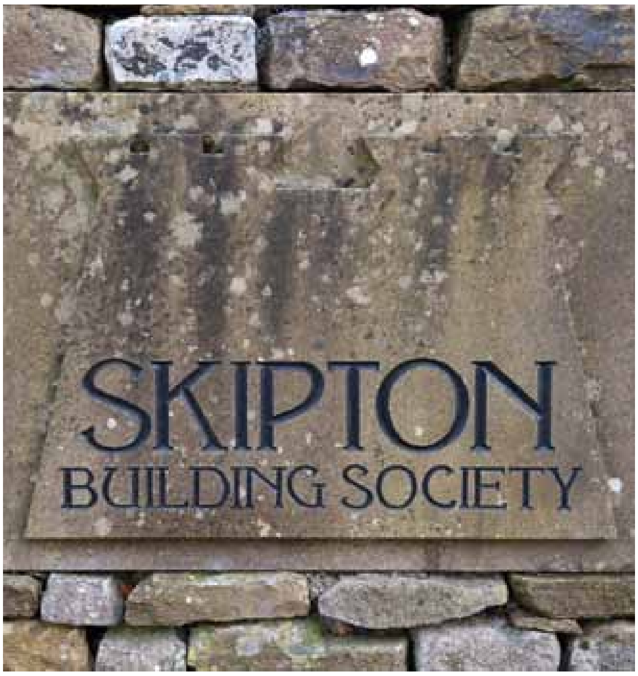
I am pleased to say that the prudence we have exercised throughout the global financial crisis and the recession which followed – coupled with our willingness to make necessary and pragmatic decisions such as increasing the Society's mortgage Standard Variable Rate ('SVR') and restructuring to manage cost effectively – have contributed to our latest reported performance. All of this is, of course, further underpinned by our diversified Group, which brings additional income and opportunity to the Society through the economic cycle.

We have improved our performance over the past 12 months, as shown by increased underlying profits and a stronger capital base. Our funding has remained robust and we have responded to the regulatory requirements to hold higher quality liquidity. Risks faced by the business continue to be closely managed including the potential for increased arrears resulting from the pressures the current economic climate is placing on individuals.

> "2011 will see Skipton continuing to pursue a strategy of controlled growth with members' interests firmly at its core."

There is little doubt that further potential threats to economic recovery, and thus to the Group's businesses, remain on the horizon for 2011. These include continued uncertainty about the pace and extent of economic recovery; the risks associated with increasing inflation; the expected impact of rising unemployment which will affect the Society's mortgage arrears levels; a housing market and house prices which seem set to remain flat at best for the next 12 months and the probability that historically low interest rates will remain for some considerable time. These continue to put pressure on our earnings and thus our ability to generate the capital required to support our growth. We will continue to work with others in the sector to develop a form of external capital which is consistent with mutual ownership, attractive to the market and accepted by the regulator.

Our members can, however, rest assured that we remain vigilant and well-placed to withstand such issues, and 2011 will see Skipton continuing to pursue a strategy of controlled growth with members' interests firmly at its core. We will remain true to our mutual ethos by offering what our members tell us they require; straightforward, dependable, good value savings accounts and competitive and innovative mortgage products for people feeling the detrimental effects of current market conditions on both the returns on their savings and the amount of equity in their homes. We will also offer a variety of options which cater effectively for the full range of our members' needs, through attractive products and services ranging from independent financial advice to will writing and funeral planning.



We continue to maintain our commitment to the communities in which our members live and work, through our established partnerships, branch-based giving to local communities through our Community Contribution Award Scheme and the Skipton Building Society Charitable Foundation.

I was appointed chairman in the spring, succeeding John Rawlings on his retirement. I must take this opportunity to thank John for his contribution to Skipton over 14 years of service – five as Chairman – during which time he played an integral part in ensuring the Society's continued success despite latterly experiencing one of the most difficult economic environments in a generation. During the year we also said goodbye with regret to two Non-Executive Directors, John Spence and Paula Hay-Plumb, who resigned from the Board due to potential conflicts of interest posed by new roles they have taken up elsewhere. I would like to thank them both sincerely for their contributions to the Group during their time with Skipton. Our former Group Finance Director, Tom Wood, also left the Society in September to develop his career elsewhere and I was pleased that we were able to reappoint Richard Twigg to this role, which he had previously held for seven years.

I must also give credit to the achievement of our skilled team of senior managers. Through their delivery of consistently solid results, our members, counterparties and other stakeholders can have confidence that the Society has the management capability and experience needed to ensure our ongoing success as the current economic recovery hopefully consolidates.

Of course, such resilience would not have been possible without the efforts of all our people in all our businesses and, on behalf of the Board, I recognise the contribution of our staff who have demonstrated energy, determination and commitment in order to deliver positive business and service performance for the benefit of Skipton's members.

While challenging economic conditions remain, we are confident that, supported by a strategic business transformation programme – we, both members and those who work in our businesses, can all look forward to remaining part of an organisation of which they can be truly proud.

A I Findlay

Chairman

22 February 2011

Overview

I am pleased to report that Skipton Building Society further improved its financial strength during 2010 by both substantially increasing the Group's trading profits and improving its Core Tier One capital ratio to 11.1%.

Despite a continuation of historically low interest rates and constrained money markets, together with a subdued housing market during the second half of the year, the Society has continued to enhance its financial strength by implementing a clear strategy to grow the business whilst maintaining appropriate levels of capital and liquidity.

Operating in the long-term best interests of the Society

Skipton remains a successful mutual building society with tremendous future opportunities; and it is thanks to the tireless commitment and team effort of our people that we remain optimistic about the future, and our ability to overcome any external challenges which may arise.

During 2010 we introduced a number of pragmatic measures designed to mitigate the impact of extraordinary market conditions on the Society, including the historically low Bank Base Rate of 0.5% for almost two years. In March, due to these exceptional circumstances, we exercised our right to remove the ceiling on our mortgage Standard Variable Rate ('SVR'). The Society subsequently increased its SVR from 3.50% to 4.95%; however, at 4.95% our SVR still remains below the average of the top 10 UK building societies.

We also undertook a business restructuring programme in the spring, to maximise efficiency across the business. We reduced our balance sheet to an appropriate level to protect the business in the short-term and pave the way for longer-term growth.

We have also taken steps to re-focus on core business and related activities, reaffirming our members' status at the heart of everything we do, which resulted in – among other things – the sale of our subsidiary mortgage distribution business Pink Home Loans for a profit of £1.2m.

> "...mutuals like ourselves face a rare opportunity to meet consumers' desire for greater competition and alternative solutions in financial services, in this immediate post-credit crunch environment."

It is widely recognised that mutuals like ourselves face a rare opportunity to meet consumers' desire for greater competition and alternative solutions in financial services, in this immediate post-credit crunch environment. Consequently, we believe that we are in a key phase of our successful history, and are seizing the opportunity to commence a business transformation programme, focusing on everything from systems capability to the kinds of products and services we offer. This will underline our mutual commitment to offering the best possible experience to our customers for many years to come.

Financial Highlights

From a financial perspective, the highlights for 2010 included a further improvement in our capital ratios and an almost doubling of profits from continuing operations.

- Group profit before tax from continuing operations increased by 94% to £35m, compared to £18m in 2009 (i.e. excluding the one-off gain of £40m from the sale of Callcredit Information Group in December 2009 and the profits it generated that year);
- The £17m increase in Group profits from continuing operations was largely due to the improvement in the Mortgages and Savings division, where losses reduced by £26m, from £33m to £7m. The Group profits were also bolstered by another good performance from the Estate Agency division which delivered profits of £48m (2009: £54m);
- Our Core Tier One capital ratio, a measure of financial strength, was 11.1% at 31 December 2010. The increase from 9.4% at 31 December 2009 was partly due to our strategy of deliberately reducing the size of the balance sheet. Group mortgage assets declined by £1,025m during the year (9.6%);
- The net interest margin reported for the full year of 0.37% remained similar to the prior year (2009: 0.36%), but was more than double at 0.40% for the second half of 2010 when compared to the same period in 2009;
- Impairment losses on loans and advances reduced by £29m, from £44m in 2009 to £15m in 2010.

Savings

With a constant eye on understanding and catering for our customers' needs, we have continued to strengthen our retail savings franchise by offering innovative new products and services for varying circumstances, such as our first Telephone Saver account and the My Savings online range helping members achieve their savings goals. As a result, 82% of our funding is now derived from customers, up from 79% the year before. At the same time, we have maintained a delicate balance between offering our members straightforward, transparent and dependable long-term good value, complemented by regular special offers, and keeping retail funding costs at a sensible level in the best interests of all our members.

Mortgages

We continue to support one of our principal mutual objectives to help our members in achieving their home ownership aspirations. During 2010, after deliberately reducing lending volumes while we concentrated on strengthening our capital position, we cautiously increased our lending activity, offering a competitive range of products for differing needs. Mortgage completions amounted to £481m, an increase of 18%. These included lower deposit loans for people affected by the impact of housing market volatility on the equity in their homes and one of the only First Time Buyer mortgages available at the time, requiring a deposit of just 5%. The often market leading competitiveness of our mortgage and savings products was recognised with 471 mentions in independent newspaper 'Best Buy' tables during the course of the year. In order to, again, balance our customer focus with the need to control risk to the business, these products were offered in limited edition tranches. Our efforts are now focused on maintaining this cautious growth throughout 2011.

Our mortgage portfolios continue to perform well, and in line with industry norms. We have significantly reduced our impairment losses during the year, largely as a result of consistently applying our prudent credit risk management processes to our North Yorkshire Mortgages and Amber Homeloans portfolios, while always seeking to treat customers fairly and as individuals. While Society arrears rose slightly, this was a modest increase from a very low base and they remained in line with industry averages.

Chesham Merger

We completed our second merger in two years, with Chesham Building Society, successfully integrating systems and infrastructure to ensure an uninterrupted service for former Chesham customers from the completion of the merger. This union has further enhanced Skipton's retail distribution capability, creating an enlarged mutual with three extra branches. The majority of Chesham staff were re-employed by Skipton, though its former Head Office was closed as the most cost effective solution for the combined business.

Children enjoying a workshop by the Society-funded Skipton Building Society Camerata at Christ Church C.E. School in Skipton.

> "...we remain vigilant; committed to helping our members navigate a course through unprecedented obstacles; and cautiously optimistic that we are well placed to take advantage of the appropriate strategic opportunities that will present themselves."

Service

During the year the Society made a significant investment in new sub-branches, opening 13 new outlets in South Yorkshire, the Wirral, the Home Counties and North Devon. Sharing premises with our estate agency business Connells, we hope this will boost accessibility and convenience for new and existing members in these communities, as well as being a cost effective way of enhancing our distribution capability.

Community

In addition to our day-to-day service to members out in their communities, we believe in actively investing in the areas where they live and work both through the Society and our independent Skipton Building Society Charitable Foundation. To this end, we continued to play an active part both in our North Yorkshire heartland and in branch regions across the country during 2010, with an emphasis on organisations which reflect our charitable priorities such as the Arts, sport, general community enhancement and money advice.

Group

Skipton's diversified Group structure continues to be a lynchpin of our ongoing success, with our range of businesses which, collectively, have continued to weather the storm well, continuing to make a positive contribution to the Society during 2010. Our Estate Agency division, headed by estate agency network Connells, achieved profits of £48m, another impressive performance. This was a reduction of 11% year-on-year, due to decreasing transaction levels in the second half of 2010 resulting from a subdued housing market. Of our other major subsidiaries, our unique national in-branch whole of market financial advice company, Skipton Financial Services, continued to thrive, thanks partly to the popularity of the market leading solution it offers to help customers keep track of their investments, called *M*II (Monitored Informed Investing).

Our financial services outsourcing provider Homeloan Management ('HML'), saw its profitability temporarily impacted by a moribund mortgage market. Its operating profits (excluding integration costs) reduced from £4.7m in 2009 to £2.6m. However, HML has been re-positioning the business over the last couple of years and, following extensive restructuring and investment in its proposition, is set to benefit from an expected improvement in the market for outsourcing financial services products, as well as a healthy pipeline of mortgage administration opportunities. This strategy will also see the company diversify into unsecured lending and savings administration.

Outlook

Once again, the outlook remains mixed for the year ahead, with the impact of the Government's fiscal tightening on economic growth and unemployment as yet unclear. This means we will continue to manage the business carefully and prudently. However, it is my belief that economic growth will be positive but modest in 2011, and the road ahead remains a lengthy and arduous one. It is clear to me that the prospects of housing market recovery will remain limited until the strictures still impacting on credit markets are removed, enabling lending to pick up again. House prices have now fallen in excess of 20% since their 2007 peak, and there is a real possibility of further, albeit limited, falls given subdued lending activity, a lack in consumer confidence and the potential effects of regulatory changes.

Given these further risks to recovery, it is our view that the Base Rate will remain low for some considerable time. As well as the continued constraints this will place on our profitability, we are acutely aware of the impact on our saving members and will do everything possible to help cushion them in the year ahead and beyond.

Therefore, we remain vigilant; committed to helping our members navigate a course through unprecedented obstacles; and cautiously optimistic that we are well placed to take advantage of the appropriate strategic opportunities that will present themselves.

David Cutter

D J Cutter

Group Chief Executive

22 February 2011

The Board of Directors


Alastair Findlay


David Cutter


Peter (Nimble) Thompson


Richard Twigg


Peter Hales


Noel Hutton


William Worsley


Alexandra (Sandy) Kinney

Alastair Findlay

Chairman

Alastair Findlay, a Chartered Accountant, joined the Board as a Non-Executive Director in June 2006, and was appointed Chairman in April 2010 after two years serving as Vice Chairman. He is Chairman of the Nominations Committee and has served on the Audit Committee. After a number of years' experience in the corporate finance department of a City investment bank, he was Group Finance Director of The Mersey Docks and Harbour Company from 1996 to 2005. Alastair is also Vice Chairman of the Countess of Chester Hospital NHS Foundation Trust.

David Cutter

Group Chief Executive

David Cutter, a Chartered Accountant, joined the Society as Head of Audit in 1993, was appointed to the Board in 2000 and became Group Chief Executive in January 2009. David was Chairman of the Society's Operational Board from 2002 until 2005 and had Board responsibility for the Group's subsidiary businesses until December 2008. He is Chairman of the Society's Executive Committee, Chairman of the Group Retail Credit Committee and a member of the Asset & Liability Committee and Board Risk Committee. Externally, he is a Governor of Malsis Preparatory School.

Peter (Nimble) Thompson

Non-Executive Director

Nimble Thompson joined Skipton in April 2009, and sits on the Board Risk Committee and the Audit Committee, having been on the Board of Scarborough Building Society for three years. He qualified as a solicitor and became Senior Partner and then Deputy Chairman of Eversheds before he retired in 1999. Nimble is Chairman of N G Bailey and a Non-Executive Director of a number of other companies. In addition, he was Chairman of Leeds Metropolitan University for six years, Chairman of Eureka! until 2007 and was Regional Chairman of the Institute of Directors in Yorkshire and the Humber until June 2009, and is a Non-Executive Director nationally.

Richard Twigg

Group Finance Director

Richard Twigg is a Chartered Accountant who joined the Skipton Group in 1993. Having previously been Finance Director of HML and then Connells, he was appointed to the Board in 2002 and served as Group Finance Director until 2009. As Group Commercial Director up to September 2010 he had responsibility for managing the Group's portfolio of subsidiary companies. He was re-appointed Group Finance Director in September 2010. He chairs the Asset & Liability Committee and is a member of the Society's Executive Committee and risk committees. Richard is a Trustee of the Society's Charitable Foundation and is a Governor of Ermysted's Grammar School, Skipton, and Menston Primary School.

Peter Hales

Non-Executive Director

Peter Hales joined the Board as a Non-Executive Director in May 2007 and is Chairman of the Board Risk Committee and a member of the Nominations Committee and Remuneration Committee. Prior to joining the Board he was Sales and Marketing Director of Norwich Union, having previously been a Director of General Accident and CGU. He was President of the Chartered Insurance Institute, the professional body for the insurance industry in 2006. He is also a Director of UNUM Ltd, a member of the Accenture Insurance Advisory Board and a member of the Advisory Board of Simply Biz Plc.

Noel Hutton

Vice Chairman

Noel Hutton joined the Board as a Non-Executive Director in July 2004. He is a member of the Audit Committee and Nominations Committee, Chairman of the Remuneration Committee and was appointed Vice Chairman in April 2010. Before his retirement in 2004, he was a partner in Hammonds, the international law firm, where he specialised in corporate finance.

William Worsley

Non-Executive Director

William Worsley joined the Board in 2009 and serves on the Board Risk Committee. Formerly Chairman of Scarborough Building Society, he is a Fellow of the Royal Institution of Chartered Surveyors and is President of the Country Land & Business Association. He is also a Non-Executive Director of The Brunner Investment Trust Plc and a former member of the Private Banking Board of the merchant bank Guinness Mahon & Co. His early career was spent with property consultants Savills and Humberts.

Alexandra (Sandy) Kinney

Non-Executive Director

Sandy Kinney joined the Board as a Non-Executive Director in July 2003 and is Chairman of the Audit Committee and a member of the Nominations Committee and Remuneration Committee. During her career as an accountant, Sandy was a partner of PricewaterhouseCoopers and was previously a Director at KPMG. In June 2005, she was appointed by the FSA as a Non-Executive Director of the Financial Services Compensation Scheme. In September 2010, she joined Irish Life & Permanent Group Holdings Plc as a Non-Executive Director.

Group Structure

Skipton Building Society is the UK's fourth largest building society, with approximately 779,000 members, £13.7bn of assets, and a national presence represented by its 104 branches. It heads up the Skipton Group, whose divisions have significant interests in estate agency and related businesses (through Connells group), provision of financial services outsourcing (through Homeloan Management), independent financial and related advisory businesses, and support services to the mutual sector.

The Group's operating results are regularly reviewed by the Board (chief operating decision maker) in the following reportable segments. Each segment offers different products and services and is managed on a divisional basis in line with the Group's management and internal reporting structure. The divisions are:

- Mortgages and Savings – principally the Society, but also includes specialist mortgage businesses Amber Homeloans ('Amber') and North Yorkshire Mortgages ('NYM'), and deposit taking and lending in Jersey and Guernsey through Skipton International ('SIL').
- Mortgage Services – mortgage administration services, principally Homeloan Management ('HML'), also includes Specialist Mortgage Services ('SMS') and Baseline Capital.
- Estate Agency – including survey and valuations, conveyancing, lettings, asset management and mortgage broking carried out through the Connells group.
- Financial Advice – provision of financial advice and broking services through four separate financial advice companies.
- Investment Portfolio – includes holding companies and a number of other small trading companies that do not fall within the core operating segments. Individually, these companies are not of a material size to the Group.

The Credit & Marketing Solutions division provided credit reference agency and database services through the Callcredit Information Group. This division became a discontinued operation from 7 December 2009 on disposal.

Overview

The Skipton Group has continued to demonstrate the strength of its diversified business model over the last 12 months. Excluding the profits generated from the sale of the Credit & Marketing Solutions division, and the profits the division generated in 2009, the Group has increased reported profits before tax by 94% to £35.0m (2009: £18.0m). These pleasing results have been achieved during a period of low interest rates, increased competition in the retail savings market and overall market uncertainty.

In the face of the challenging economic environment we have focused on a number of key imperatives:

- Ensuring the Group continues to trade profitably – Group profit before tax from continuing operations £35.0m (2009: £18.0m).
- Increasing capital ratios – Core Tier 1 ratio 11.1% (2009: 9.4%).
- Improving the Society's net interest margin and overall profitability.
- Maintaining a strong and diversified funding base – 82% of funding is sourced from retail customers (2009: 79%).
- Holding high levels of quality liquid instruments – Maintaining a healthy liquidity buffer above the recently announced new regulatory minimum requirement.
- The effective management of impaired assets – Proactive management of loans which have gone into arrears, supporting the borrower where possible, whilst protecting the balance sheet for the benefit of all members.
- Increasing efficiency across the business – Increasing business volumes whilst driving marginal costs down through restructuring of business operations where possible to prepare for sustained controlled growth.

The regulatory capital position of the Society (Solo) and Group (UK Group) remains good with a capital adequacy, on a Basel II basis, of 218% (2009: 186%) and 221% (2009: 192%) respectively and a Group solvency ratio of 16.6% (2009: 14.5%). The Group's Tier 1 capital position is set out below:

	2010	2009
Tier 1 capital (£m)	**719**	691
Tier 1 capital (%)	**12.64**	10.77

Financial performance

Total Group pre-tax profits for 2010 were £35.0m (2009: £63.5m). The table below sets out the profit contribution of the Group's continuing and discontinued operations:

	2010 £m	2009 £m
Profit before tax from continuing operations	**35.0**	18.0
Profit before tax from discontinued operations	**-**	5.8
Profit on sale of discontinued operations	**-**	39.7
Group profit before tax	**35.0**	63.5

The Group's total profits include a number of items which we consider to be non-routine and the following table seeks to adjust the reported profit and provide a clearer representation of the underlying performance of the Group.

	2010 £m	2009 £m
Group profit before tax	**35.0**	63.5
Non-routine items:		
Profit on sale of subsidiary companies	**(1.2)**	(39.7)
Financial Services Compensation Scheme levy	**0.9**	(4.3)
Impairment / (recoveries) of investment securities	**0.1**	(1.3)
Curtailment gain on closure of pension schemes	**-**	(10.4)
Impairment of goodwill	**7.5**	12.0
Net gains from fair value volatility	**(2.0)**	(3.9)
Merger expenses	**2.9**	4.8
Negative goodwill arising on merger	**(3.1)**	-
Profits from sale and leaseback	**(5.7)**	-
Profit before tax after adjusting for non-routine items	**34.4**	20.7

The current period adjustments highlighted above are as a result of the following:

- During the year the Group disposed of its holding in Pink Home Loans generating a £1.2m profit for the Group.
- The majority of the provision charge for the Financial Services Compensation scheme ('FSCS') levy relates to a specific FSCS levy within the Financial Advice division due to the demise of Keydata, and the subsequent nil value rating of investments placed in its Lifemark counterparty. This had the effect of exhausting the FSCS limit within the Investment Intermediation class. Whilst none of the companies within Skipton Group had advised on any such plans, the specific levy placed on them totalled £0.7m.
- Impairment of investment securities represents the loss on sale of a debt security.
- Due to the continuing market uncertainty and reductions in business volumes the Group recognised £7.5m of goodwill impairment against a number of subsidiary undertakings. See note 18 for details.
- Net movements in the fair value of certain financial instruments arising from hedge accounting; these timing differences reverse over time.
- Merger expenses represent legal and other expenses following the merger with the Chesham Building Society and the integration of the SMS business into HML.
- The merger with Chesham Building Society on 1 June 2010 did not involve the transfer of any cash consideration. Instead, in line with IFRS 3, *Business Combinations (2008 Revised)*, an imputed consideration was calculated which represented the fair value of the Chesham business. This resulted in a value of £6.1m attributed to the imputed consideration whilst the fair value of the net assets amounted to £9.2m. The £3.1m difference is negative goodwill and was credited to the Income Statement.
- During the year, the Society recognised a profit of £5.7m from the sale and leaseback of several properties.

Profit before tax after adjusting for non-routine items has increased year-on year to £34.4m (2009: £20.7m). This has been achieved whilst pursuing a prudent approach to new lending, impairment provisioning, liquidity management and the carrying value of our investments.

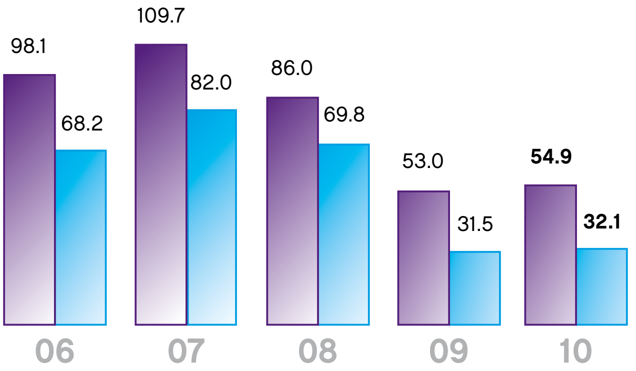
A further analysis of the Group's Income Statement, excluding the above non-routine items, is as follows:

	2010 £m			2009 £m		
	Total*	**Continuing operations**	**Discontinued operations**	Total*	Continuing operations	Discontinued operations
Net interest income	**54.9**	**54.9**	**-**	53.0	53.3	(0.3)
Other income	**379.3**	**379.3**	**-**	431.3	382.6	48.7
Share of profits from joint ventures and associates	**0.3**	**0.3**	**-**	0.2	0.2	-
Total income	**434.5**	**434.5**	**-**	484.5	436.1	48.4
Administrative expenses	**(385.1)**	**(385.1)**	**-**	(419.9)	(377.3)	(42.6)
Regulatory and other provisions	**(0.2)**	**(0.2)**	**-**	(0.3)	(0.3)	-
Impairment losses on loans and advances	**(14.8)**	**(14.8)**	**-**	(43.6)	(43.6)	-
Adjusted profit before tax	**34.4**	**34.4**	**-**	20.7	14.9	5.8

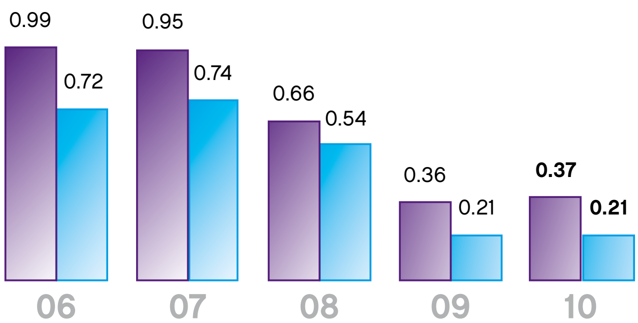
*The following Income Statement analysis on pages 16 to 17 is based upon the total profit columns above and excludes non-routine items.

Net interest income

The Group's net interest margin for the year was 0.37% (2009: 0.36%). This compares to 0.18% achieved in the second half of 2009 reflecting the stabilisation and improvement in the Group's net interest margin throughout 2010.



Net interest income (£m)



Net interest margin (%)

The Society took decisive action to remove the Standard Variable Rate ('SVR') cap from 1 March 2010, and increase its SVR to 4.95%. This was taken in response to exceptional circumstances within the economy, in particular the historically low level of Bank Base Rate. The Society has committed to re-impose the cap once 'exceptional circumstances' (as defined to affected borrowers) no longer prevail.

Other actions that have been taken to improve the Society's margin include reducing the level of expensive retail funding that was required following the sector-wide credit rating downgrade that occurred in 2009, by offering competitive but affordable savings products to customers. We also cautiously increased our lending activity, funded by retail savings priced at sensible levels, to ensure the effective management of the net interest margin.

These actions have improved the net interest margin of the Group over the past 18 months as set out in the table below:

	%
Six months to 31 December 2009	**0.18**
Six months to 30 June 2010	**0.35**
Six months to 31 December 2010	**0.40**

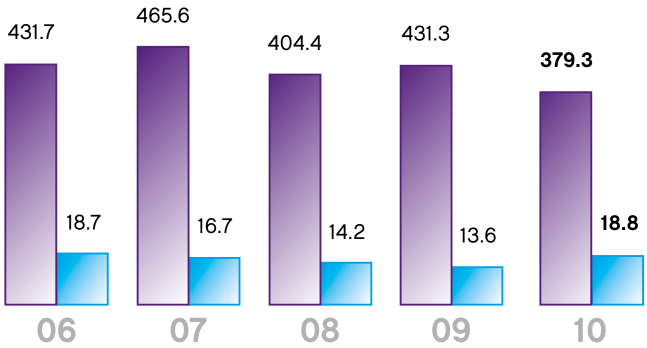
Other income

The Group's other income represents the income earned from our divisions together with insurance commissions, income from the sale of investment products and other non-margin income.

The Group's underlying other income for the year was £379m, down 12% (2009: £431m). 2009 income includes £49m of income from the Credit & Marketing Solutions division which was classified as a discontinued operation when it was sold in December 2009. Adjusting for this shows a year-on-year reduction of just 1%. This has been primarily driven by the slow-down in activity in the housing market in the second half of 2010 reducing Estate Agency income and lower arrears volumes impacting arrears

management income levels in the Mortgage Services division. Other income by division is set out below:

	2010 £m	2009 £m
Mortgages and Savings	**17.2**	18.1
Mortgage Services	**76.9**	86.4
Estate Agency	**206.7**	213.0
Financial Advice	**42.8**	37.8
Investment Portfolio	**40.3**	38.8
Inter-division adjustments	**(4.6)**	(11.5)
	379.3	382.6
Credit & Marketing Solutions (Discontinued)	**-**	48.7
	379.3	431.3



Other income (£m) Group Society

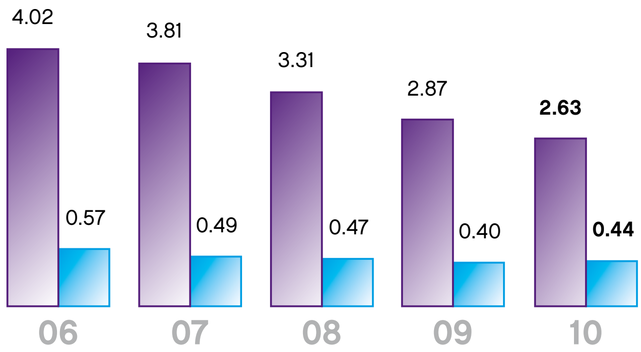
For details of the Group's performance by business area refer to pages 23 to 25.

Administrative expenses

Total administrative expenses, excluding non-routine items, fell by 8% to £385m (2009: £420m). The 2009 administrative expenses included £43m of costs in relation to the Credit & Marketing Solutions division, stripping these out, costs have increased by £8m. £1.7m of the increase is volume related and corresponds to an increase in income (£5.0m) generated by the Financial Advice division. Also included in administrative expenses in 2010 is £6.7m of restructuring costs incurred in a number of business areas (predominantly the core Society and Mortgage Services division).

The Society has continued to tightly manage costs, however the reduction in its balance sheet and the impact of the business' restructuring programme has resulted in its ratio of administrative expenses to mean assets increasing to 0.44% (2009: 0.40%). Excluding restructuring costs the ratio would be 0.42% (2009: 0.40%).

At a Group level, this management expense ratio is less comparable, given the investments we have made in our trading businesses. However, the Group-wide focus on controlling costs has meant the Group has managed to reduce this from 2.87% to 2.63%.



Management expense ratio (%) Group Society

Impairment losses on loans and advances

The Group's impairment charge on loans and advances reduced year-on-year to £15m (2009: £44m). The reduction is mainly due to the Group's action to proactively manage loans which have gone into arrears whilst supporting such customers where possible especially within the Amber and NYM portfolios. In the Society an impairment charge of £13m (2009: £10m) was recognised. The £13m charge still only represents 0.18% (2009: 0.12%) of the Society's mortgage balances totalling £7,164m (2009: £8,122m), which reflects the high quality of the Society's lending.

The loan books in our Guernsey based subsidiary, SIL, and our debt factoring business, Skipton Business Finance, remain of high quality and the charge for impairment losses on these loans remains negligible at £0.4m (2009: £0.4m) for the year.

Merger

On 1 June 2010 the Society merged with the Chesham Building Society ('Chesham') under section 42B(3)(b) of the Building Societies Act on the basis of a board resolution of Skipton as permitted by a direction given by the FSA. The merger was approved by Chesham members on 31 March 2010.

The merger increases the Society's total membership by approximately 2.5% and provides an additional three branches to the Skipton branch network.

Details of the merger are set out in note 38 to these accounts.

Financial position

Loans and advances to customers

Since the onset of the economic downturn, the Society has prudently scaled back its lending, in order to maintain high liquidity and strong capital. During 2010, our financial strength and signs that the economy was stabilising, led to a new suite of products being launched in May 2010, to slow the contraction of the balance sheet and commence controlled lending growth.

An analysis of gross residential mortgage advances is shown below:

	2010 £m	2009 £m
Society	341.7	298.9
Amber Homeloans*	1.1	3.5
North Yorkshire Mortgages*	0.3	0.5
Skipton International	137.8	104.1
	480.9	407.0

* Following the decision to cease new lending in 2008, these advances represent further loans to existing borrowers and stage payments on self build loans.

Society lending continues to be well diversified by product type and geographical distribution. As at 31 December 2010 the Society's average indexed loan-to-value for the residential mortgage book was 50.6% (2009: 49.5%). This well-managed spread of risk ensures that the quality of the Society's mortgage lending remains high.

SIL grew its mortgage book in the year with gross residential mortgage advances totalling £138m (2009: £104m), however, the average indexed loan-to-value has reduced to 59.8% (2009: 65.1%) demonstrating our focus on managing our credit risk exposures.

The Group's total new advances on buy-to-let products remained modest at £18m (2009: £15m) – the bulk of which was through SIL. The risks attached to buy-to-let lending are managed by prudent consideration of the level of equity in the property, where we generally accept lower loan-to-value ratios compared with our residential lending, and the level of rental cover compared with the mortgage payments.

Overall, the Group's loans and advances have reduced by 10% to £9,688m from £10,713m at the end of 2009 as set out in the table below:

	2010 £m	2009 £m
Residential mortgages	9,092.7	10,112.0
Commercial loans	501.2	523.9
Other lending:		
Debt factoring loans	39.5	32.7
Other loans	54.7	44.5
Gross balances	9,688.1	10,713.1
Impairment provisions	(79.4)	(85.1)
Hedge fair value adjustments	206.0	185.3
	9,814.7	10,813.3

The Group has taken action to actively manage loans which have gone into arrears, supporting the borrower where possible whilst protecting the business for the benefit of all members. The arrears performance of the Group's residential mortgages has improved, with a reduction from 1,522 to 1,376 in the number of cases where the arrears balance was greater than 2.5% of the total outstanding balance, representing 1.57% (2009: 1.57%) of the book.

The performance of the Society's residential mortgages remains good with only a modest increase in arrears during the year. At 31 December 2010 there were 540 cases (0.77%) where the arrears balance was greater than 2.5% of the total outstanding balance, compared with 411 cases (0.52%) a year ago. During the year the Society took 86 cases (2009: 126) into possession, of which 35 cases (2009: 43) remained in possession as at 31 December 2010.

The specialist nature of Amber mortgages means that this subsidiary business has typically higher levels of arrears than those in the Society. However, action taken in 2009 and through to 2010 to manage down arrears through proactive collections processes has resulted in a fall in arrears in the Amber portfolio. As at 31 December 2010, there were 602 cases (6.39%) where the arrears balance was greater than 2.5% of the total outstanding balance, compared with 868 cases (8.48%) at 31 December 2009. During the year Amber took 139 cases (2009: 313) into possession, of which 75 cases (2009: 137) remained in possession as at 31 December 2010.

NYM is also a specialist lender, albeit on a smaller scale than Amber. NYM has experienced a fall in the total number of cases in arrears but to a lesser degree, with 231 cases (4.11%) where the arrears balance was greater than 2.5% of the total outstanding balance as at 31 December 2010 compared to 243 cases (4.00%) a year ago. During the year NYM took 80 cases (2009: 111) into possession, of which 41 cases (2009: 63) remained in possession as at 31 December 2010.

New lending in both Amber and NYM ceased in March 2008. The Group stopped offering commercial loans in November 2008.

SIL continued to grow its Channel Islands mortgage book during the year, and mortgage balances stood at £483m at the year end (2009: £401m); the quality of this book remains excellent with just three cases (0.11%) where the arrears balance was greater than 2.5% of the total outstanding balance (2009: nil).

The Group continues to manage the level of arrears through proactive collections processes. However, these processes have been applied responsibly and as part of our strategy to support customers in arrears we have capitalised arrears in a number of cases.

The Group applies a policy of capitalising residential arrears, with the customer's consent, once the customer has made at least six consecutive contractual monthly mortgage repayments following the instance of non-payment. The effect is to bring the loan account up to date and it is therefore no longer past due or individually impaired. If a customer's arrears have previously been capitalised, the customer is required to have made at least 12 consecutive contractual monthly repayments in order to qualify for further capitalisation.

The Society applies a similar policy for its commercial loan book as for its residential book, whereby customer arrears can be capitalised following six consecutive contractual monthly repayments following the instance of non-payment, or 12 such repayments if the account has previously had arrears capitalised.

The following table shows the balance of those loans that have been renegotiated *during the year* and would have been past due or impaired if their terms had not been renegotiated:

	Residential		Commercial	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Society	**41.2**	34.7	**6.2**	11.1
Amber Homeloans	**52.2**	43.8	**-**	-
North Yorkshire Mortgages	**20.4**	10.2	**-**	-
Skipton International	**1.1**	5.6	**-**	-
	114.9	94.3	**6.2**	11.1

The *cumulative* balance of loans that would have been past due or impaired had their terms not been renegotiated are as follows:

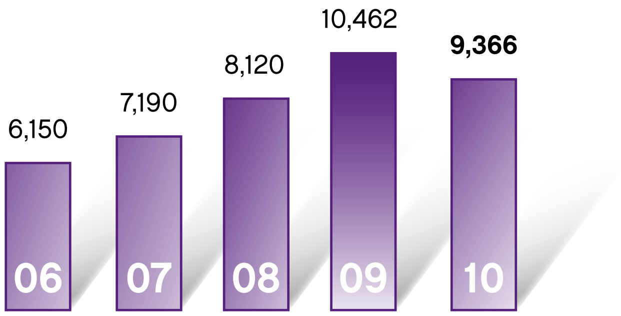
	Residential		Commercial	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Society	**70.7**	41.5	**19.0**	14.0
Amber Homeloans	**92.2**	51.3	**-**	-
North Yorkshire Mortgages	**27.2**	10.2	**-**	-
Skipton International	**8.4**	11.0	**-**	-
	198.5	114.0	**19.0**	14.0

The level of capitalised arrears is built into the loan impairment models utilised by the Group.

Funding

Retail

As a mutual, the Group is required to obtain the majority of its funding through retail member deposits and 82% (2009: 79%) of our funding comes from retail savings. Excluding £188m of retail deposits that were transferred to the Society at the date of the merger with Chesham, the Society saw a net outflow of £1,268m in the period (2009: inflow of £714m). The net outflows during the year reflect the Group's strategy to shrink the balance sheet and manage down levels of expensive retail funding.



Retail balances (£m)

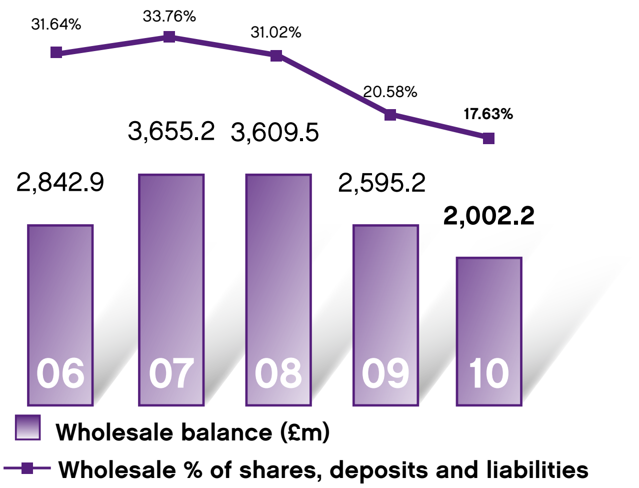
In addition to our UK retail funding, the Group also accepts deposits through our Guernsey based operation, SIL. The benefits of offshore funding have reduced under the new liquidity regime, so the Group allowed some of the expensive funding within SIL to leave during the year in order to boost the net interest margin. Offshore retail balances decreased in the year to £750m (2009: £855m).

Wholesale

The remainder of the Group's funding comes from the wholesale markets. At 31 December 2010 our wholesale funding balances amounted to £2,002.2m (2009: £2,595.2m), a decrease of £593m. The shrinkage of the Group's balance sheet to further bolster capital ratios also allowed the Society to reduce its reliance on the wholesale funding markets and as a result the wholesale funding ratio fell from 20.6% to 17.6%.

Despite showing some encouraging signs of improvement in the early part of the year, wholesale credit markets have remained weak in 2010. In the second quarter of 2010 concerns regarding the ability of certain European sovereign countries to continue to meet their debt obligations started to take hold and risk aversion returned to the markets. However, as the Society had undertaken its £650m government guaranteed bond issue in the fourth quarter of 2009 its level of wholesale funding going into 2010 was strong. Therefore, despite repaying its €400m medium-term note maturity in March, the Society did not need to raise any additional long-term wholesale funding from the markets in the year.

Wholesale funding



The following table analyses the change in the composition of our wholesale funding since December 2009:

	2010 £m	2009 £m
Repo and other secured agreements	**306.0**	285.2
Deposits	**887.1**	1,005.8
Certificates of deposits	**71.1**	135.7
Medium-term notes	**738.0**	1,168.5
	2,002.2	2,595.2

The Society is assigned credit ratings by two major credit rating agencies, Fitch and Moody's. These credit ratings are important as they are key influences on the wholesale funding markets that the Society is able to access and the associated cost of funding. The Society's current credit ratings were maintained during the period:

	Fitch	Moody's
Long-term	A-	Baa1
Short-term	F2	P-2
Subordinated	BBB	Ba2

In addition, our covered bond programme retained its AAA rating from both agencies.

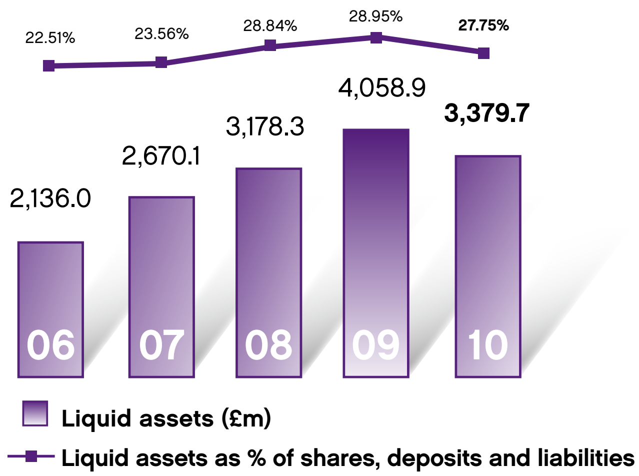
Liquidity

The Group has continued to hold high levels of liquidity throughout the economic downturn. In the run up to new liquidity rules that took effect from 1 June 2010, the Society increased its holding of very high quality 'buffer'* liquidity. An analysis of the Group's liquidity position is shown below:

	2010	2009
Liquidity balance (£m)	**3,379.7**	4,058.9
As % of shares and deposit liabilities (%)	**27.75**	28.95
Core liquidity buffer*- eligible assets (£m)	**1,902.4**	1,501.1
Core liquidity buffer* as % of liquidity balance (%)	**56.29**	36.98

*Buffer eligible assets include gilts, treasury bills, supranational bonds and reserves held with the Bank of England.

Liquid assets



With difficult and uncertain market conditions persisting, the focus remains on conservative and prudent liquidity management. The Group continues to have no exposures to structured investment vehicles (SIVs), hedge funds or to the US sub-prime market.

The Group's treasury investments are held to provide actual liquidity and 98% (2009: 98%) of the Group's treasury investments are rated A3 or better (as shown below).

Rating	2010 £m	2009 £m
Aaa	**2,572.6**	2,277.1
Aa1	**82.6**	205.9
Aa2	**171.5**	276.4
Aa3	**307.3**	881.0
A1	**153.5**	188.1
A2	**9.3**	93.0
A3	**25.1**	54.3
Baa1	**6.3**	37.5
Baa2	**6.7**	6.7
Baa3	**34.7**	3.5
Ba3	**-**	3.5
Caa1	**6.6**	-
Caa2	**-**	3.9
Unrated:		
Building societies	**3.0**	17.6
Local authorities	**0.5**	10.4
	3,379.7	4,058.9

The Group policy is that initial investments in treasury assets must be investment grade or above. However, the adverse market conditions have resulted in a small proportion of investments falling below this rating. These investments are monitored on a regular basis for impairment.

The Group employs a rigorous credit assessment process and considers the risks of all assets before they are acquired and throughout the period they are held. Credit approval, along with monitoring the Group's exposure concentrations against a variety of criteria including country of risk, is carried out by an independent Market Risk function.

The table below sets out the Group's treasury investments by industry sector / asset class:

	2010 £m	2009 £m
Cash in hand and balances with the Bank of England	**664.6**	1,272.1
Cash with banks and building societies	**294.6**	437.4
Gilts	**200.8**	152.7
Treasury bills	**749.4**	-
Certificates of deposit	**205.4**	903.6
Local authority investments	**0.5**	10.4
Fixed rate bonds	**452.6**	283.8
Floating rate notes	**530.8**	684.8
Residential mortgage backed securities	**233.3**	255.9
Commercial mortgage backed securities	**47.7**	58.2
	3,379.7	4,058.9

Treasury assets are valued using quoted market prices or prices obtained from counterparties. Where reliable market prices are not available, discounted cash flow models are used.

During the year liquidity balances have reduced as part of the planned reduction in the overall size of the balance sheet. The Society has reduced the proportion of its liquidity held within its Bank of England Reserve Account. The reduction in liquid assets held in the Reserve Account has been more than offset by investment in supranational bonds and further treasury bills which are also counted as core liquidity buffer eligible assets. The residential and commercial mortgage backed securities have been in run-off during 2010.

Within the treasury investments portfolio, the Group has no direct sovereign exposure to Greece, Ireland, Italy, Portugal or Spain ('GIIPS') as at 31 December 2010. The Group does have £38m of senior debt exposure to financial institutions based in Ireland. However, whilst the political and economic environment in Ireland remains very challenging, we do not currently expect any impairment to be required for these investments.

Capital structure

The Financial Services Authority ('FSA') regulates the Group which is required to manage its capital in accordance with the rules and guidance issued by the FSA. The capital requirements of the Group are monitored on a monthly basis and the results of this monitoring are reported to the Group Capital Committee and the Board. Capital is ultimately held for the protection of retail depositors. The internal level of capital is set with the aim of ensuring that the business has sufficient levels of capital for current and projected future activities, to withstand downturn stresses and, to ensure that the minimum regulatory requirement is always met. Throughout 2010, the Group has operated comfortably in excess of the minimum capital levels set by the FSA.

The following table shows the composition of the Group's capital at 31 December 2010:

	2010 £m	2009 £m
Tier 1		
Reserves	**809.6**	752.2
Permanent Interest Bearing Shares (note 1)	**90.0**	90.0
Pension fund deficit add back (note 2)	**3.7**	8.7
Deductions from Tier 1 capital (note 3)	**(190.9)**	(182.2)
Unrealised losses on available-for-sale debt securities	**6.9**	6.2
Unrealised losses on cash flow hedges	**(0.3)**	16.0
Total Tier 1 capital	**719.0**	690.9
Tier 2		
Subordinated debt (note 1)	**204.4**	207.8
Collective impairment allowance	**21.2**	29.6
Total Tier 2 capital	**225.6**	237.4
Total capital	**944.6**	928.3
Risk weighted assets		
Retail mortgages	**3,756.1**	4,250.8
Commercial loans	**432.7**	449.4
Treasury assets	**362.5**	505.2
Other assets	**469.8**	476.8
Operational risk	**662.6**	722.5
Market risk	**5.7**	8.1
	5,689.4	6,412.8
Core Tier 1 (%) (note 4)	**11.06**	9.37
Tier 1 ratio (%) (note 4)	**12.64**	10.77
Total capital (%) (note 4)	**16.60**	14.48
Tier 2 to Tier 1 ratio (%)	**31.38**	34.36

Notes

1. Under FSA rules Permanent Interest Bearing Shares ('PIBS') and subordinated debt are included in the solvency calculation in accordance with UK GAAP rather than IFRS. The PIBS and subordinated debt are disclosed at par value therefore the associated merger fair value adjustments are recognised in the general reserve.
2. The regulatory capital rules allow the pension fund deficit to be 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.
3. Under FSA rules intangible assets must be deducted from regulatory capital.
4. Calculated as relevant capital divided by risk weighted assets. Core Tier 1 relates to Tier 1 capital excluding PIBS.

For statutory purposes, under Basel II, we are required to calculate our capital ratios for both the Solo consolidation group and the UK consolidation group. The Solo consolidation group comprises the Group's UK based mortgage lending businesses whilst the UK consolidation group consists of the entire Group except a small number of entities whose activities are not deemed to be closely aligned with the core business.

The table below sets out the capital resources of the Solo and the UK consolidation groups, together with the associated capital resource requirements as at 31 December 2010. Both ratios are comfortably above the regulatory threshold.

	UK consolidation group		Solo consolidation group	
	2010	2009	**2010**	2009
Capital resources (£m)	**928.2**	912.5	**848.2**	822.0
Pillar 1 capital resource requirement (£m)	**419.2**	475.3	**388.6**	441.5
Capital ratio (%)	**221.4**	192.0	**218.3**	186.2

Pension funds

The Group operates five defined benefit schemes as described in note 35, in addition to defined contribution stakeholder schemes open to current employees.

The aggregate valuation of the five funds at 31 December 2010 resulted in a deficit of £31.8m (2009: £47.4m) using the methodology set out in IAS19. We have taken steps to actively manage the deficit, including the following:

- The Skipton Building Society Pension & Life Assurance Scheme is closed to new members and existing members have accrued benefits on a Career Averaged Revalued Earnings basis since 2003. During 2009, it was agreed that future pension accrual would cease in these schemes with effect from 1 January 2010 for all members who would then be eligible to participate in stakeholder schemes.
- The Connells Limited Pension & Life Assurance Scheme, the Sequence (UK) Limited (1997) Pension & Life Assurance Scheme and the Sequence (UK) Limited (South) Staff Pension Scheme were closed to new members in 2008. Future pension accruals ceased in these schemes with effect from 1 January 2009 for all members.
- Employee contributions were increased prior to the schemes' closures.
- Special contributions totalling £30.2m have been paid between 2006 and 2010, and plans have been agreed with the Trustees to actively manage the deficit and associated long-tail risk.
- We have also initiated an enhanced transfer value exercise on certain schemes (see note 32(c)).

We will continue to monitor the deficit on the schemes to manage the funds in a responsible manner, with the aim of eliminating the actuarial funding deficit in the medium-term.

As a result of changes in Government legislation, certain benefits are now linked to increases in the CPI index rather than the RPI index. This has resulted in a reduction in liabilities of around £13.3m for the Group and £6.2m for the Society as at 31 December 2010. The resulting credit was recognised in equity.

Bank levy

On 22 June 2010 the Government announced its intention to introduce a new bank levy which will apply to certain UK banks, building societies and the UK operations of foreign banks from 1 January 2011. The Bank Levy will not be charged on the first £20 billion of chargeable liabilities so will not impact the Skipton Group for the foreseeable future.

Performance by business area

The Group operates in five main divisions (as described on page 14); the results by business area are as follows:

Business area	**2010 £m**	2009 £m
Profit before non-routine items (see note 34):		
Mortgages and Savings	**(16.2)**	(44.0)
Mortgage Services	**2.6**	4.7
Estate Agency	**48.2**	54.1
Financial Advice	**3.8**	1.9
Credit & Marketing Solutions	**-**	5.8
Investment Portfolio	**(5.4)**	(2.9)
Inter-division adjustments	**1.4**	1.1
Sub-total	**34.4**	20.7
Non-routine items	**0.6**	42.8
Group profit before tax	**35.0**	63.5

Mortgages and Savings

The Group's Mortgages and Savings division comprises the Society, Amber Homeloans, North Yorkshire Mortgages, Skipton International, Skipton Covered Bonds LLP, Bailey Computer Services and Skipton Trustees. The Mortgages and Savings division made an operating loss of £16.2m, a significant improvement on the 2009 operating loss of £44.0m.

The Society has remained focused on maintaining a prudent asset base and the key focus for 2010 was on improving interest margin, returning to profitability, and improving other income streams. Interest margin in the second half of 2009 and the first half of 2010 was 0.13%, improving to 0.30% in the second half of 2010. This was achieved partly by increasing the Society's SVR from 3.50% to 4.95% in March 2010, but also by careful management of the balance sheet to reduce levels of expensive retail and wholesale funding. The Society has also achieved improvements in 'other income' streams which are up by 38% to £18.8m (2009: £13.6m) excluding non-routine income of £5.7m from the sale and leaseback of several properties in the year. During the year the Society also commenced a business transformation programme. This is focused on improving all aspects of the business including the re-engineering of the Society's key processes and the delivery of the best possible experience to our customers through innovative products and services.

Amber and NYM performed better in 2010 due to the actions taken in 2009 to manage arrears through proactive collections processes. Amber and NYM combined incurred impairment losses of £1.8m in the year, down from £33m in 2009, due to improvements in the levels of arrears and crystallised losses. Amber's arrears greater than 2.5% of the total outstanding balance stood at 6.39% at 31 December 2010, down from 8.48% in 2009. Having ceased new lending in early 2008, the attrition of Amber's mortgage balances has continued and mortgage balances were £1,236m at 31 December 2010 (2009: £1,331m).

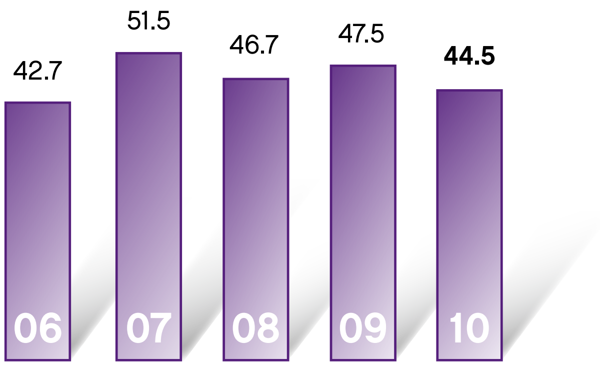
NYM also ceased lending in 2008. Arrears cases in NYM have also fallen during 2010 although when expressed as a percentage of total cases shows a slight increase due to the shrinkage of the mortgage book. Arrears greater than 2.5% of the total outstanding balance stood at 4.11% at 31 December 2010, compared to 4.00% in 2009. NYM's outstanding mortgage balance stood at £760m at 31 December 2010 (2009: £829m).

Our Channel Islands operation, SIL, made a profit of £4.1m in 2010 (2009: £0.4m). During the year SIL was the winner of the Best Offshore Business Account at the 2010 Moneyfacts awards. Mortgage lending in Guernsey and Jersey has increased by £82m during the year to £483m (2009: £401m) and the quality of this book remains excellent with arrears greater than 2.5% of the total outstanding balance of 0.11% (2009: nil).

Mortgage Services

The Mortgage Services division provides outsourcing to a number of specialist and high street financial services companies. The business is the largest third party mortgage servicer in the UK with total assets under management of £44.5bn. HML recorded a profit of £2.6m before integration costs of £2.5m in relation to the transfer of the SMS business into the HML Group. This compares to a profit of £4.7m in 2009. The £2.6m profit is after charging £3.0m of restructuring costs which will lay the foundation for future growth. During the year HML has vacated a number of disparate sites and moved into a purpose built new headquarters in Skipton which will improve the future efficiency of the division.

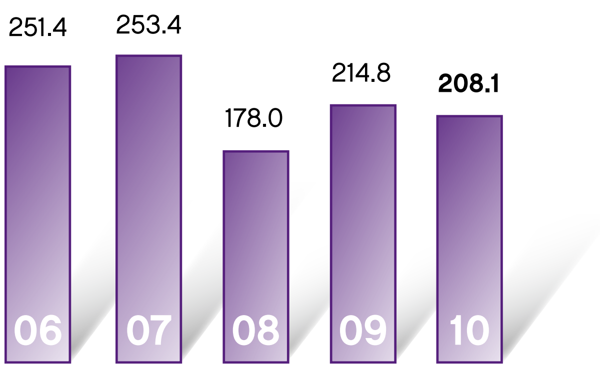
HML has also continued its major investment strategy to improve its IT infrastructure, risk framework and operational processes which has enabled the business to adapt from its traditional market of specialist mortgage servicing into parallel markets. Successes include the take-on of legacy mortgages, the development of a savings proposition and a partnership with an unsecured loan servicer.



Assets under management (£bn)

Estate Agency

The first half of 2010 saw volumes of agreed second hand house sales consistent with the levels achieved in the same period in 2009 and as a result of the strong pipeline when entering 2010, operating profits for the first half of the year were ahead of the same period in 2009. However volumes began to fall away in the second half of 2010 resulting in full year fee income of £208m compared with £215m in 2009.



Estate Agency total fee income (£m)

The Estate Agency division continues to focus on improving revenues and maintaining a tight control of costs throughout the group. As a result, the operating profits for the Connells group were £48.2m in 2010 (2009: £54.1m).

Financial Advice

The Financial Advice division offers a range of services as diverse as execution only investments, financial planning, and employee benefits. The division has performed well during 2010 generating a profit before non-routine items of £3.8m compared to £1.9m in 2009. This performance has resulted from additional business revenues due to increased investor confidence, the upward revision of fees and repeat revenues following the launch of revised customer service propositions, and good cost control.

Included as a non-routine item is our share of the Financial Service Compensation Scheme levy (£0.9m) which includes a significant specific industry levy of £0.7m in 2010, resulting from the failure of Keydata and associated counter-party Lifemark. Whilst none of the companies in the Group had advised on any such plans, we are still subject to the levy. Also included as a non-routine item is a £1.9m charge for the impairment of goodwill following a revision in future cashflows and based upon our assessment of the recoverable amounts of a number of subsidiary undertakings within the division.

The FSA has released its final rules in relation to the Retail Distribution Review. Whilst a degree of uncertainty still exists around some of the key tenets of the new regulations, the Financial Advice division remains very well placed to comply with and capitalise on the regulation emerging from it.

Investment Portfolio

The Investment Portfolio division includes a range of businesses and the current economic environment has created some opportunities but, equally, some businesses have been adversely affected by the current trading environment.

Skipton Business Finance (provider of invoice discounting) and The Private Health Partnership (specialising in private medical insurance and medical support) have both reported healthy profits in 2010 despite a tough trading environment. In contrast, the performance of Sterling International Brokers (money markets broker) has been disappointing, due to the reduction in the wholesale cash market and the lack of movements in interest rates.

On 30 November 2010, the Group sold its investment in Pink Home Loans, and its subsidiary BDS Mortgage Group, generating a £1.2m profit for the Group.

Principal risks and uncertainties

Risk management framework

Through its risk management framework, the Group has a formal structure for managing risks throughout the business. This framework is designed to deliver the Corporate plan in line with the Board's overall risk appetite and is based upon the best practice 'three lines of defence' model, comprising:

- First line of defence, being line management within the business which, through the implementation of the organisation's risk framework, identifies, assesses, and manages risk.
- Second line of defence comprising independent Group risk functions (Operational, Credit and Market) and related risk functions including Compliance, Systems Security, Finance and Insurance. These functions challenge, monitor, guide and support the business in managing its risk exposure. The Risk framework includes a number of risk committees (Asset and Liability Committee ('ALCO'), Group Retail Credit Committee ('GRCC') and Group Operational Risk Committee ('GORC')) responsible for setting policy and framework and monitoring implementation by the business. The independent Group risk functions are represented on each of these risk committees.

  To strengthen governance and risk management oversight a Board Risk Committee was formed during the year. Headed by a Non-Executive Chairman the Committee is responsible for oversight of the risk management framework and monitoring of business risk profile against Board approved risk appetite.
- Third line of defence, provided by Group Audit Services, is designed to provide independent assurance to the Board (via the Audit Committee) of the adequacy and effectiveness of control systems operating within the first and second lines in identifying and managing risk.

The key risks and uncertainties faced by the Group, which are managed within the framework described above, are set out below.

Business conditions and the economic environment

The Skipton Group is almost solely focused in the UK market and the main divisions are in large part exposed to the UK property market. Therefore the general UK macro-economic environment is a key determinant of the success of the Group. The main drivers that impact the Group include:

- interest rates (Base and LIBOR);
- inflation;
- unemployment; and
- the housing market (volume of transactions and house price inflation).

The Mortgages and Savings division continues to face challenges from the low interest rate environment, with ongoing pressure on its net interest margin. However, actions taken during the year such as reducing the level of expensive retail funding and improving mortgage margins has assisted in partially alleviating this pressure.

Subdued wholesale markets and fierce competition for retail funds as the Government and the Bank of England unwind the various liquidity support schemes in place will result in savings rates remaining high in relation to base rate and create ongoing margin pressure.

The Society's mortgage SVR was capped at 3% above bank base; however, given the continuation of exceptional circumstances in the economy with Bank Base Rate at historically low levels, the Society exercised its contractual right to remove this cap and increased its SVR from 3.5% to 4.95% on 1 March 2010. The Society has committed to reintroduce the cap when exceptional circumstances, as communicated to members, have passed.

The Government's austerity measures and general fragility of the economy could also impact the Mortgages and Savings division through an increase in impairment driven by increasing unemployment creating higher levels of arrears and possessions.

The results of the Estate Agency division are principally driven by the volume of UK property transactions, particularly second hand property sales. This market is heavily influenced by consumer confidence, driven to some extent by the overall level of unemployment and interest rates. A slowdown in the housing market will put pressure on income levels. However, the Estate Agency division is partially protected against the performance of its core business through its Asset Management businesses that assist lenders in their management of non-performing loans.

The Financial Advice division is also exposed to the wider UK economy. The main influence on its performance is consumer confidence and the willingness of customers to invest in longer-term products.

The ability of the Group to maintain profitability and boost capital in the toughest external environment faced for at least a generation provides confidence that the Group is capable of withstanding the current challenging environment and the issues that would be faced should the current recovery lose momentum.

Credit risk

Credit risk is defined as the current or prospective loss to earnings and impact to capital arising from lending as a result of counterparties defaulting on their obligations due to the Group.

The Group faces this risk in respect of:

- individual customers (retail mortgages);
- businesses (through historic commercial lending). The Society ceased new commercial lending in November 2008 when we concluded that the outlook for commercial property was poor; and
- other financial institutions (wholesale lending). Credit risk within our treasury portfolio assets arises from the investments held by the Group in order to meet liquidity requirements and for general business purposes.

Changes in the credit quality and the recoverability of loans and amounts due from counterparties influence the Group's exposure to credit risk. Adverse changes in the credit quality of counterparties, collateral values or deterioration in the wider economy, including rising unemployment, deterioration in household finances and further contraction in the UK property market leading to falling property values, could affect the recoverability and value of the Group's assets and influence its financial performance. A reversal of the economic recovery and continuation of the falls in house prices and commercial property values could affect the level of impairment losses.

The Group has embedded a comprehensive and robust risk management framework with clear lines of accountability and oversight as part of its overall governance framework. The Group has effective processes and policies to monitor, control, mitigate and manage credit risk within the Group's conservative risk appetite.

Retail mortgage lending to customers

The Group actively lends in the prime residential (inclusive of buy-to-let) UK mortgage market through the Society and via Skipton International across the Channel Islands.

Retail credit risk is managed in accordance with Board approved lending policies which define the Board's approach to credit granting and risk appetite. The risk appetite defines a series of Board approved limits regarding customer and collateral credit quality to which all lending activity must adhere. Lending policies and risk appetite are subject to regular review and annual Board approval.

The credit decision process is achieved by automated credit scoring and policy rules with lending policy criteria supporting manual underwriting. All aspects of the credit decision process are subject to regular independent review and development ensuring they support decisions in line with Board expectations.

The Group also has credit exposures through Amber and NYM which comprises residential (inclusive of buy-to-let) UK mortgages across prime and sub-prime markets. These portfolios are closed to new lending and are subject to ongoing monitoring of credit performance supporting effective management of customer interests and creation of maximum value for the Group.

Commercial lending to customers and businesses

The Society retains a commercial mortgage portfolio which is UK based and is closed to new lending. This portfolio is subject to ongoing monitoring of credit performance supporting the effective management of counterparty interests and creation of maximum value for the Group.

Other loans

The majority of these loans have an original maturity of less than one year and include a number of individual loans and loans made by our factored debt and invoice discounting business.

GRCC provides oversight to the effectiveness of all credit management across the Group and the controls in place ensure lending is within Board approved credit risk appetite.

Wholesale lending to other financial institutions

The wholesale credit markets remain volatile, particularly in the Eurozone, and a further deterioration could lead to additional fair value adjustments in the Group's portfolio of available-for-sale assets coupled with further impairment of our treasury investments portfolio. The Group has £38m exposure to the senior debt of financial institutions based in Ireland. Whilst political and economic uncertainty continues in Ireland, the EU has indicated that such senior debt will continue to be supported and hence no loss is expected.

Wholesale credit risk is managed in line with Board approved risk appetite and wholesale credit policies. Wholesale credit policies and risk appetite are subject to regular review and annual Board approval.

ALCO provides oversight to the effectiveness of wholesale credit risk management.

Market risk

Market risk is the risk that the value of, or income from, the Group's assets and liabilities is impacted as a result of changes in market risk factors. The Group's market risk factors comprise three types of risk: interest rate risk, currency risk and equity risk. The other standard risk factor is commodity prices, which do not impact the Group.

ALCO provides oversight of the effectiveness of the control framework in place to manage Market risk.

Interest rate risk

This is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Interest rate risk arises from the mortgage, savings and other financial products that we offer. This risk is managed through the use of appropriate financial instruments, including derivatives, with established risk limits, reporting lines, mandates and other control procedures.

Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics, for example, LIBOR and Bank of England Base Rate) are also monitored closely and regularly reported to ALCO. This risk is managed through the use of appropriate derivatives, with established risk limits and other control procedures.

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Both at the year end and during the year, the Group had no material direct exposure to foreign currency exchange fluctuations. The currency risk appetite of the Group is low and any issuance denominated in foreign currency is immediately swapped into GBP. The exception to this is the Group's equity investments in Jade Software Corporation Limited and Northwest Investments NZ Limited which are denominated in New Zealand Dollars. The foreign currency fluctuations in relation to these equity investments are not material and are not hedged, but are recognised in the Group's translation reserve.

The Group has a small exposure to foreign currency interest rates at the year end arising from a hedging mismatch on a Sterling mortgage product whose rate is linked to US Dollar interest rates. In addition, the Group has Euro debt issuances, however due to the effect of cross currency swaps the net exposure is immaterial.

Equity risk

As at 31 December 2010, the Group had a small amount of issued equity-linked savings products. Derivative contracts to reduce this exposure have been transacted which exactly match the terms of the savings products and the market risk on such contracts is, therefore, fully hedged.

Liquidity risk

This is the risk that the Group is unable to meet its current and future financial obligations as they fall due. These obligations include investors' deposits as well as repayments of other borrowings and loan capital.

The Board sets limits over the level, composition and maturity of liquidity and deposit funding balances, reviewing these at least annually. Compliance with these limits is monitored daily by Finance personnel (i.e. independent of Treasury). In addition, a series of liquidity stress tests are performed weekly by Market Risk and formally reported to ALCO monthly, to ensure the Group maintains adequate liquidity for business purposes even under stressed conditions. If at any time the test results forecast that the Society may be approaching the limits set by ALCO, action can be taken in line with the documented Contingency Funding Plan. These tests include idiosyncratic stresses, a market wide stress and combinations of both.

The wholesale markets remain constrained and opportunities for the Group to raise longer-term unsecured funding in public debt markets remain limited.

The majority of our funding comes from retail sources and we have been successful in attracting such balances in recent years. As savers continue to demand a safe haven for their deposits we will continue to offer good value products to attract further balances.

We continue to maintain a close watching brief on the money markets, but until such times as we believe the markets are returning to more normal conditions we will continue to hold high levels of liquidity and fund growth in lending from retail balances.

The FSA introduced new requirements (PS09/16 Strengthening Liquidity Standards) for liquidity management and reporting applicable from June 2010. The Society has made significant investment in its infrastructure to comply with this and is compliant with the new regulatory requirements. The Board operates an Internal Liquidity Adequacy Assessment ('ILAA') process which analyses the Society's current and future liquidity requirements. The Board has defined its liquidity risk appetite which is monitored daily. Since the introduction of the new liquidity regime regulations, the Society has exceeded all its liquidity risk appetite tests at all times.

Operational risk

The Society has adopted the standardised approach to operational risk, compliant with the requirements of BIPRU 6, and has defined operational risk as 'the risk of loss arising from inadequate or failed internal processes, people or systems or from external events'. This definition includes legal, financial (the risk of loss arising from poor financial control) and reputational risk.

Operational risk management is overseen by an executive Group Operational Risk Committee ('GORC') that reviews the Group's operational risk management framework and standards, monitors the Group's exposure to operational risks and reviews the framework for measuring and controlling these risks. GORC also makes recommendations in relation to control improvements and is responsible for making recommendations to the Board Risk Committee on what the operational risk appetite should be, which is defined at a divisional level.

Through the Operational Risk Management Framework, the Board ensures the management and oversight of the key risk exposures facing the Group in the following risk categories:

- Business Continuity
- Change
- Customer / Client Experience
- Financial Management & Management Information
- Fraud
- Information Security
- Information Technology
- Legal & Regulatory
- People
- Premises
- Process
- Third Party Relationships

Each business entity within the Group has nominated 'Risk Champions' who are supported by a central Operational Risk function to ensure consistency across the Group, consolidating, analysing and challenging line management in its assessment of risk, proposed actions and timelines. This independent function reports on the key operational risks facing the business to GORC bi-monthly, and the Board monthly (via the Board Risk Committee quarterly).

At an operational level, the Group manages its operational risk exposures through a framework of internal controls and risk mitigation techniques such as insurance and business continuity planning. Risks are monitored through a risk and control self-assessment process and analysis of actual loss and 'near miss' data. Operational risk self-assessment is undertaken by each business unit quarterly, specifying the likelihood and financial impact of specific operational risk events (analysed by each operational risk sub-category). Consolidated outputs of the self-assessment process are reviewed by the Divisional / Operational Board of each Group entity at least annually.

Given the nature of the regulated sectors in which the Group operates one of the key operational risks is the potential failure to maintain ongoing compliance with relevant external regulation across the Group. Each of the regulated businesses has an established Compliance team which both monitors compliance with existing legislation and considers the impact of new requirements. Oversight is provided by a central Compliance function which ensures best practice is adhered to and shared across the Group as appropriate.

The FSA initiated a market-wide review of the sale of Mortgage Payment Protection and Payment Protection Policies during 2010. Four businesses within the Group have sold such policies and while initial review suggests that appropriate sales practices have been employed, the FSA's proposed approach to reviewing such sales is rigorous and could see unexpected compensation payments, however these are not expected to materially impact the Group's performance.

Regulatory risk

Regulatory risk is the risk arising from regulatory changes and enforcement with the potential for fines and / or restrictions in business activities.

Over recent years, the financial services industry has seen increased regulatory scrutiny and supervision around governance, capital, liquidity and remuneration. There has also been focus on conduct and treating customers fairly.

The Group regularly engages with the FSA and other regulators to proactively manage this risk.

Reputational risk

Reputational risk arises from a deterioration in the perception of the Society's or Group's standing in the eyes of either the wholesale markets or the general public. Management has considered how this might arise and what the impact could be. An event threatening the Society's or Group's reputation may result in an increase in retail deposit outflows and / or counterparties withdrawing funding lines to the Group. This is modelled and controlled under the Group's liquidity risk management framework described earlier.

Pension obligation risk

Pension obligation risk is the risk that the Group's obligations to its pension schemes may lead to the Group not being able to pay its other liabilities as they fall due; and the risk that an increase in the funding requirements results in a significant reduction in the Group's capital resources. The Group's exposure to pension risk emanates from its five defined benefit pension schemes, all of which have been closed to new members for a number of years and are all now closed to future accrual of benefit.

The following controls are in place to limit the Group's exposure to pension obligation risk:

- Senior management and the scheme trustees receive professional advice, from separate actuarial advisers, regarding the management of the pension scheme obligations on a regular basis.
- The pension trustees meet every quarter to monitor and make, in consultation with the principal employer, investment decisions with regard to the plan assets within the five schemes.
- The pension obligation position is updated every quarter and reported to the Board and the pension scheme trustees.

The Group also performs stress testing on the pension scheme liabilities and assets as part of its capital planning methodologies, articulated in the ICAAP. Note 32(c) of these Report and Accounts sets out the steps management have undertaken to actively manage the current deficit.

Additional information on risk is also set out in the Group's Pillar 3 disclosures available on our website.

Taxation risk

Taxation risk is the risk associated with changes in tax law or in the interpretation of tax law. It also includes the risk of changes in tax rates and the risk of failure to comply with procedures required by tax authorities. Failure to manage tax risks could lead to an additional tax charge.

The withdrawal of VAT exempt status on third party administration services in the UK following the AXA Denplan ruling by the European Court of Justice in October 2010 may impact the Group as there is uncertainty surrounding how this ruling may impact the Group's mortgage servicing business, HML.

Outlook

There has been a gradual recovery in the UK economy during 2010, but it still faces challenges in the years ahead. The measures announced by the Government in the Comprehensive Spending Review are aimed at ensuring the longer-term stability of the UK public finances, but are expected to keep the pace of economic recovery relatively subdued in the near term. As a result it is expected that the Bank of England is likely to keep official interest rates low for the foreseeable future, despite inflation remaining above the Government's target of 2%, in order to offset the dampening impact of spending cuts.

Competition within the savings and lending sector is expected to continue unabated as new banks enter the market and existing banks and building societies fight for retail funds, as Government funding mechanisms unwind. The Society remains committed to offering long-term good value to members whilst also keeping the cost of retail funding at a sensible level.

The housing market in 2010 was a tale of two halves, with the first half of the year continuing the upward momentum in prices seen throughout 2009 driven by low levels of supply. However, the second half of the year saw a change in the market as the number of properties for sale increased, possibly as a result of the abolition of Home Information Packs, and buyer numbers fell as caution returned to the market, resulting in an inevitable fall in prices. We currently anticipate the housing market will remain subdued for 12 months.

The regulatory landscape also continues to evolve at pace, especially in relation to liquidity, capital, and mortgage and investment market reforms. However, our continued focus on proactively identifying and managing the risks the business faces will be instrumental in ensuring we remain well placed to meet the challenges of both the external and regulatory environment.

The Group has increased its underlying profits during 2010, and the steps taken to rebalance the balance sheet and improve margin mean we are confident that we will continue to generate sustained value for our members and customers.

R J Twigg

R J Twigg

Group Finance Director

22 February 2011

The Directors have pleasure in presenting their Annual Report and Accounts for the year ended 31 December 2010.

As set out more fully in the statement of accounting policies, the Annual Report and Accounts are prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU. The financial information given in this Directors' report is taken from the statutory accounts prepared on this basis. Further, unaudited information which allows comparison between 2010 and 2009 is set out in the Business Review on pages 14 to 29.

Business objectives

The Society's long-term objectives remain to maximise the long-term value for an increasing number of retail savings and borrowing members, and to create safe and rewarding employment for its staff. The Directors believe that our status as a building society enables us to deliver attractive products to customers. Our focus on profitably growing our core business of retail savings and mortgages remains, but investment in related complementary businesses, where appropriate opportunities are identified, will continue. The profits generated by our investment in subsidiary companies continue to deliver long-term benefit to our members.

The Group offers a comprehensive range of financial services products and services to individual consumers, from mortgages and investments, financial advice, outsourced mortgage servicing, estate agency services and life and other insurance sales.

Business Review and future developments

The Chairman's statement, Group Chief Executive's report and Business Review set out on pages 6 to 29 report on the performance of the business and its future objectives.

Key performance indicators ('KPIs')

Understanding and managing the risks faced by the Group, and maintaining sufficient levels of capital is pivotal to ensure that the business remains protected. To grow and take the business forward we must exceed our customers' and potential customers' expectations.

This can be achieved by offering and delivering, through our staff, financial products and services they value. The KPIs used by management provide the framework to help ensure these strategic objectives are met. The KPIs set out below have been agreed by the Board and performance against these measures is monitored by the Board on a monthly basis.

The Group's Financial KPIs are set out in the 'Financial Performance' section of the Business Review on pages 15 to 23 and help to ensure we are focused upon:

- ensuring the Group continues to trade profitably;
- improving capital strength;
- maintaining a strong and diversified funding base;
- retaining optimum liquidity levels;
- the effective management of impaired assets; and
- increasing efficiency across the business.

We also monitor a number of non-financial indicators including customer and employee KPIs, which support the delivery of our key strategic objectives. These non-financial indicators are monitored through regular staff surveys, performance reviews, member reviews, levels of complaints and mystery shopper exercises. Our latest Society employee opinion survey showed that employee satisfaction was 75%. During 2010, the Society was re-accredited by Customer First – the national customer service standard.

Key performance indicator	Why?
Group pre-tax profit (£)	Generating sufficient income and controlling costs to ensure the long-term security of the business for our members.
Management expense (%)	Managing costs is essential in ensuring that we increase efficiency across the business.
Impairment charge (£)	Effective management of credit quality delivers long-term value to members.
Capital adequacy measures: • Total capital ratio (%) • Tier one ratio (%) • Basel II capital resources (£)	Maintaining a strong capital base ensures financial stability and security for our members and staff.
Liquidity adequacy measures: • Liquidity as % of shares, deposits and liabilities • Core liquidity buffer (£)	Maintaining appropriate levels of liquidity to ensure we can meet our financial obligations as they fall due.
Customer satisfaction measures	Developing the relationship with our customers and ensuring we meet their needs is vital to our success.
Employee satisfaction	Developing and retaining a committed and engaged work force is central to delivering excellent products and services to our customers.

Profits and capital

The reported profit before tax based on continuing operations was £35.0m (2009: £18.0m). Total Group profit before tax was £35.0m (2009: £63.5m). The profit after tax transferred to the general reserve was £25.5m (2009: £57.4m).

Total Group reserves at 31 December 2010 were £818.0m (2009: £762.9m) including the available-for-sale reserve of £(6.9)m (2009: £(6.2)m) and the cash flow hedging reserve of £0.3m (2009: £(16.0)m).

Gross capital at 31 December 2010 was £1,120.0m (2009: £1,063.0m) including £214.2m (2009: £213.0m) of subordinated liabilities and £84.7m (2009: £83.6m) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings at 31 December 2010 was 9.20% (2009: 7.58%) and the free capital ratio was 7.01% (2009: 5.79%).

Mortgage arrears

Group mortgage balances at 31 December 2010 included 564 mortgage cases (2009: 703), either in possession or where payments were 12 months or more in arrears. The capital balances of these loans were £96.7m (2009: £107.5m). The total amount of arrears was £8.1m (2009: £8.6m).

Charitable donations

During the year the Group made charitable donations of £0.1m (2009: £0.1m). No contributions were made for political purposes.

Creditor payment policy

The Group's policy concerning the payment of suppliers is to negotiate and agree terms and conditions with all suppliers and upon complete provision of goods and services, unless there is an express provision for stage payments, undertake to pay suppliers within the agreed payment period, usually 30 days. The number of Group trade creditor days as at 31 December 2010 was 17 days (2009: 17 days).

Risk management

As a result of its normal business activities, the Group is exposed to a variety of risks, the most significant of which are operational risk, credit risk and liquidity risk. The Group has established a number of committees and policies to manage these risks. These principal risks and uncertainties are set out in the Business Review on pages 25 to 29 and in note 33.

The financial management objectives and policies of the Group are shown in the Business Review on pages 25 to 29 and in note 33 on pages 86 to 104.

Employees

The Group remains committed to its policy of treating all employees and job applicants equally at all times. Our policy is that no employee, or potential employee, is treated less favourably on the grounds of race, colour, religion, nationality, ethnic origin, sex, marital status or sexual orientation. We also give all applications from disabled people full consideration in relation to the vacancy concerned and their own aptitudes and abilities. In the event of an existing employee becoming disabled, we make every effort to maintain their present position or to employ them in alternative suitable work.

We also aim to provide high quality relevant training and development opportunities to all staff which enables them to achieve their full potential and helps the Group meet its corporate objectives. All employees have equal access to training and have the opportunity to acquire relevant professional qualifications for their respective roles.

The Group's Board meets on a monthly basis and the Society's management is briefed regularly on matters arising. There is a comprehensive internal communications structure to cascade relevant business information to staff throughout the organisation in an appropriate and timely way. The Society's subsidiary companies have similar arrangements in place to ensure that their employees are effectively managed.

The Society and certain Group companies recognise an independent staff association ('SURGE'), with which management meets regularly to consult and negotiate on a wide variety of matters and to which staff may make their views known on issues affecting their interests.

Property, plant and equipment

The Directors consider that the overall market value of the Group's freehold and leasehold properties, excluding the Principal Offices of the Society and HML, is in excess of the book value. In arriving at this view the Directors have taken account of internal and external valuations of the Group's property portfolio. The Principal Offices of the Society and HML are special purpose facilities and the Board considers that their value in use to the Group is greater than their book value.

Directors' responsibilities in respect of the preparation of the Annual Accounts

This statement, which should be read in conjunction with the Independent auditor's report on page 43, is made by the Directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the Directors' emoluments disclosures within the Directors' Remuneration Report, the Directors' Report and the Annual Business Statement.

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 IFRS accounts giving a true and fair view are references to their achieving a fair presentation. In preparing those Annual Accounts, the Directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Annual Accounts; and
- prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

The Directors are also required by the Disclosure and Transparency Rules of the Financial Services Authority to include a management report containing a fair review of the business and a description of the principal risks and uncertainties facing the Group.

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 connected undertakings.

A copy of the Annual Accounts is placed on the Society's website.

Directors' responsibilities for accounting records and internal controls

The Directors are responsible for ensuring that the Group:

- keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society, in accordance with the Act;
- takes 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 taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Society's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' statement pursuant to the Disclosure and Transparency Rules

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware:

- the Annual Accounts, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Society; and
- the management report contained in the Business Review includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

Going concern

The Group's business activities together with its financial position, capital resources and the factors likely to affect its future development and performance are set out in the Business Review on pages 14 to 29. In addition note 33 to the Annual Accounts includes the Group's objectives, policies and processes for managing its liquidity risk, details of financial instruments and hedging activities, and its exposure to credit risk and liquidity risk.

In common with many financial institutions, the Group meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources, and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business. The Group's forecasts and objectives, taking into account a number of potential changes in trading performance and funding retention, show that the Group should be able to operate at adequate levels of both liquidity and capital, for the foreseeable future.

Consequently, after reviewing the Group's forecasts and the risks it faces, the Directors are satisfied that there are no material uncertainties that may cast significant doubt about the Group's ability to continue as a going concern for the foreseeable future and have, therefore, continued to adopt the going concern basis in preparing the Annual Accounts.

Directors

The Directors of the Society during the year were as follows:

Mr A I Findlay	(Chairman)
Mr C N Hutton	(Vice Chairman)
Mr D J Cutter*	(Group Chief Executive)
Mr P R Hales	
Ms P M Hay-Plumb	(resigned 21 December 2010)
Ms A B E Kinney	
Mr J B Rawlings	(retired 27 April 2010)
Mr J Spence	(resigned 30 September 2010)
Mr P J S Thompson	
Mr R J Twigg*	
Mr T F Wood*	(resigned 22 September 2010)
Mr W R Worsley	

* Executive Directors

Details of Directors' service contracts are disclosed in the Directors' Remuneration Report.

No Director at 31 December 2010 had any interest in the shares of any group undertaking at 31 December 2010.

Auditors

In accordance with Section 77 of the Building Societies Act 1986, a resolution for the re-appointment of KPMG Audit Plc as auditors is to be proposed at the forthcoming Annual General Meeting.

The Directors who held 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 Society's auditors are unaware; and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Society's auditors are aware of that information.

By Order of the Board

A I Findlay

Chairman

22 February 2011

The Board is committed to best practice in corporate governance. This report explains how the Board applies the principles of the Corporate Governance Code ('the Code') issued by the Financial Reporting Council (published in June 2008). The Board has also taken into consideration the Code issued in 2010 which will come into force in 2011 and the BSA Guidance for Building Societies on the Code.

Governance Framework

The Group comprises Skipton Building Society ('the Society') and its direct and indirect holdings in numerous legal entities, operating in different jurisdictions, many of which are regulated.

The Society's governance arrangements ensure that it meets the requirements of its customers, employees and regulators through a framework which organises the Group into five divisions:

- Mortgages and Savings (including the Society)
- Mortgage Services
- Estate Agency
- Financial Advice
- Investment Portfolio

The Board's Governance Principles, which are summarised below, provide the framework through which the Society establishes its systems and processes concerned with planning and delivering the overall direction, effectiveness, supervision and accountability of the Group.

Directors

The Board

The Society recognises that it must be headed by an effective Board, which is responsible for the success of the Society.

The Board's terms of reference clearly set out its responsibility for the overall stewardship of the Group within the context of the Society's 'Principles of Governance', which may be summarised as follows:

1. **Governing Body** - The Society will be headed by the Board, which is responsible for the success of the Society. The Board shall formulate strategy and establish the Society's risk appetite and balance sheet strategy. It shall have a proper understanding of, and competence to deal with, the current and emerging issues of the business of the Society and its businesses; effectively reviewing and challenging the performance of management and exercising independent judgement;
2. **Management and Oversight** - The Society's management and oversight framework shall enable the Board to provide strategic guidance for and effective oversight of management at both the Society and its divisions. The framework will clarify the respective roles and responsibilities of Board members and Senior Executives in order to facilitate Board and management accountability to both the Society and its members and will ensure a balance of authority such that no single individual has unfettered powers. It will have clear, risk-based, lines of sight into activities to support challenge and direction which will enable the Board to ensure that assurance is obtained over the integrity of reporting and the adequacy of the control framework and control activities; and
3. **Recognise and Manage Risk** - The Board will have a sound system of risk oversight and management and internal control. This framework shall identify, assess, manage and monitor risk. It will inform Senior Executives and the Board of material changes to the risk profile of the Society or any of its divisions and shall monitor and provide assurance over the effectiveness of the control framework and control activities and integrity of reporting.

The Board has established a framework of authorities which maps out the structure of high level delegation below Board level and specifies those issues which remain the responsibility of the Board. The Board also has a general duty to ensure that the Group operates within the Society's rules, relevant laws, rules and guidance issued by relevant regulatory authorities and that proper accounting records and effective systems of internal control are established, maintained, documented and audited.

In addition to the formal schedule of matters which are reserved to it, the Board has also delegated authority in other matters to a number of Board Committees, as described below. The Board has set clear terms of reference for each of these Committees, and has established an organisational structure with clearly defined and documented delegated authority to Executive management, together with reporting systems for financial results, risk exposure and control assessment.

The Board meets monthly (except August), and also holds an annual strategy review meeting. The Non-Executive Directors also meet, without Executive Directors present, at least once a year.

All Directors have access to independent professional advice, if required, and have the benefit of appropriate liability insurance cover at the Society's expense.

Chairman and Group Chief Executive

The offices of the Chairman and Group Chief Executive are distinct and are held by different individuals. The role of each is set out in their terms of appointment or contract respectively. The Chairman is responsible for leading the Board and communicating with the Society's members on behalf of the Board. The Chairman is independent and has no conflicting relationships or circumstances that could affect his judgement.

The Group Chief Executive is responsible for managing the Group's business within the parameters set by the Board.

The Board elects its Chairman and Vice Chairman annually at the Board meeting immediately following the Annual General Meeting.

Board balance and independence

The Society's rules detail the appointment process for Directors and require that the Board comprises not less than six nor more than 15 Directors.

The Board has determined that its current composition is appropriate. The Board considers all the Non-Executive Directors to be independent in accordance with the criteria set out in the Code.

The Board has appointed Mr Hutton as the Senior Independent Director.

Appointments to the Board

The Board has a Nominations Committee to lead the process for Board appointments and succession planning. The Committee, at least annually, reviews the structure, size and composition of the Board to ensure it contains the required balance of skills, knowledge and experience relevant to the activities of the Group.

Candidates for Non-Executive positions are identified in a number of ways, including the use of external search consultants. In addition, members of the Society have the right, under the Society's rules, to nominate candidates for election to the Board. All Directors must meet the FSA's fitness and propriety standards and be registered with the FSA as an Approved Person in order to fulfil their Controlled Function as a Director. A copy of the Non-Executive Director appointment letter can be obtained from the Group Secretary.

Information and professional development

On appointment, new Directors receive appropriate induction; ongoing training and development needs are identified and addressed through an annual performance evaluation process.

Through the Group Secretary, the Chairman ensures that Directors receive accurate, timely and clear information to facilitate effective contribution to Board discussions and decision making.

Directors have access to the advice and services of the Group Secretary, whose appointment is a matter for the Board, and who is responsible for ensuring that Board procedures are followed and for advising the Chairman on matters relating to governance.

Performance evaluation

The Board reviews its effectiveness annually with reference to the Group's performance against its corporate objectives. During 2010 the Board commissioned an independent evaluation of Directors' performance and the Board's effectiveness including the Board's interactions with its sub-committees and Society and Group management.

Individual Non-Executive Directors are evaluated on a one to one basis by the Chairman. Executive Directors are evaluated by the Group Chief Executive against agreed performance targets for their areas of responsibility and their own personal performance. The Chairman evaluates the Chief Executive's performance and the Vice Chairman evaluates the Chairman's performance.

Re-election Policy

The Society's Rules require that Directors stand for election at the Annual General Meeting ('AGM') following their appointment and for re-election every three years thereafter. Non-Executive Directors are appointed for an initial period of three years and are not expected to serve more than three terms.

The Board will assess the appropriateness of the Code's provisions on the annual election of directors during 2011.

Remuneration

Details relating to Directors' remuneration and contracts are contained in the Directors' Remuneration Report set out on pages 39 to 42.

Accountability and Audit

Financial reporting

The responsibilities of the Directors in relation to the preparation of the Society's Annual Accounts and a statement that the Society is a going concern are contained in the Directors' Responsibilities Statement, set out on pages 31 to 33.

Internal control

The Board is responsible for determining the Society's strategy for managing risk and overseeing its systems of internal control. The Executive Directors and senior management are responsible for designing, operating and monitoring risk management and internal controls. Such systems are designed to manage rather than eliminate the risk of failure to achieve the Society's business objectives. The principal categories of financial risk inherent in the Group are described in greater detail in the Business Review under the heading 'Principal

Risks and Uncertainties' on pages 25 to 29, together with an explanation of the framework adopted by the Group for managing financial risk.

The Group's appetite and risk management policy framework are formally approved by the Board on an annual basis.

The Board reviews the effectiveness of systems of internal control through a combination of processes including:

- Regular reports and presentations to the Board by the Chairmen of the various Board Committees – see below;
- Presentations to the Board by Divisional Managing Directors about the performance of companies within each of the divisions, summarising both historic and future performance together with key business risks, issues and strategies. Significant risk areas are highlighted, and appropriate control strategies and accountabilities are agreed;
- Regular reports to the Board, through the Audit Committee, from the internal audit function ('Audit Services') in respect of their independent audits of risk management processes and internal controls' effectiveness across the Society and its subsidiaries. The General Manager, Audit Services, has direct access to the Chairman of the Audit Committee;
- Regular reports to the Board, through the Board Risk Committee, from the Risk function on the principal operational, credits, business and regulatory risks facing the Group and the strength of the controls in place to mitigate such risks;
- Reports on at least a quarterly basis presented by the Chief Risk Officer and Secretary.

The Society is committed to embed internal control and risk management into the operation of the Group and to deal with areas of improvement, which come to the attention of Executive management and the Board.

The Society has a comprehensive system for reporting financial results to the Board. Each of the divisions prepares monthly results with comparisons against budget. The Board reviews these for the Group as a whole and determines appropriate action.

The Society has a number of central functions including Group Finance, Group Taxation, and Risk and Compliance, that establish and monitor the implementation of business standards across the Group. Each of these functions has documented procedures and is also subject both to self-assessment and to reviews by the internal audit function.

The internal audit function is responsible for independently reviewing and reporting on the adequacy and effectiveness of internal controls operated by Management throughout the Group, thereby helping to evaluate and improve the effectiveness of risk management, regulatory compliance, control and governance processes. Through its programme of work, agreed by the Audit Committee, the internal audit function is able to provide assurance on control effectiveness. The Board is satisfied that during 2010 the Society maintained an adequate system of internal control that met the requirements of the Code.

Board Committees

In addition to the Audit Committee (see below), the following Board committees exist:

The Board Risk Committee is responsible for ensuring that the Group implements an effective risk governance structure. The members of the Committee are:

Mr Hales, Non-Executive Director (Committee Chairman)
Mr Worsley, Non-Executive Director
Mr Thompson, Non-Executive Director
Mr Cutter, Group Chief Executive
Mr Twigg, Group Finance Director
Mr Gibson, Chief Risk Officer and Secretary

The Nominations Committee is responsible for assessing the necessary and desirable competencies of Board members, evaluating the Board's performance, succession planning and the appointment and removal of Directors. Director appointments and the appointment of the Group Secretary are confirmed by the full Board. The members of the Committee are:

Mr Findlay, Chairman (and also Committee Chairman)
Mr Hutton, Vice Chairman
Mr Hales, Non-Executive Director
Ms Kinney, Non-Executive Director

The Remuneration Committee is responsible for reviewing the adequacy and effectiveness of the Society's remuneration policy, considering the risk management implications of the policy and for approving the Directors' Remuneration Report included within this report. Further detail is set out in the Directors' Remuneration Report. The members of the Committee are:

Mr Hutton, Non-Executive Director (Committee Chairman)
Ms Kinney, Non-Executive Director
Mr Hales, Non-Executive Director

The Non-Executive Remuneration Committee is responsible for the review of the fees to be paid to the Vice Chairman and other Non-Executive Directors, in accordance with the Society rules. Mr Findlay chairs the Committee which also comprises Messrs Cutter and Twigg.

Additionally, the Board has delegated responsibility to the following bodies:

The Group Operational Risk Committee meets bi-monthly and its primary responsibility is to develop and keep under review the Group's operational risk management framework. Mr Varney (Chief Operating Officer) chairs the Committee which comprises the Chief Risk Officer and

Secretary, Group Finance Director and Senior Executives from each of the divisions and the Operational risk team.

The Asset and Liability Committee is primarily responsible for developing and maintaining policies on structural risk management, liquidity and deposit funding, recommending changes to these policies to the Board, monitoring implementation to ensure that the Group operates within risk limits and that the Society has adequate liquid financial resources to meet its liabilities. Mr Twigg (Group Finance Director) chairs the Committee which comprises the Group Chief Executive, Chief Risk Officer and Secretary and senior Executives from Treasury, Finance, Risk and the Group's lending division.

The Group Retail Credit Committee is primarily responsible for developing and maintaining policies for monitoring and controlling the risks to the Group arising from the credit quality of its retail loan books and the residual values of leased and other assets, recommending changes to these policies to the Board and monitoring implementation to ensure that the Group operates within risk limits. Mr Cutter (Group Chief Executive) chairs the Committee which comprises the Group Finance Director, Chief Risk Officer and Secretary together with Senior Executives from the credit risk team and the Group's lending businesses.

The Executive Committee is responsible for ensuring that the Group meets its strategic and operational objectives as defined in the Corporate Plan. Mr Cutter (Group Chief Executive) chairs the Committee which comprises the Group Finance Director and other senior executives.

Divisional Boards exist for the Estate Agency and, the Mortgage Services divisions. Each board is chaired by a Senior Executive from that division. Also represented on the board are two Shareholder Directors (Society Executive Directors) and the divisional executive management. The Divisional Boards are responsible for the prudent management of the division, within delegated authorities, to meet its strategic and operational objectives as defined in the corporate plan.

Each business within the Mortgages and Savings, Financial Advice and Investment Portfolio divisions is governed by an Operational Board. Each board is chaired by the divisional Managing Director. Also represented on the board are at least one other Shareholder Director (Executive Directors or other senior Society executives) and the business executive management. Their Operational Boards are responsible for the prudent management of the business, within delegated authorities, to meet its strategic and operational objectives as defined in the corporate plan.

The Terms of Reference of key Board Committees are available from the Group Secretary on request.

Audit Committee and Auditors

The Audit Committee, which meets at least four times a year, comprises three Non-Executive directors, currently Ms Kinney (Chairman), Mr Thompson and Mr Hutton. In addition, the Group Chief Executive, Group Finance Director, Chief Risk Officer and Secretary, external audit representatives and the General Manager, Audit Services, regularly attend meetings, by invitation. The Board is satisfied that the composition of the Audit Committee contains a Director with relevant, recent financial experience to provide appropriate challenge to management. Ms Kinney is a Fellow of the Institute of Management Accountants. Biographical details for all of the Board are set out in page 13 of this report.

The responsibilities of the Committee are in line with the provisions of the Financial Reporting Council Guidance on Audit Committees. The Audit Committee's primary responsibilities include:

- monitoring the integrity of the Group's financial statements, any formal announcements relating to the Group's financial performance and significant reporting judgments contained in them;
- monitoring the effectiveness of the external audit process and making recommendations to the Board on the appointment, re-appointment and remuneration of the external auditors;
- ensuring that an appropriate relationship between the Group and the external auditors is maintained, including reviewing non-audit services which can be provided and fees;
- reviewing the effectiveness of the internal audit function. The Committee is responsible for approving, upon the recommendation of the Group Chief Executive, the appointment and removal of the General Manager, Audit Services.

The Board has delegated responsibility for reviewing the effectiveness of the Group's internal controls and risk management systems to the Audit Committee.

In 2010, the Committee met eight times in the execution of its responsibilities and, in particular considered reports on the following matters:

- the system of internal controls;
- the integrity of financial statements;
- the activities of internal and external auditors;
- the effectiveness of the internal audit function;
- the performance of the external auditor;
- the effectiveness of the committee;
- the whistleblowing arrangements.

The Committee also held private discussions with the external auditors, the Chief Risk Officer and Secretary, the General Manager, Audit Services and the Head of Compliance.

The minutes of the Audit Committee are distributed to the Board and the Committee Chairman reports verbally to the Board meeting immediately following Committee meetings.

Auditors

The Audit Committee regularly monitors the Society's relationship with the external auditors and has adopted a framework for ensuring auditor independence and objectivity, which defines unacceptable non-audit assignments, pre-approval of acceptable non-audit assignments and procedures for approval of other non-audit assignments across the Group. The external auditor, KPMG Audit Plc, undertook a number of non-audit related assignments for the Group during 2010. These were conducted in accordance with the framework and are considered to be consistent with the professional and ethical standards expected of the external auditor. Details of the fees paid to the external auditors for audit and non-audit services are set out in note 7 to these Annual Accounts.

Board and Committee membership attendance record

The attendance of Directors at the scheduled Board, Audit Committee, Nominations Committee, Remuneration Committee and Risk Committee meetings during the year is set out below.

Relations with members

As a mutual, the Society's membership is comprised almost exclusively of individuals (rather than institutions), all of whom are our customers.

The Society encourages communication with its members and seeks to respond quickly to all enquiries received. Publications are sent to members regularly throughout the year inviting feedback. We also conduct customer service feedback surveys, market research and analyse customer feedback received through branches and at our head office.

Constructive use of the Annual General Meeting

Each year the Society gives all eligible members at least 21 days' notice of the AGM. At the AGM, the Chairman and Group Chief Executive make presentations on the previous years' performance and the main developments in the business. Members present have the opportunity to raise questions and put forward their views. All Directors attend the AGM and are available for questions both during a "question and answer" session within the meeting, and on an individual basis before and after the meeting.

All eligible members are encouraged to participate in the AGM, either in person or by voting proxy. Members can vote by post, in any of the branches, online at skipton.co.uk/agm or at the AGM. All votes are returned to independent scrutineers. A poll is called in relation to each resolution at the AGM and the results of the vote are published on the Society's website and in branches.

In addition, the Summary Financial Statement is included as part of the Annual General Meeting magazine, the format of which is aimed at making its reading as accessible as possible.

Copies of the full Annual Report and Accounts 2010 are also available on request in branches or by post.

A I Findlay
Chairman
22 February 2011

	Board	Audit Committee	Nominations Committee	Remuneration Committee	Risk Committee
Mr J B Rawlings (retired 27 April 2010)	4/4	-	1/1	-	-
Mr A I Findlay	14/14	-	4/4	-	-
Mr C N Hutton	14/14	-	4/4	7/7	-
Mr D J Cutter	13/14	-	4/4	6/7	2/3
Mr P R Hales	12/14	4/5	2/2	1/1	3/3
Mrs P M Hay-Plumb (resigned 21 December 2010)	14/14	8/8	2/2	6/6	-
Ms A B E Kinney	13/14	2/2	1/1	6/7	-
Mr J Spence (resigned 30 September 2010)	9/11	5/6	-	-	1/1
Mr P J S Thompson	14/14	8/8	-	-	2/2
Mr R J Twigg	13/14	-	-	-	1/2
Mr T F Wood (resigned 22 September 2010)	9/10	-	-	-	-
Mr W Worsley	13/14	-	-	5/6	3/3

This report aims to provide information about the Group's policies on remunerating Directors and discloses the remuneration of the Directors. The Board is committed to best practice in its remuneration policy for directors and this report explains how the Group applies the principles in the Corporate Governance Code relating to remuneration, insofar as they are considered appropriate to building societies.

A summary of this report will be sent to all members entitled to vote at this year's Annual General Meeting, where members will have the opportunity to vote on the report.

Remuneration Committee

The Remuneration Committee is responsible for determining, on behalf of the Board, the Group's remuneration policy and reviewing its adequacy and effectiveness. The Committee is also responsible for setting, reviewing and approving remuneration for the Chairman, the Executive Directors and certain other key individuals. The Committee also receives recommendations from the Group Chief Executive for approval of the remuneration for Senior Executives.

The Committee operates under the remuneration principles (see below) which it has adopted and that take into account the FSA's Remuneration Code. During 2010 the Committee reviewed its policies relating to bonus pay and adopted a set of incentive principles over the design and award of both annual and longer-term bonus pay.

During 2010, the Committee received an annual report from the Chief Risk Officer and Secretary on the implications of the remuneration practices within the Group for risk and risk management, and compliance with the Committee's remuneration principles and incentive principles.

The Committee reports to the Board and all recommendations are considered by the Board, but no Director participates in any decisions relating to their own remuneration.

The Remuneration Committee met eight times during 2010. In discharging its duties, the Committee reviews and takes into account independently produced data in relation to similar financial services organisations. Independent remuneration consultants advising the Committee have no other connection with the Group.

The Committee comprises three Non-Executive Directors, Messrs Hutton (Chairman) and Hales and Ms Kinney. The Chairman, Group Chief Executive, Chief Risk Officer and Secretary, Human Resource representatives and external advisers may be invited to attend meetings as and when appropriate.

The Non-Executive Directors' Remuneration Committee, which comprises Messrs Findlay (Chairman), Cutter and Twigg, determines the level of the other Non-Executive Directors' fees.

Directors' remuneration policy

Executive Directors' remuneration

The Board's policy is designed to ensure that Executive Directors' remuneration reflects performance and enables the Group to attract, retain and motivate a sufficient number of high calibre individuals to lead and direct the organisation and deliver continually improving business performance.

In establishing, implementing and maintaining the remuneration policy the Committee applies the Group's remuneration principles. The principles are relevant to the Society and each of its divisions and references to 'Group' include the Society. The remuneration principles are:

- Remuneration at Skipton encourages the highest levels of stewardship and corporate governance.
- Remuneration does not encourage inappropriate taking of risk.
- Remuneration is sufficient to secure and retain the services of talented individuals from other companies or mutuals, recognising the diverse nature of the Group and the nature of its stakeholders.
- Remuneration recognises the appropriate level of Group / divisional and individual performance which will create a strong and sustainable Society for the benefit of borrowers and savers, now and in the future.
- Remuneration for some senior management has an element tied to the longer-term performance of their division to reflect the time horizons of the decisions made by divisional leaders.
- Remuneration arrangements are straightforward to communicate, understand, and administer.

The main components of Executive Directors' remuneration are as follows:

- Basic salary – which takes into account job content and responsibilities, individual performance (assessed annually) and salary levels of similar positions in comparable organisations.
- Annual Performance Pay – as a mutual building society the Society does not issue shares on the Stock Exchange. For this reason the annual performance pay cannot be based upon Share Option Schemes or Share Incentives Plans unlike executive directors of quoted companies. Instead, the Executive Directors participate in a non-pensionable performance incentive scheme. This is calculated by reference to business performance measured together with individual performance against personal objectives, both of which are linked to the achievement of the Group's strategic objectives which include effective risk management.

- Pensions – the Executive Directors receive contributions of 20% of basic salary payable into defined contribution pension arrangements.
- Other benefits include provision of a car or car allowance, and private medical insurance.

2010 Executive Directors' Remuneration review

The Executive Directors' pay and performance related awards are subject to review against the Group's overall performance in respect of profitability and, in the light of the Society's financial performance in 2009, the Committee decided that there would be no increase in basic pay for 2010.

As part of the Society's efforts to reduce operating costs, the defined benefit pension scheme was closed to future accrual on 31 December 2009 and from that date the Executive Directors receive pension benefits under the Society's defined contribution arrangements.

Based on the recent performance of the business and the individual performance of the Executive Directors, the Remuneration Committee awarded each of the current Executive Directors bonuses for 2010 amounting to 21.2% of their basic salary.

Non-Executive Directors' remuneration

Non-Executive Directors' fees (excluding the Chairman) are reviewed annually by the Non-Executive Remuneration Committee with recommendations made to the Board. The reviews are based on the responsibilities and time commitments required for Board and Board sub-committee meetings and also reflect comparable data from similar financial services organisations. Additional fees are paid to those Non-Executives Directors who undertake additional duties and responsibilities, including chairmanship of Board committees.

Non-Executive Directors only receive fees, do not participate in any performance pay scheme, nor do they receive pension or other benefits. The Non-Executive Directors' basic fee for 2010 remains unchanged since 2007.

The Chairman's fees are reviewed and approved by the Remuneration Committee.

Service contracts

The Executive Directors are employed on rolling service contracts which can be terminated by either the Society or the Director giving one year's notice. Unless notice to terminate is given by either party, the contracts continue automatically to the age of 65.

Non-Executive Directors do not have service contracts.

Directors' emoluments

KPMG Audit Plc has audited the information set out in the next three tables.

Non-Executive Directors

	2010			2009		
	Fees £000	**Committee Fees £000**	**Total £000**	Fees £000	Committee Fees £000	Total £000
Mr A I Findlay (Chairman) (note 1)	**63**	**-**	**63**	48	4	52
Mr C N Hutton (Vice Chairman) (note 2)	**45**	**4**	**49**	40	3	43
Mr P R Hales (note 3)	**40**	**1**	**41**	40	-	40
Ms P M Hay-Plumb (resigned 21 December 2010) (note 4)	**40**	**8**	**48**	40	3	43
Mr W H Jack (retired 28 April 2009)	**-**	**-**	**-**	13	-	13
Ms A B E Kinney (note 5)	**40**	**-**	**40**	40	-	40
Mr J B Rawlings (retired 27 April 2010)	**23**	**-**	**23**	70	-	70
Mr J Spence (resigned 30 September 2010)	**30**	**-**	**30**	23	-	23
Mr P J S Thompson	**40**	**-**	**40**	30	-	30
Mr W R Worsley	**40**	**-**	**40**	30	-	30
	361	**13**	**374**	374	10	384

Notes

1. Mr Findlay became Chairman on 28 April 2010. Prior to this date he was Vice Chairman and up until 31 July 2009 he chaired the Audit Committee.
2. Mr Hutton became Vice Chairman on 28 April 2010, and is Chairman of the Remuneration Committee.
3. Mr Hales is the Chairman of the Board Risk Committee which was established in September 2010.
4. Ms Hay-Plumb was appointed Chairperson of the Audit Committee on 1 August 2009 until her resignation as a director on 21 December 2010.
5. Ms Kinney was appointed Chairperson of the Audit Committee on 21 December 2010.

Executive Directors 2010	Salary £000	Annual performance pay £000	Benefits (1) £000	Sub total £000	Increase in accrued pension £000	Pension Scheme contributions £000	Total £000
Mr D J Cutter	320	68	11	399	-	64	463
Mr R J Twigg	250	53	12	315	-	50	365
Mr T F Wood (resigned 22 September 2010)	182	-	9	191	-	38	229
	752	121	32	905	-	152	1,057

Mr Wood's emoluments have been calculated to 22 September 2010, the date on which he ceased to be a Director of the Society. In line with amounts due under his service contract he has also been paid compensation for loss of office amounting to £262,068.

Executive Directors 2009	Salary £000	Annual performance pay £000	Benefits (1) £000	Sub total £000	Increase in accrued pension £000	Pension Scheme contributions £000	Total £000
Mr D J Cutter	320	-	15	335	19	26	380
Mr R J Twigg	247	-	12	259	7	22	288
Mr T F Wood (appointed 7 September 2009)	80	25	102	207	-	16	223
	647	25	129	801	26	64	891

Notes

1. Benefits comprise the provision of a car, or car allowance and private medical insurance contributions. Mr Wood's 2009 benefits include £97,770 in relation to relocation costs.

Directors' pension benefits

The information below shows the value of Directors' pension benefits in the Skipton Building Society Pension & Life Assurance Scheme. The increase in accrued pension represents the change in the annual pension to which each Director is entitled as the result of changes in pensionable earnings (excluding inflation) and increases in pensionable service during the year. The transfer value equivalent represents the present capital value of the changes in Directors' accrued pension entitlements excluding members' contributions for the year. The Skipton Building Society Pension & Life Assurance Scheme closed to future accrual on 31 December 2009 so no further employer or employee contributions were paid in the year.

	Increase in accrued pension in the year to 31 December 2010 £000	Accrued pension entitlement as at 31 December 2010 £000	Transfer value of accrued rights at 31 December 2009 £000	Members' contribution for the year ended 31 December 2010 £000	Transfer values equivalent of increase in accrued pension for the year ended 31 December 2010 £000	Transfer values of accrued rights at 31 December 2010 £000
Mr D J Cutter	-	79	900	-	(141)	759
Mr R J Twigg	-	64	657	-	(116)	541

As a result of changes in Government legislation, certain benefits are now linked to increases in the CPI rather than the RPI. This has resulted in a reduction in the transfer values as set out above. For further details refer to note 35.

	Increase in accrued pension in the year to 31 December 2009 £000	Accrued pension entitlement as at 31 December 2009 £000	Transfer value of accrued rights at 31 December 2008 £000	Members' contribution for the year ended 31 December 2009 £000	Transfer values equivalent of increase in accrued pension for the year ended 31 December 2009 £000	Transfer values of accrued rights at 31 December 2009 £000
Mr D J Cutter	19	79	421	22	457	900
Mr R J Twigg	7	64	346	18	293	657

C N Hutton
Chairman of the Remuneration Committee
22 February 2011

We have audited the Group and Society Annual Accounts of Skipton Building Society for the year ended 31 December 2010 set out on pages 44 to 116. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

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 auditors

As explained more fully in the Directors' Responsibilities Statement set out on pages 31 to 33, the Directors are responsible for the preparation of Annual Accounts which give a true and fair view. Our responsibility is to audit, and express an opinion on, the Annual Accounts 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 (APB's) Ethical Standards for Auditors.

Scope of the audit of the Annual Accounts

A description of the scope of an audit of Annual Accounts is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion the Annual Accounts:

- give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of affairs of the Group and of the Society as at 31 December 2010 and of the income and expenditure of the Group and of the Society for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and regulations made under it and, as regards the Group Annual Accounts, 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 each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations thereunder.
- the information given in the Directors' Report for the financial year for which the Annual Accounts are prepared is consistent with the accounting records and the Annual Accounts; 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 Annual Accounts 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.

J L Ellacott (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor

Chartered Accountants

Leeds

22 February 2011

Income Statements

For the year ended 31 December 2010

	Notes	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Continuing operations					
Interest receivable and similar income	2	**363.6**	421.8	**373.2**	408.7
Interest payable and similar charges	3	**(308.7)**	(368.5)	**(341.1)**	(377.2)
Net interest receivable		**54.9**	53.3	**32.1**	31.5
Fees and commissions receivable	4	**381.7**	389.0	**13.8**	11.7
Fees and commissions payable	5	**(20.8)**	(19.4)	**(2.7)**	(2.3)
Fair value gains on financial instruments		**2.0**	3.9	**1.7**	6.6
Income from shares in subsidiary undertakings		**-**	-	**70.3**	52.7
Profit on disposal of subsidiary undertakings	17b)	**1.2**	-	**1.9**	-
Share of profits from joint ventures and associates	17c)	**0.3**	0.2	**-**	-
Other income	6	**24.1**	13.0	**13.4**	4.2
Total income		**443.4**	440.0	**130.5**	104.4
Administrative expenses	7	**(395.5)**	(383.7)	**(66.9)**	(53.1)
Negative goodwill arising on merger	38	**3.1**	-	**3.1**	-
Impairment losses on loans and advances	16	**(14.8)**	(43.6)	**(12.6)**	(10.4)
Impairment (losses) / recoveries on debt securities	13	**(0.1)**	1.3	**-**	1.3
Provisions for liabilities	27	**(1.1)**	4.0	**(0.2)**	4.3
Provisions against investment in subsidiary undertakings	17a)	**-**	-	**(36.9)**	(2.8)
Provisions against loans to subsidiary undertakings	17a)	**-**	-	**(0.8)**	(2.5)
Profit before tax		**35.0**	18.0	**16.2**	41.2
Tax (expense) / income	11	**(9.8)**	(4.3)	**9.6**	2.5
Profit for the financial year from continuing operations		**25.2**	13.7	**25.8**	43.7
Discontinued operation					
Profit from discontinued operation		**-**	43.9	**-**	-
Profit for the financial year		**25.2**	57.6	**25.8**	43.7
Profit for the financial year attributable to:					
Members of Skipton Building Society					
Profit for the financial year from continuing operations		**25.5**	13.5	**25.8**	43.7
Profit for the financial year from discontinued operations		**-**	43.9	**-**	-
		25.5	57.4	**25.8**	43.7
Non-controlling interests					
(Loss) / profit for the financial year from continuing operations		**(0.3)**	0.2	**-**	-
		25.2	57.6	**25.8**	43.7

Segmental performance of the Group is shown in note 34.

The notes on pages 51 to 116 form part of these Accounts.

For the year ended 31 December 2010

	Notes	**Group 2010 £m**	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Profit for the financial year		**25.2**	57.6	**25.8**	43.7
Other comprehensive income:					
Available-for-sale investments: valuation (losses) / gains taken to equity	31	**(0.5)**	9.4	**1.3**	8.7
Cash flow hedges: gains taken to equity	31	**22.6**	7.1	**23.1**	6.6
Exchange differences on translation of foreign operations	31	**1.4**	2.6	**-**	-
Movement in reserves attributable to non-controlling interests	31	**(0.1)**	(1.1)	**-**	-
Non-controlling interests share restructure	31	**-**	0.5	**-**	-
Actuarial gain / (loss) on retirement benefit obligations	35	**9.7**	(17.9)	**4.6**	(9.3)
Income tax relating to components of other comprehensive income	31	**(9.7)**	0.7	**(8.4)**	(1.6)
Other comprehensive income for the year, net of tax		**23.4**	1.3	**20.6**	4.4
Total comprehensive income for the year		**48.6**	58.9	**46.4**	48.1
Total comprehensive income attributable to:					
Members of Skipton Building Society		**48.9**	58.7	**46.4**	48.1
Non-controlling interests		**(0.3)**	0.2	**-**	-
		48.6	58.9	**46.4**	48.1

The notes on pages 51 to 116 form part of these Accounts.

Statements of Financial Position

As at 31 December 2010	Notes	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Assets					
Cash in hand and balances with the Bank of England		**664.6**	1,272.1	**664.5**	1,272.0
Loans and advances to credit institutions	12	**293.9**	447.5	**191.0**	309.1
Debt securities	13	**2,421.2**	2,339.3	**2,391.7**	2,273.6
Derivative financial instruments	14	**140.6**	265.5	**169.6**	315.4
Loans and advances to customers	15	**9,814.7**	10,813.3	**7,330.6**	8,273.1
Current tax asset		**1.9**	5.6	**3.2**	4.2
Deferred tax asset	28	**26.2**	45.0	**16.4**	19.6
Investments in group undertakings	17	**1.5**	1.7	**3,211.3**	3,322.6
Intangible assets	18	**190.9**	182.2	**3.4**	4.0
Property, plant and equipment	19	**89.4**	88.7	**42.8**	37.4
Investment property	20	**6.8**	10.3	**28.5**	17.9
Other assets	21	**87.8**	97.6	**6.4**	9.6
Total assets		**13,739.5**	15,568.8	**14,059.4**	15,858.5
Liabilities					
Shares	22	**9,388.5**	10,470.2	**9,388.5**	10,470.2
Amounts owed to credit institutions	23	**853.6**	942.2	**1,132.8**	1,371.5
Amounts owed to other customers	24	**1,088.8**	1,203.9	**1,377.9**	1,339.9
Debt securities in issue	25	**846.2**	1,405.6	**846.2**	1,405.6
Derivative financial instruments	14	**260.8**	263.7	**251.2**	251.1
Other liabilities	26	**69.6**	89.7	**7.4**	6.6
Accruals and deferred income		**39.0**	50.0	**6.0**	4.9
Provisions for liabilities	27	**31.3**	19.3	**8.2**	11.8
Deferred tax liability	28	**9.9**	13.8	**6.7**	7.5
Retirement benefit obligations	35	**31.8**	47.4	**9.7**	19.5
Subordinated liabilities	29	**214.2**	213.0	**225.6**	224.3
Subscribed capital	30	**84.7**	83.6	**84.7**	83.6
Total liabilities		**12,918.4**	14,802.4	**13,344.9**	15,196.5
Members' interests					
General reserve		**819.6**	781.5	**720.2**	685.4
Available-for-sale reserve		**(6.9)**	(6.2)	**(6.0)**	(7.0)
Cash flow hedging reserve		**0.3**	(16.0)	**0.3**	(16.4)
Translation reserve		**5.0**	3.6	**-**	-
Attributable to Members of Skipton Building Society		**818.0**	762.9	**714.5**	662.0
Non-controlling interests		**3.1**	3.5	**-**	-
Total members' interests		**821.1**	766.4	**714.5**	662.0
Total members' interests and liabilities		**13,739.5**	15,568.8	**14,059.4**	15,858.5

These Accounts were approved by the Board of Directors on 22 February 2011 and were signed on its behalf by:

A I Findlay	Chairman
D J Cutter	Group Chief Executive
R J Twigg	Group Finance Director

The notes on pages 51 to 116 form part of these Accounts.

For the year ended 31 December 2010

Group

	General reserve £m	Available-for-sale financial assets £m	Cash flow hedges £m	Translation of foreign operations £m	Sub Total £m	Non-controlling interests £m	Total £m
Balance at 1 January 2010	**781.5**	**(6.2)**	**(16.0)**	**3.6**	**762.9**	**3.5**	**766.4**
Profit / loss for the financial year	25.5	-	-	-	**25.5**	(0.3)	**25.2**
Other comprehensive income							
Actuarial gain on retirement benefit obligations	6.5	-	-	-	**6.5**	-	**6.5**
Net (losses) / gains from changes in fair value	-	(0.7)	16.3	-	**15.6**	-	**15.6**
Exchange differences on translation of foreign operations	-	-	-	1.4	**1.4**	-	**1.4**
Movement in reserves attributable to non-controlling interests	-	-	-	-	**-**	(0.1)	**(0.1)**
Total other comprehensive income (note 31)	**6.5**	**(0.7)**	**16.3**	**1.4**	**23.5**	**(0.1)**	**23.4**
Total comprehensive income for the year	**32.0**	**(0.7)**	**16.3**	**1.4**	**49.0**	**(0.4)**	**48.6**
Transfer of engagements	6.1	-	-	-	**6.1**	-	**6.1**
Balance at 31 December 2010	**819.6**	**(6.9)**	**0.3**	**5.0**	**818.0**	**3.1**	**821.1**

	General reserve £m	Available-for-sale financial assets £m	Cash flow hedges £m	Translation of foreign operations £m	Sub Total £m	Non-controlling interests £m	Total £m
Balance at 1 January 2009	737.0	(13.2)	(21.2)	1.0	703.6	3.9	707.5
Profit for the financial year	57.4	-	-	-	57.4	0.2	57.6
Other comprehensive income							
Actuarial loss on retirement benefit obligations	(12.9)	-	-	-	(12.9)	-	(12.9)
Net gains from changes in fair value	-	5.6	5.2	-	10.8	-	10.8
Exchange differences on translation of foreign operations	-	-	-	2.6	2.6	-	2.6
Movement in reserves attributable to non-controlling interests	-	-	-	-	-	(1.1)	(1.1)
Non-controlling interests share restructure	-	-	-	-	-	0.5	0.5
Transfer of engagements	-	1.4	-	-	1.4	-	1.4
Total other comprehensive income (note 31)	(12.9)	7.0	5.2	2.6	1.9	(0.6)	1.3
Total comprehensive income for the year	44.5	7.0	5.2	2.6	59.3	(0.4)	58.9
Balance at 31 December 2009	781.5	(6.2)	(16.0)	3.6	762.9	3.5	766.4

For the year ended 31 December 2010

Society

	General reserve £m	Available-for-sale financial assets £m	Cash flow hedges £m	Total £m
Balance at 1 January 2010	**685.4**	**(7.0)**	**(16.4)**	**662.0**
Profit for the financial year	25.8	-	-	**25.8**
Other comprehensive income				
Actuarial gain on retirement benefit obligations	2.9	-	-	**2.9**
Net gains from changes in fair value	-	1.0	16.7	**17.7**
Total other comprehensive income (note 31)	**2.9**	**1.0**	**16.7**	**20.6**
Total comprehensive income for the year	**28.7**	**1.0**	**16.7**	**46.4**
Transfer of engagements	6.1	-	-	**6.1**
Balance at 31 December 2010	**720.2**	**(6.0)**	**0.3**	**714.5**
Balance at 1 January 2009	648.3	(13.2)	(21.2)	613.9
Profit for the financial year	43.7	-	-	43.7
Other comprehensive income				
Actuarial loss on retirement benefit obligations	(6.6)	-	-	(6.6)
Net gains from changes in fair value	-	6.2	4.8	11.0
Total other comprehensive income (note 31)	(6.6)	6.2	4.8	4.4
Total comprehensive income for the year	37.1	6.2	4.8	48.1
Balance at 31 December 2009	685.4	(7.0)	(16.4)	662.0

The notes on pages 51 to 116 form part of these Accounts.

For the year ended 31 December 2010	Notes	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Cash flows from operating activities					
Profit before taxation from continuing operations		**35.0**	18.0	**16.2**	41.2
Profit before taxation from discontinued operations		**-**	45.5	**-**	-
Adjustments for:					
Impairment losses on loans and advances	16	**14.8**	43.6	**12.6**	10.4
Impairment losses / (recoveries) on debt securities	13	**0.1**	(1.3)	**-**	(1.3)
Loans and advances written off, net of recoveries		**(21.1)**	(29.9)	**(3.5)**	(2.7)
Provisions against investment in subsidiary undertakings	17a)	**-**	-	**36.9**	2.8
Provisions against loans to subsidiary undertakings	17a)	**-**	-	**0.8**	2.5
Goodwill impairment	18	**7.5**	12.0	**-**	-
Depreciation and amortisation	18,19,20	**19.9**	23.2	**4.8**	4.4
Impairment of investment property	20	**1.4**	-	**1.4**	-
Dividends received		**-**	-	**(70.3)**	(52.7)
Interest on capital and subordinated liabilities		**25.1**	23.3	**25.1**	23.3
(Profit) / loss on sale of property, plant and equipment and investment property	6	**(6.7)**	0.2	**(7.1)**	0.1
Negative goodwill arising on merger	38	**(3.1)**	-	**(3.1)**	-
Share of profits from joint ventures and associates	17c)	**(0.3)**	(0.2)	**-**	-
Profit on disposal of subsidiary undertakings	17b)	**(1.2)**	(39.7)	**(1.9)**	-
Dividends received from joint venture		**0.5**	-	**-**	-
Other non-cash movements		**71.3**	54.2	**77.8**	130.0
		143.2	148.9	**89.7**	158.0
Changes in operating assets and liabilities:					
Movement in prepayments and accrued income		**2.3**	7.9	**(1.2)**	28.1
Movement in accruals and deferred income		**(10.6)**	(197.8)	**(8.6)**	(197.6)
Movement in provisions for liabilities		**11.8**	(8.3)	**(3.8)**	(7.9)
Movement in loans and advances to customers		**1,192.8**	811.6	**1,124.5**	598.5
Movement in shares		**(1,268.4)**	713.9	**(1,268.4)**	713.9
Net movement in amounts owed to credit institutions and other customers		**(225.3)**	(1,152.8)	**(213.0)**	(1,242.4)
Net movement in debt securities in issue		**(502.5)**	47.7	**(502.5)**	35.3
Net movement in loans and advances to credit institutions		**157.5**	851.7	**155.6**	851.2
Net movement in other assets		**17.6**	3.2	**5.2**	1.1
Net movement in other liabilities		**(28.2)**	16.1	**0.6**	(1.2)
Income taxes (paid) / received		**(4.9)**	(0.3)	**10.6**	2.2
Net cash flows from operating activities		**(514.7)**	1,241.8	**(611.3)**	939.2

For the year ended 31 December 2010	Notes	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Net cash flows from operating activities		**(514.7)**	1,241.8	**(611.3)**	939.2
Cash flows from investing activities					
Purchase of debt securities	13	**(3,623.8)**	(6,036.0)	**(3,623.8)**	(6,036.0)
Proceeds from disposal of debt securities	13	**3,555.4**	5,771.8	**3,520.0**	5,747.0
Purchase of intangible assets	18	**(8.9)**	(11.7)	**(1.0)**	(1.1)
Purchase of property, plant and equipment and investment property	19,20	**(11.2)**	(23.9)	**(21.2)**	(17.7)
Proceeds from disposal of property, plant and equipment and investment property		**9.8**	0.9	**9.6**	0.1
Dividends received		**-**	-	**70.3**	52.7
Dividends paid to non-controlling interests	26	**(3.3)**	(3.8)	**-**	-
Cash acquired on transfer of engagements	38	**0.1**	17.9	**0.1**	-
Further investment in subsidiary undertakings	17a)	**(20.9)**	(6.9)	**(31.2)**	(1.5)
Cash received from sale of subsidiary undertakings	17b)	**1.6**	97.8	**1.2**	3.2
Debt repaid on sale of subsidiary undertakings		**-**	(19.7)	**-**	-
Net cash flows from investing activities		**(101.2)**	(213.6)	**(76.0)**	(253.3)
Cash flows from financing activities					
Decrease in loans to subsidiary undertakings	17a)	**-**	-	**105.4**	246.6
Interest paid on subordinated liabilities		**(16.9)**	(16.2)	**(16.9)**	(16.2)
Interest paid on Permanent Interest Bearing Shares		**(8.2)**	(7.1)	**(8.2)**	(7.1)
Net cash flows from financing activities		**(25.1)**	(23.3)	**80.3**	223.3
Net (decrease) / increase in cash and cash equivalents		**(641.0)**	1,004.9	**(607.0)**	909.2
Cash and cash equivalents at 1 January		**1,396.3**	391.4	**1,260.3**	351.1
Cash and cash equivalents at 31 December		**755.3**	1,396.3	**653.3**	1,260.3

Analysis of the cash balances as shown in the Statement of Financial Position:

	Notes	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Cash in hand and balances with the Bank of England		**664.6**	1,272.1	**664.5**	1,272.0
Mandatory reserve deposit with the Bank of England		**(11.2)**	(11.7)	**(11.2)**	(11.7)
		653.4	1,260.4	**653.3**	1,260.3
Loans and advances to credit institutions repayable on demand	12	**101.9**	135.9	**-**	-
Cash and cash equivalents as at 31 December		**755.3**	1,396.3	**653.3**	1,260.3

The notes on pages 51 to 116 form part of these Accounts.

1. Accounting policies

The principal accounting policies applied consistently in the preparation of these consolidated Annual Accounts are set out below.

a) Basis of preparation

The Annual Accounts of the Group and the Society are prepared on a going concern basis (see page 32 of the Directors' Report) and in accordance with International Financial Reporting Standards ('IFRS') and its interpretations as adopted by the EU and effective at 31 December 2010; and with those parts of the Building Societies (Accounts and Related Provisions) Regulations, 1998, and the Building Societies Act 1986 applicable to societies reporting under IFRS.

The Annual Accounts have been prepared under the historical cost convention as modified by the revaluation of available-for-sale assets, derivatives and other financial assets at fair value through the Income Statement.

The Annual Accounts are presented in pounds Sterling and, except where otherwise indicated, have been rounded to the nearest one hundred thousand pounds.

The Directors have adopted IAS 27, *Consolidated and Separate Financial Statements (2008)*; IFRS 3, *Business Combinations (2008 Revised)* and Eligible Hedged Items (Amendment to IAS 39*, Financial Instruments: Recognition and Measurement)*.

Note 36 to the Accounts sets out details of forthcoming standards and interpretations, which are likely to affect the Group, and summarises their impact as at 31 December 2010, and also details the impact of newly adopted standards.

b) Basis of consolidation

Subsidiary undertakings

Subsidiary undertakings are entities controlled by the Society. Control exists when the Society has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of the subsidiary undertakings are included in the results from the date that control commences until the date that control ceases. The Group Accounts consolidate the financial statements of the Society and all its subsidiary undertakings, eliminating intra-group balances.

The results of subsidiary undertakings acquired or disposed of during the year are included in the consolidated Income Statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the accounts of subsidiary undertakings to bring the accounting policies in line with those used by the Group. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

As part of the Group's acquisition strategy, within a number of subsidiary undertakings which have less than 100% ownership, there is an option for non-controlling shareholders to sell their shares to the Group at some point in the future. In accordance with IAS 32, *Financial Instruments: Disclosure and Presentation*, the Group recognises the present value of the non-controlling options as a financial obligation, along with recognition of further goodwill on the purchase of remaining non-controlling interests. Under this accounting policy the Group consolidates 100% of the results of affected subsidiary undertakings to reflect the 100% ownership implicit in the recording of the future purchase of the non-controlling remaining shareholdings (that is, put option liability).

In accordance with IAS 27 (amended), all transactions with non-controlling interests are recorded in equity if there has been no change in control and in accordance with IFRS 3, *Business Combinations*, goodwill is accounted for only upon the acquisition of a subsidiary undertaking as subsequent changes in interest are recognised in equity. Any changes in the valuation of an acquired entity where a put option exists is credited or charged through the Income Statement. Previously, any change in valuation would have been recognised in goodwill. All transaction or acquisition costs are written off to the Income Statement as incurred. This applies to business combinations which take place from 1 January 2010 onwards.

Non-controlling interests in the net assets of non-100% consolidated subsidiary undertakings are identified separately from the Group's equity therein. Non-controlling interests comprise the amount of those interests at the date of the original business combination and the non-controlling changes in equity since that date. Losses applicable to the non-controlling interests in excess of the non-controlling interests in the subsidiary undertaking's equity are allocated against the interests of the Group except to the extent the non-controlling entity has a binding obligation and is able to make an additional investment to cover the losses.

1. Accounting policies (continued)

Joint ventures and associates

A joint venture is an undertaking in which the Group has joint control, established by contractual agreement.

An associate is a company over which the Group has significant influence and that is neither a subsidiary undertaking nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is neither control nor joint control over those policies.

The results and assets and liabilities of joint ventures and associates are accounted for in these consolidated financial statements using the equity method of accounting. Investments in joint ventures and associates are carried in the Statement of Financial Position at cost, as adjusted by post-acquisition changes in the Group's share of the net assets of the joint venture or associate, less any impairment in the value of individual investments.

c) Intangible assets

Goodwill

Goodwill arising on the acquisition of subsidiary undertakings, joint ventures, associates or businesses represents the excess of the fair value of consideration over the fair value of identifiable net assets and contingent liabilities acquired at the date of acquisition. In accordance with IFRS 3, *Business Combinations*, goodwill is not systematically amortised but is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill which is recognised as an asset is reviewed for impairment at least annually. Any impairment is recognised in the Income Statement and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash generating units expected to benefit from the synergies of combination. The impairment test compares the carrying value of goodwill to its associated value in use. The value in use calculations are carried out by discounting the future cash flows of the cash generating unit (note 18). Future cash flows are based upon approved profit budgets for the next three years (adjusted for non-cash items) and assumed growth thereafter for the next 12 years in line with long-term growth rates. The Group estimates the discount rate based upon the weighted average cost of capital which takes into account the risks inherent in each cash generating unit. A 15-year time horizon has been used to reflect that cash generating units are held for the long-term.

On the sale of a subsidiary undertaking, the profit or loss on sale is calculated after crediting the net book value of any related goodwill.

Goodwill arising on acquisitions before the transition to IFRS on 1 January 2005 has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to that date has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

Negative goodwill arising on an acquisition is recognised directly in the Income Statement.

Computer software, databases and customer contracts

In accordance with IAS 38, *Intangible Assets*, computer software development costs, databases and customer contracts (including internally generated costs) are recognised as an intangible asset only if all of the following tests are met:

- An asset is created that can be identified (such as software and new processes);
- It is probable that the asset created will generate future economic benefits; and
- The development cost of the asset can be measured reliably.

Expenditure incurred to maintain existing levels of performance is recognised as an expense.

Computer software licences, databases and customer contracts recognised as intangible assets are initially recognised at cost and subsequently amortised from the date they are available for use using the straight line method over their estimated useful economic lives, which range from three to ten years.

Intangible assets are tested for impairment at each reporting date or when there is an indication of impairment. The Group identifies impairment by comparing the future economic benefit against the carrying value of the asset.

d) Financial assets

In accordance with IAS 39, *Financial Instruments: Recognition and Measurement*, the financial assets of the Group have been classified into the following four categories:

1. Accounting policies (continued)

At fair value through profit or loss

The Group uses derivative financial instruments to hedge its exposure to market risks (e.g. interest rate risk) arising from operational, financing and investment activities. In accordance with its treasury policy and the Building Societies Act 1986, the Group does not hold or issue derivative financial instruments for trading purposes.

Derivative financial instruments (both assets and liabilities) are held at fair value in the Statement of Financial Position with changes in their fair value going through the Income Statement. However, by applying the hedge accounting rules set out in IAS 39, the changes in fair value of derivatives used to hedge particular risks can either be offset in the Income Statement or deferred to equity.

There are two types of hedge accounting strategies that the Group undertakes and these are summarised below:

- Fair value hedges - Where a derivative financial instrument hedges the changes in fair value of a recognised asset or liability or an unrecognised firm commitment, any gain or loss on the hedging instrument is recognised in the Income Statement. To the extent that there is an effective hedge relationship, the associated hedged items (for example, mortgage assets) are stated at fair value in respect of the hedged risk, with any gain or loss also recognised in the Income Statement. As a result the hedging instrument and hedged items offset each other and reduce profit volatility. Any residual fair value hedge ineffectiveness is recognised in the Income Statement.
- 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. 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

The Group discontinues hedge accounting when:

- it is evident from testing that a derivative is not, or has ceased to be, highly effective as a hedge;
- the derivative expires, or is sold, terminated or exercised; or
- the underlying item matures or is sold or repaid.

The Group may also decide to cease hedge accounting even though the hedge relationship continues to be highly effective by ceasing to designate the financial instrument as a hedge.

If the derivative no longer meets the criteria for hedge accounting, the cumulative fair value hedging adjustment is immediately reflected in the Income Statement.

Derivatives that do not qualify for hedge accounting are held at fair value with changes in fair value recognised in the Income Statement with no offset within the Income Statement or deferral to equity.

Certain derivatives are embedded within other non-derivative host financial instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risk of the host instrument and where the hybrid instrument is not measured at fair value, the embedded derivative is separated from the host instrument with changes in fair value of the embedded derivative recognised in the Income Statement. Depending on the classification of the host instrument, the host is then measured in accordance with the relevant accounting policy.

Fair values are obtained from quoted market prices in active markets, recent market transactions, and valuation techniques, including discounted cash flow models and option pricing models, as appropriate. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. Income and expense on derivative financial instruments are recognised as interest in the Income Statement. Gains and losses on all derivatives, hedged items, and on the sale of available-for-sale assets are recognised in the Income Statement, 'Fair value gains and losses on financial instruments' caption.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group's loans and advances to customers together with certain investment securities are classified as loans and receivables, which are measured at amortised cost using the effective interest method. The effective interest method implies an interest rate which exactly discounts the forecast cash flows of an asset over its expected life back to its carrying value.

1. Accounting policies (continued)

In accordance with the effective interest method, upfront costs and fees such as cashbacks, mortgage premia paid on acquisition of mortgage books, mortgage indemnity guarantee insurance paid by customers, procuration fees and completion fees are deferred and recognised over the expected life of mortgage assets. Mortgage discounts are also recognised over the expected life of mortgage assets. Historical and forecast mortgage redemption data and management judgement are used to estimate the expected lives of mortgage assets.

Included in Loans and advances to customers of the Society are balances which have been transferred from the Society to Skipton Covered Bonds LLP, a Limited Liability Partnership which is consolidated into the Group Accounts. The loans secure covered bonds issued by the Society. The loans are retained on the Society's Statement of Financial Position as the Society retains substantially all the risks and rewards relating to the loans.

Available-for-sale

Available-for sale assets are non-derivative financial assets that are not classified into either of the two categories above. Available-for-sale assets are initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in their fair value recognised in equity, except for impairment losses which are recognised in the Income Statement. Interest income is recognised in the Income Statement on an effective yield basis.

The premia and discounts arising on the purchase of these assets are amortised over the period to the maturity date of the security on an effective yield basis. Any amounts amortised are charged or credited to the Income Statement in the relevant financial years.

The fair values of available-for-sale assets are based on quoted prices or, if these are not available, fair value valuation techniques developed by the Group. For quoted prices the bid price is used for assets and the ask price is used for liabilities. Fair value valuation techniques include, but are not limited to, the use of discounted cash flow models, option pricing models and recent arm's-length transactions.

Held to maturity

The Group has not classified any assets as held to maturity. Purchases and sales of financial assets are accounted for at trade date.

e) Financial liabilities

All financial liabilities including shares, deposits, debt securities in issue and subordinated liabilities held by the Group are recognised initially at fair value, being the issue proceeds, net of premia, discounts and transaction costs incurred. Financial liabilities are subsequently measured at amortised cost using the effective interest method, except for those financial liabilities, for example, derivative liabilities, which are measured at fair value through profit and loss.

Permanent Interest Bearing Shares with no fixed maturity are classified as financial liabilities and are carried at amortised cost.

f) Impairment of financial assets

Impairment of loans and advances secured on residential property or land

Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession or where fraud or negligence has been identified. Objective evidence of impairment may include indications that the borrower or group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments or the debt being renegotiated to reduce the burden on the borrower. Based upon these assessments an individual impairment reduction of these assets is made.

In addition, a collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be realised. The impairment value is calculated by applying various economic factors to our mortgage portfolio exposures. These factors take into account the Group's experience of default rates, the level of capitalisation of arrears, loss emergence periods, the effect of regional movements in house prices based on a recognised index and adjustments to allow for ultimate forced sales values and realisation costs.

Impairment provisions are recognised in the Income Statement and reflected as a deduction against the carrying value of the asset on the balance sheet. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment losses to decrease, the decrease in impairment loss is recognised through the Income Statement.

Where a loan is not recoverable, it is written off against the related provision for loan impairment once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the Income Statement.

1. Accounting policies (continued)

Renegotiated loans

Loans are classed as renegotiated when their terms have changed during the year. Those loans that would have been past due or impaired if their terms had not been renegotiated are as follows:

Loans and advances secured on residential property

The Group applies a policy of capitalising arrears, with the customer's consent, once the customer has made at least six consecutive contractual monthly mortgage repayments following the instance of non-payment. The effect is to bring the loan account up to date and it is therefore no longer past due nor individually impaired (if indeed the individual impairment trigger was the fact that the account was in arrears). If a customer's arrears have previously been capitalised, the customer is required to have made at least 12 consecutive contractual monthly repayments in order to qualify for further capitalisation.

Loans and advances secured on land

The Society applies a similar policy for its commercial loan book as for its residential book, whereby customer arrears can be capitalised following six consecutive contractual monthly repayments following the instance of non-payment, or 12 such repayments if the account has previously had arrears capitalised.

Impairment of other loans and advances

Individual impairment provisions are made to reduce the value of other impaired loans and advances to the amount that the Directors consider is likely ultimately to be received, based upon objective evidence.

Impairment of other financial assets

At each reporting date the Group assesses, on an individual security basis, whether there is objective evidence that financial assets (not at fair value through profit or loss) held by the Group are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that financial assets are impaired may include default or delinquency by a counterparty, the disappearance of an active market for a security, indications that a counterparty will enter bankruptcy or a significant and prolonged decline in the fair value of a security or evidence of a sovereign debt crisis.

Impairment losses on financial assets carried at amortised cost are measured as the difference between the carrying value of the asset and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in the Income Statement and reflected as a deduction against the carrying value of the asset. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment losses to decrease, the decrease in impairment loss is recognised through the Income Statement.

Impairment losses on available-for-sale assets are recognised by transferring the cumulative loss that has been recognised directly in equity to the Income Statement. The cumulative loss that is removed from equity and recognised in the Income Statement is measured as the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss on that asset previously recognised in the Income Statement.

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

g) Derecognition of financial assets and liabilities

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

h) Foreign currency transactions

All non-Sterling assets and liabilities are translated at the closing rate of exchange. All exchange differences are taken to the Income Statement as they arise.

Foreign exchange transactions are translated into Sterling using the exchange rates prevailing at the dates of the transactions.

The Income Statements of subsidiary undertakings with non-Sterling functional currencies are translated into Sterling at the monthly average rates for the period, and assets and liabilities are translated at the closing rate of exchange at the reporting date. Any exchange differences arising on the translation of net assets of overseas subsidiary undertakings are taken to reserves as a separate component of equity and disclosed in the Statement of Comprehensive Income.

1. Accounting policies (continued)

i) Taxation

The income tax expense on the profits for the year comprises current tax and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is 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 reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the Statement of Financial Position liability method, which recognises temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor income and expenditure, and differences relating to investments in subsidiary undertakings to the extent that it is probable they will not reverse in the foreseeable future. Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which temporary differences reverse, based on tax rates and laws enacted or substantively enacted at the reporting date.

A deferred tax asset is only recognised to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at least annually and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

j) Leases

Where the Group enters into a lease, which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. The asset is recorded in the Statement of Financial Position as an item of property, plant and equipment and is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease less accumulated depreciation and impairment losses. Future instalments under such leases, net of finance charges, are included within payables. Rentals payable are apportioned between the finance element, which is charged to the Income Statement at a constant annual rate, and the amount which reduces the outstanding obligation for future instalments.

All other leases are accounted for as operating leases and the rental charges are charged to the Income Statement on a straight-line basis.

Assets held by the Group on which operating leases are granted are included as items of property, plant and equipment. Rents receivable under operating leases are recognised in the Income Statement on a straight line basis over the term of the lease.

Where leasehold premises cease to be occupied by the Society or its subsidiary undertakings and current market conditions are expected to preclude sub-letting for a rental sufficient to cover the rental costs, a provision is made to cover the expected deficit.

When the Group enters into a sale and leaseback arrangement, the leaseback is accounted for as a finance lease or an operating lease, according to its terms. If it is a finance lease, and the sale and leaseback gives rise to a profit, the profit is not recognised immediately but is deferred and amortised over the term of the lease. No loss is recognised unless the asset is impaired. If it is an operating lease, any profit or loss is accounted for in the period of disposal in other income and the operating lease rentals are charged to administration expenses in the year in which the expenditure is incurred.

k) Employee benefits

Defined contribution pension arrangements

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

Defined benefit schemes

The Group operates five funded defined benefit pension schemes administered by trustees, the funds of which are separate from those of the Group.

Included in the Statement of Financial Position are the Group's net obligations in respect of the defined benefit pension schemes. The obligation of each scheme is calculated separately by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods.

1. Accounting policies (continued)

That benefit is discounted to determine its present value, and the fair value of any scheme assets is deducted. The discount rate is based on the average yield available from long-dated AA-rated corporate bonds. The calculation is performed by a qualified actuary using the projected unit credit method.

Past and current service costs are recognised immediately in the Income Statement. Actuarial gains and losses arise from the differences between previous actuarial assumptions and what has actually occurred. These gains and losses are recognised in the Statement of Comprehensive Income.

Contributions are transferred to the trustees on a regular basis to secure the benefits provided under the rules of the scheme. Pension contributions are assessed in accordance with the advice of a professionally-qualified actuary.

l) Fees and commissions

Other than those included in the 'effective interest method', fees and commissions receivable are generally recognised, net of VAT (where applicable), when all contractual obligations have been fulfilled. Commissions earned on the sales of properties are recognised as earned on the date contracts are exchanged if thereafter the contract is, or is expected to be, completed.

Commission receivable from the sale of third party Regulated Financial Services products is recognised upon fulfilment of contractual obligations, that is when policies go on risk or on completion of a mortgage, with a provision for future clawbacks for repayment in the event of early termination by the customer.

Commission income received monthly over the life of a policy is recognised on a cash received basis as this approximates to recognition of income over the period of the service.

Fees and commissions payable are generally recognised on an accruals basis as services are provided.

m) Government grants

Grants relating to expenditure on property, plant and equipment are treated as deferred income and are credited to the Income Statement over the useful economic lives of qualifying assets. Grants relating to revenue expenditure are matched with the expenditure to which they relate.

n) Property, plant and equipment

Property, plant and equipment are measured at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of those items.

Depreciation is calculated to write down the cost of items of property, plant and equipment less estimated residual values over their estimated useful lives as set out below on a straight-line basis unless stated otherwise.

Freehold and long-leasehold buildings	50 to 100 years
Special purpose head office facility	40 years
Refurbishment of freehold and long-leasehold buildings	5 to 10 years
Short-leasehold buildings	Period of lease
Equipment, fixtures and fittings	2 to 10 years
Motor vehicles	25% of net book value

Land is not depreciated. Major items of property, plant and equipment purchased are depreciated on a monthly basis from the date the asset is available for utilisation. In accordance with IAS 36, *Impairment of Assets*, all items of property, plant and equipment are regularly reviewed for indications of impairment. Any impairment identified is charged to the Income Statement.

o) Segmental reporting

The Group adopted IFRS 8, *Operating Segments*, on 1 January 2009. IFRS 8 requires operating segments to be identified on the basis of internal reports and components of the Group regularly reviewed by the chief operating decision maker to allocate resources to segments and to assess their performance. For this purpose, the chief operating decision maker of the Group is the Board of Directors.

Each segment is determined according to distinguishable operating components of the Group that are regularly reviewed by the Group's chief operating decision maker and for which discrete financial information is available. We have not aggregated any of our operating segments for the purpose of financial reporting.

Information regarding the results of each reportable segment is included in note 34.

1. Accounting policies (continued)

p) Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash comprises cash in hand and loans and advances to credit institutions repayable on demand less the mandatory reserve deposit with the Bank of England. Cash equivalents comprise highly-liquid investments that are readily convertible into cash with an insignificant risk of changes in value with original maturities of less than three months.

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

q) Investment properties

Properties held by the Group to earn rentals or for capital appreciation are recognised as investment properties at cost less depreciation. The market value of investment properties is disclosed within the Notes to the Accounts, and a valuation is carried out internally on an annual basis.

The depreciation policy for investment properties is consistent with the policy for property, plant and equipment. In accordance with IAS 36, *Impairment of Assets*, investment properties are regularly reviewed for indications of impairment. Any impairment identified would be charged to the Income Statement.

r) Financial guarantee contracts

Where the Society has entered into financial guarantee contracts with a Group company, the Society has previously asserted explicitly that these were insurance contracts. Therefore, under IAS 39, the Society has elected to apply IFRS 4, *Insurance Contracts*, to such financial guarantee contracts and as a result does not fair value such contracts. Under this election the Group assesses at each reporting date whether a financial liability needs to be recognised in relation to the financial guarantee contracts.

s) Sale and repurchase agreements

Investment and other securities may be lent or sold subject to a commitment to repurchase them (a 'repo'). Such securities are retained in the Statement of Financial Position when substantially all the risks and rewards of ownership remain within the Group, and the counterparty liability is included separately in the Statement of Financial Position as appropriate.

The difference between sale and repurchase price is accrued over the life of the agreements.

t) Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year.

The Group also has to make judgements in applying its accounting policies which affect the amounts recognised in the financial statements.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The key estimates, assumptions and judgements are set out below:

Effective interest rate

The valuation of assets or liabilities measured at amortised cost is calculated using the effective interest method. The effective interest method imputes an interest rate which discounts the future forecast cash flows of an asset over its expected life back to its carrying value. The most critical factor in calculating the amortised cost of assets and liabilities held by the Group is the expected lives of these assets and liabilities which are determined on the basis of historical data and management judgement.

The impact of a one month increase in the anticipated life of mortgage assets would result in a £2.7m (2009: £2.1m) increase in the Group's interest income and a £1.7m (2009: £1.1m) increase in the Society's interest income.

During the year a credit of £6.5m for the Group and £0.7m for the Society was recognised through interest income, following a reassessment of the expected lives of mortgage assets.

Impairment of mortgage loans and advances

The Group regularly reviews its residential loan portfolios to assess the level of impairment. In determining whether an impairment loss should be recorded in the Income Statement, management makes judgements as to whether there is any objective data indicating that there is a measurable impairment loss. Specifically, management regularly assesses key assumptions such as the probability of an account going into possession, the time period over which an account will exhibit objective evidence of impairment loss (the 'emergence period') and the eventual loss incurred in the event of forced sale or write off.

1. Accounting policies (continued)

A critical estimate in calculating the eventual loss incurred in the event of sale is the future level of house prices. Based upon the loss provisioning model used by the Group, a 10% fall in house prices would increase the year end residential impairment provision by £8.1m. Other sensitivities include the emergence period, where an increase of three months would increase the loan impairment provision by £4.1m, and the loss given default rate, where a 10% increase equates to a £6.1m increase in the loan impairment provision.

In respect of commercial loan exposures these are individually reviewed on a monthly basis and expert knowledge is applied by suitably qualified commercial underwriters to objectively assess whether an impairment provisions is required.

Impairment of treasury investments

Treasury investments are regularly reviewed for objective evidence of impairment. In determining whether objective evidence exists, the Group considers, amongst other factors, current market conditions (including the disappearance of an active market), fair value volatility (including any significant reduction in market value), any breach of contract or covenants, the financial stability or any financial difficulties of the counterparty and the country it is resident in (i.e. sovereign debt issues).

Put option obligation

Where the Group acquires a majority shareholding in a subsidiary undertaking, but grants the non-controlling shareholders an option to sell their shares to the Group at some future date, on acquisition the Group estimates the fair value of the total consideration payable in calculating the goodwill arising.

The fair value of both the put option obligation and the associated goodwill recognised are dependent on the following assumptions: an estimate of when the put option will be exercised by the non-controlling shareholders, the market value growth of the obligation and the discount rate used at the reporting date. These assumptions are reviewed on a regular basis by senior management.

Extending the estimated exercise date of all existing put options by one year would result in the reduction of the aggregate put option obligation by £1.8m (2009: £0.5m). A 10% increase in the aggregate market value of these businesses would increase the put option liability by £1.5m (2009: £1.2m).

Goodwill

The carrying value of goodwill is determined from value in use calculations. The key assumptions for the value in use calculations are those regarding cashflows, discount rates and growth rates. These assumptions are reviewed on a regular basis by senior management.

The future cashflows of the cash generating units are based on the latest detailed three year forecasts available and are sensitive to assumptions regarding the long-term growth pattern thereafter. The cashflows reflect management's view of future business prospects at the time of the assessment.

The discount rate used to discount the future expected cashflows is based on the cost of capital assigned to each cost generating unit (see note 18) and can have a significant effect on the valuation of a cost generating unit. The cost of capital is derived from a weighted average cost of capital calculation which incorporates a number of inputs including the risk-free interest rate and a premium to reflect the inherent risk of the business being evaluated. These variables are subject to fluctuations in external markets and economic conditions which are out of management's control and therefore are established on the basis of management judgement.

At 31 December 2010, to the extent that discount rates were to increase by 10%, the impairment charge would increase by £1.0m. In addition, a reduction in the long-term growth rate assumption from 2.5% to 0% would increase the impairment charge by £2.1m.

Fair value of derivatives and financial assets

Fair values are determined by the three tier valuation hierarchy as defined within IAS 39 and Amendments to IFRS 7, *Financial Instruments: Disclosures* as described in note 33.

The most reliable fair values of derivatives and financial assets are quoted market prices in an actively traded market. Where there are no active markets, valuation techniques are used. Valuation techniques include net present value and discounted cashflow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and other valuation models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, foreign currency exchange rates, equity index prices and expected price volatilities.

1. Accounting policies (continued)

Taxation

Judgement is required in determining the provision for corporation tax. There are a number of transactions for which the final tax determination is uncertain at the reporting date. In these instances a prudent approach is taken.

Retirement benefit obligations

In conjunction with its actuaries, the Group makes key financial assumptions which are used in the actuarial valuation of the defined pension benefit obligation and, therefore, changes to these assumptions have an impact on the defined pension obligation, service cost and expected return on plan assets. These assumptions include the inflation and discount rates, the expected return on plan assets and the rate of increase of pensions in payment; see note 35 for further details on these assumptions.

One key assumption is the discount rate used to discount future plan liabilities where currently a 0.25% increase in the discount rate would reduce the pension obligation by £10.5m (2009: £10.5m) and vice versa. Another key assumption surrounds mortality rates where a one-year increase in expected lives would increase the pension obligation by £4.0m (2009: £4.0m) and vice versa.

Financial Services Compensation Scheme

The ultimate liability for levies payable to the Financial Services Compensation Scheme ('FSCS') to safeguard protected deposits from the deposit takers which failed still remains uncertain. The FSCS continues to have significant borrowings of some £20bn in the form of loans from HM Treasury to cover the compensation costs paid and payable in respect of the major bank defaults.

Following FSA guidance, the Society provides for an estimate of the management expense levy payable for those scheme years triggered by the reporting date.

The amount provided by the Group is based upon the following factors:

- the FSCS' estimate of the total management expense levy;
- the Directors' estimate of the Group's share of qualifying deposits;
- the Directors' estimate of future interest rates.

It is currently uncertain whether a capital shortfall will arise in the scheme, therefore no provision has been recognised for this.

The impact of a 1% increase in the estimate of the 12-month LIBOR rate would increase the provision by £0.2m (2009: £1.8m) and vice versa.

A specific FSCS levy relative to the Financial Advice division occurred in 2010 due to the demise of Keydata, and the subsequent nil value rating of Investments placed in the Lifemark counterparty. This had the effect of exhausting the FSCS limit within the Investment Intermediation class. Whilst none of the companies within the Skipton Group had advised on any such plans, the specific levy placed on us totalled £0.7m.

Fair value business combination calculations

The transfer of engagements of the Chesham Building Society has been accounted for in accordance with IFRS 3 (2008 Revised): *Business Combinations*. All assets and liabilities acquired including intangible assets which may not have been recognised by the acquiree, have been measured at fair value at the acquisition date.

The most significant fair value adjustment relates to the write down of the credit and interest rate risk on the acquired mortgage book.

The credit risk adjustments are based on a number of assumptions with the most significant being the expectation of future house price movements, probabilities of default and the discount required in the event of a forced sale. To the extent that the expectation of future house price movements on the merger date differed from that estimated by 10%, the credit risk adjustment would have changed by an estimated £0.1m and vice versa. To the extent that the estimated probability of default was 10% higher, the credit risk adjustment would have increased by an estimated £0.1m and vice versa. To the extent that the discount required in the event of a forced sale increased from the original estimate by 10%, the credit risk adjustment would have increased by an estimated £0.1m and vice versa.

The interest rate adjustment is dependent upon the discount rate used, which represents the rates available in the market on similar product types at the time of the transaction. This rate is adjusted to remove the credit spread inherent in the interest rate, as credit losses have already been accounted for through the credit risk adjustment.

Similar adjustments apply to the fair value adjustment made in respect of interest rate risk on the acquired savings book. The valuation is similarly dependent upon the discount rate used, which is based on the rate available in the market on similar product types at the time of the transaction.

2. Interest receivable and similar income

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
On loans fully secured on residential property	**421.4**	460.1	**321.2**	341.5
On other loans:				
To subsidiary undertakings	**-**	-	**82.6**	66.6
Other	**19.4**	22.6	**17.1**	20.3
On debt securities	**35.8**	41.1	**35.1**	39.8
On other liquid assets	**9.0**	10.3	**8.8**	11.9
Net expense on derivative financial instruments	**(122.0)**	(112.3)	**(91.6)**	(71.4)
	363.6	421.8	**373.2**	408.7

Included within Group and Society interest receivable and similar income on debt securities is income from fixed income securities of £22.4m (2009: £9.2m).

Included within interest receivable and similar income is interest accrued on impaired financial assets: Group £11.8m (2009: £13.3m), Society £5.0m (2009: £2.5m).

3. Interest payable and similar charges

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
On shares held by individuals	**257.2**	281.8	**257.2**	281.8
On subscribed capital	**8.2**	7.1	**8.2**	7.1
On deposits and other borrowings:				
Subordinated liabilities	**16.9**	16.2	**16.9**	16.2
Subsidiary undertakings	**-**	-	**52.0**	51.5
Wholesale and other funding	**47.9**	80.9	**31.0**	64.4
Net income on derivative financial instruments	**(22.2)**	(17.7)	**(24.2)**	(43.8)
Other	**0.7**	0.2	**-**	-
	308.7	368.5	**341.1**	377.2

4. Fees and commissions receivable

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Mortgage related fees	**104.6**	113.3	**3.6**	2.7
General insurance fees	**24.3**	17.3	**4.2**	5.0
Commissions earned on property sales	**128.8**	128.5	**-**	-
Other fees and commissions	**124.0**	129.9	**6.0**	4.0
	381.7	389.0	**13.8**	11.7

5. Fees and commissions payable

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Mortgage related fees	**13.1**	13.4	**0.2**	0.1
Other fees and commissions	**7.7**	6.0	**2.5**	2.2
	20.8	19.4	**2.7**	2.3

6. Other income

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Investment property income	**0.5**	0.5	**2.3**	1.5
Expected return on pension scheme assets (note 35)	**10.7**	8.8	**5.4**	4.3
Interest on pension scheme liabilities (note 35)	**(11.1)**	(10.2)	**(5.4)**	(5.2)
Government grants	**0.6**	0.1	**-**	-
Net profit on the sale of fixed assets	**6.7**	-	**7.1**	-
Other	**16.7**	13.8	**4.0**	3.6
	24.1	13.0	**13.4**	4.2

Included in the profit on sale of fixed assets for Group and Society is profits of £5.7m (2009: nil) in relation to the sale and leaseback of nine properties during the year.

7. Administrative expenses

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Employee costs:				
Wages and salaries	**223.1**	214.2	**32.0**	31.9
Social security costs	**19.9**	19.5	**2.7**	2.8
Pension costs:				
Defined contribution arrangements (note 35)	**7.1**	6.5	**1.7**	2.0
Defined benefit schemes service costs (note 35)	**-**	0.8	**-**	0.8
Defined benefit schemes curtailments (note 35)	**-**	(10.4)	**-**	(10.4)
	250.1	230.6	**36.4**	27.1
Other administrative expenses	**145.4**	153.1	**30.5**	26.0
	395.5	383.7	**66.9**	53.1
Other administrative expenses include:				
Amortisation / write offs of intangible assets (note 18)	**9.8**	8.5	**2.2**	2.1
Depreciation of property, plant and equipment (note 19) and investment properties (note 20)	**10.1**	10.8	**2.6**	2.3
Impairment of investment properties (note 20)	**1.4**	-	**1.4**	-
Impairment of goodwill (note 18)	**7.5**	12.0	**-**	-
Auditors' and their associates' remuneration:				
Audit of the Society and Group accounts	**0.2**	0.2	**0.2**	0.2
Audit of the Group's subsidiary undertakings	**0.5**	0.6	**-**	-
Other services pursuant to legislation	**-**	-	**-**	-
Other services relating to taxation	**0.1**	0.1	**-**	-
Services relating to information technology	**0.3**	-	**0.3**	-
All other services	**0.4**	0.7	**0.1**	0.4
Amounts payable under operating leases:				
Plant and machinery	**4.7**	4.7	**3.8**	2.9
Other	**19.8**	18.4	**6.8**	5.2

8. Staff numbers

The average number of persons employed (including Executive Directors and part-time staff) during the year was as follows:

	Group 2010	Group 2009	**Society 2010**	Society 2009
Principal office and administration centres	**720**	746	**720**	746
Society branch offices	**554**	524	**554**	524
Subsidiary undertakings	**6,959**	7,288	**-**	-
	8,233	8,558	**1,274**	1,270

9. Directors' emoluments

Directors' emoluments are set out within the Directors' Remuneration Report.

Total Directors' emoluments amounted to £1.7m (2009: £1.3m) including compensation for loss of office of £0.3m (2009: £nil).

10. Related party transactions

A number of transactions are entered into with related parties in the normal course of business; these are detailed below.

Key management personnel

Key management personnel comprises the Executive Directors and Non-Executive Directors, who are responsible for ensuring that the Society and its subsidiary undertakings meet their strategic and operational objectives.

The table below summarises the benefits paid to key management personnel in the year:

	2010 £m	2009 £m
Short-term employee benefits such as wages and bonuses	**1.5**	1.2
Employer pension contributions	**0.2**	0.1
	1.7	1.3

The table below sets out the outstanding balances in relation to related party transactions with key management personnel and persons who are connected with key management personnel:

	2010 £m	2009 £m
Mortgage loans outstanding at 31 December	**0.3**	0.8

	2010 £m	2009 £m
Savings balances at 31 December	**1.1**	1.2

Interest receivable and payable on the above accounts:	**2010 £000**	2009 £000
Interest receivable	**15**	15
Interest payable	**19**	46

Loans and savings of key management personnel are at normal commercial rates. There are no provisions for impairment against these loans.

10. Related party transactions (continued)

Directors' loans and transactions

At 31 December 2010 there were outstanding mortgage loans granted in the ordinary course of business amounting in aggregate to £0.3m (2009: £0.8m) to three (2009: four) Directors and persons who are connected with Directors.

A register is maintained at the Principal Office of the Society which shows details of all loans, transactions and arrangements with Directors and connected persons. A statement for the current financial year of the appropriate details contained in the register will be available for inspection at the Principal Office for a period of 15 days up to and including the Annual General Meeting.

Contributions to pension schemes

During the year, the Group and Society paid contributions of £13.4m (2009: £12.5m) and £7.0m (2009: £6.9m) respectively to pension schemes, which are classified as related parties.

Related party transactions

During the year the Society had the following related party transactions with subsidiary undertakings:

	2010 £m	2009 £m
Rendering and receiving of services	**5.0**	3.0
Recharges of central costs	**10.0**	12.9
Interest received	**82.6**	66.6
Interest paid	**(52.0)**	(51.5)
Other income	**1.9**	1.0
Collateral transferred for covered bond programme	**600.0**	300.0

All above transactions were entered into on an arm's-length basis. For details of the relationship between the Society and its principal subsidiary undertakings see note 17.

At 31 December 2010 the Society owed subsidiary undertakings £1,317.6m (2009: £1,420.4m) and was owed £3,064.3m (2009: £3,169.3m) by subsidiary undertakings and associated companies. Interest on Group borrowings is charged at the appropriate market rate.

During the year, the Group had the following related party transactions with joint ventures and associates:

	2010 £m	2009 £m
Services provided to the Group	**-**	-
Services provided by the Group	**1.3**	1.1

11. Taxation expense / (income)

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Current tax	**3.4**	8.5	**(4.5)**	(0.9)
Deferred tax (note 28)	**6.4**	(2.6)	**(5.1)**	(1.6)
	9.8	5.9	**(9.6)**	(2.5)

11. Taxation expense / (income) (continued)

A reconciliation of the tax expense / (income) on profit before tax at the standard UK corporation tax rate to the actual tax expense is as follows:

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Profit before tax from continuing operations	**35.0**	18.0	**16.2**	41.2
Less share of profits of joint venture and associate (net of tax)	**(0.3)**	(0.2)	**-**	-
	34.7	17.8	**16.2**	41.2
Tax calculated at UK standard rate of 28% (2009: 28%)	**9.7**	5.0	**4.5**	11.5
Effects of:				
Expenses not deductible for tax purposes	**3.9**	7.6	**11.2**	2.2
Adjustment to tax expense in respect of prior periods	**(0.1)**	(5.1)	**(2.7)**	(0.6)
Utilisation of tax losses	**-**	-	**0.1**	-
Non-taxable income	**(3.7)**	-	**(23.1)**	(14.7)
Corporation tax rate change	**0.4**	-	**0.3**	-
Other	**(0.4)**	(3.2)	**0.1**	(0.9)
Tax expense / (income) excluding tax on sale of discontinued operation	**9.8**	4.3	**(9.6)**	(2.5)
Tax expense / (income) from continuing operations	**9.8**	4.3	**(9.6)**	(2.5)
Tax from discontinued operation	**-**	1.6	**-**	-
	9.8	5.9	**(9.6)**	(2.5)
Tax on gain on disposal of discontinued operation	**-**	-	**-**	-
Total tax expense / (income)	**9.8**	5.9	**(9.6)**	(2.5)

The effective tax rate for the Group for the year ended 31 December 2010 is 28.2% (2009: 24.2%). The major impacts on the effective rate for the year are the non-taxable income received by the Group on asset disposals and expenditure which is not deductible for tax purposes.

The effective rate for the Society for the year ended 31 December 2010 is (59.3)% (2009: (6.1)%). The major impacts on the effective rate are the non-taxable dividend income of £70.3m received during the year and the non-taxable profit on asset disposals made during the year. Also impacting the effective rate is the non tax deductible £36.9m written off investments during the year.

The reduction in the corporation tax rate to 27% effective from 1 April 2011 results in a charge of £0.4m in the Income Statement in respect of the Group's net deferred tax asset. No account is taken of future planned reductions in Corporation tax rates as these have not yet been substantively enacted and it is not possible to quantify the effects of the proposed reductions at this time.

12. Loans and advances to credit institutions

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Repayable on demand	**101.9**	135.9	**-**	-
In not more than three months	**184.9**	307.7	**183.9**	305.2
In more than three months but not more than one year	**-**	-	**-**	-
In more than one year	**7.1**	3.9	**7.1**	3.9
	293.9	447.5	**191.0**	309.1

13. Debt securities

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Issued by public bodies	**978.4**	223.0	**950.2**	157.7
Issued by other borrowers	**1,442.8**	2,116.3	**1,441.5**	2,115.9
	2,421.2	2,339.3	**2,391.7**	2,273.6
Debt securities have remaining maturities as follows:				
In not more than one year	**1,100.6**	1,203.8	**1,089.3**	1,173.0
In more than one year	**1,320.6**	1,135.5	**1,302.4**	1,100.6
	2,421.2	2,339.3	**2,391.7**	2,273.6
Transferable debt securities comprise:				
Listed on a recognised investment exchange	**2,215.8**	1,435.7	**2,186.3**	1,370.0
Unlisted	**205.4**	903.6	**205.4**	903.6
	2,421.2	2,339.3	**2,391.7**	2,273.6
Market value of listed transferable debt securities	**2,207.9**	1,435.7	**2,178.4**	1,370.0

The Directors consider that the primary purpose of holding debt securities is prudential. The majority of debt securities are highly liquid assets which are used on a continuing basis in the Group's activities.

At 31 December 2010, £328.8m (2009: £392.2m) of investment securities were pledged as collateral under sale and repurchase agreements. All sale and repurchase transactions are conducted in line with market standard terms and conditions as defined in ISMA PSA Global Master Repurchase Agreements.

Movements in debt securities during the year may be summarised as follows:

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
At 1 January	**2,339.3**	1,734.6	**2,273.6**	1,734.6
Acquired on transfer of engagements	**13.0**	325.2	**13.0**	234.8
Additions	**3,623.8**	6,036.0	**3,623.8**	6,036.0
Disposals	**(3,555.4)**	(5,771.8)	**(3,520.0)**	(5,747.0)
Impairment (losses) / recoveries	**(0.1)**	1.3	**-**	1.3
Changes in fair value	**0.6**	14.0	**1.3**	13.9
At 31 December	**2,421.2**	2,339.3	**2,391.7**	2,273.6

Pursuant to the amendments to IAS 39, *Financial Instruments: Recognition and Measurement* and IFRS 7, *Financial Instruments: Disclosures*, the Group reclassified certain available-for-sale investment securities to the loans and receivable category. In 2008 the Group identified £339.4m of financial assets that would have met the definition of loans and receivables (if they had not been designated as available-for-sale) for which at 1 July 2008 it had the intention and the ability to hold them for the foreseeable future or until maturity. The average effective interest rate of those investment securities that have transferred is 0.90% (2009: 0.78%).

The table below sets out the financial assets reclassified and their carrying and fair values:

	Group and Society 31.12.10 £m	31.12.09 £m
Carrying value of reclassified assets	**281.8**	314.1
Fair value of reclassified assets	**277.7**	283.6

If these assets had not been reclassified, the fair value gain arising in the Statement of Comprehensive Income would have been £28.3m (2009: £4.1m).

14. Derivative financial instruments

	Group Positive market value 2010 £m	Group Negative market value 2010 £m	Society Positive market value 2010 £m	Society Negative market value 2010 £m
Derivatives designated as fair value hedges:				
Interest rate swaps	59.6	143.6	59.5	134.0
Currency swaps	20.8	-	20.8	-
	80.4	**143.6**	**80.3**	**134.0**
Derivatives designated as cash flow hedges:				
Interest rate swaps	18.3	10.3	18.2	10.3
	18.3	**10.3**	**18.2**	**10.3**
Other derivatives held at fair value:				
Quanto swaps	0.1	0.4	0.1	0.4
Mortgage products - embedded derivatives	0.1	0.2	0.1	0.2
Equity swaps	12.6	66.7	12.6	66.7
Investment products - embedded derivatives	10.4	12.5	10.4	12.5
Interest rate swaps	18.1	27.1	47.3	27.1
Options	0.6	-	0.6	-
	41.9	**106.9**	**71.1**	**106.9**
	140.6	**260.8**	**169.6**	**251.2**

	Group Positive market value 2009 £m	Group Negative market value 2009 £m	Society Positive market value 2009 £m	Society Negative market value 2009 £m
Derivatives designated as fair value hedges:				
Interest rate swaps	48.9	166.8	48.4	154.6
Currency swaps	185.5	-	185.5	-
	234.4	166.8	233.9	154.6
Derivatives designated as cash flow hedges:				
Interest rate swaps	2.5	25.3	2.0	25.3
	2.5	25.3	2.0	25.3
Other derivatives held at fair value:				
Quanto swaps	0.5	0.2	0.5	0.2
Mortgage products - embedded derivatives	0.1	1.5	0.1	1.5
Equity swaps	4.2	41.0	4.2	41.0
Investment products - embedded derivatives	8.5	4.3	8.5	4.3
Interest rate swaps	14.6	24.6	65.5	24.2
Options	0.7	-	0.7	-
	28.6	71.6	79.5	71.2
	265.5	263.7	315.4	251.1

All derivatives held are held for economic hedging purposes.

15. Loans and advances to customers

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Loans fully secured on residential property	**9,030.4**	10,036.9	**6,624.8**	7,560.5
Other loans:				
Loans fully secured on land	**497.0**	516.8	**497.0**	516.8
Other loans	**81.3**	74.3	**11.7**	23.7
Fair value adjustment for hedged risk	**206.0**	185.3	**197.1**	172.1
	9,814.7	10,813.3	**7,330.6**	8,273.1
The remaining maturity of loans and advances to customers from the reporting date is as follows:				
On call and at short notice	**52.3**	40.7	**5.9**	6.2
In not more than three months	**8.7**	5.5	**4.4**	4.4
In more than three months but not more than one year	**67.4**	30.0	**49.9**	24.9
In more than one year but not more than five years	**433.3**	371.1	**307.8**	327.9
In more than five years	**9,332.4**	10,451.1	**6,992.9**	7,930.3
	9,894.1	10,898.4	**7,360.9**	8,293.7
Less: Impairment (note 16)	**(79.4)**	(85.1)	**(30.3)**	(20.6)
	9,814.7	10,813.3	**7,330.6**	8,273.1

The maturity analysis above is based on contractual maturity not actual redemption levels experienced by the Group or Society.

Covered bonds

Loans and advances to customers include £1,031.3m (2009: £992.9m) for both the Group and Society which have been transferred from the Society to Skipton Covered Bonds LLP, a Limited Liability Partnership which is consolidated into the Group Accounts. The loans secure £750.0m (2009: £750.0m) of covered bonds issued by the Society.

16. Impairment losses on loans and advances

Group	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans £m	Total £m
At 1 January 2010				
Individual impairment	50.8	1.8	2.9	**55.5**
Collective impairment	24.3	5.3	-	**29.6**
	75.1	**7.1**	**2.9**	**85.1**
Transfer of engagements				
Collective impairment	0.5	0.1	-	**0.6**
	0.5	**0.1**	**-**	**0.6**
Amounts written off during the year				
Individual impairment	(20.4)	(0.5)	(0.2)	**(21.1)**
	(20.4)	**(0.5)**	**(0.2)**	**(21.1)**
Unwind of merger fair value adjustments				
Collective impairment	(1.7)	-	-	**(1.7)**
	(1.7)	**-**	**-**	**(1.7)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	13.3	0.9	10.2	**24.4**
Collective impairment	(3.9)	(3.4)	-	**(7.3)**
	9.4	**(2.5)**	**10.2**	**17.1**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.6)	-	-	**(0.6)**
Charge for the year	**7.1**	**(2.5)**	**10.2**	**14.8**
At 31 December 2010				
Individual impairment	**43.1**	**2.2**	**12.9**	**58.2**
Collective impairment	**19.2**	**2.0**	**-**	**21.2**
	62.3	**4.2**	**12.9**	**79.4**
At 1 January 2009				
Individual impairment	27.7	0.7	1.7	30.1
Collective impairment	13.2	0.8	-	14.0
	40.9	1.5	1.7	44.1
Transfer of engagements				
Individual impairment	4.3	-	-	4.3
Collective impairment	23.0	-	-	23.0
	27.3	-	-	27.3
Amounts written off during the year				
Individual impairment	(29.5)	-	(0.4)	(29.9)
	(29.5)	-	(0.4)	(29.9)
Unwind of merger fair value adjustments				
Collective impairment	(12.5)	-	-	(12.5)
	(12.5)	-	-	(12.5)
Income Statement				
Impairment losses on loans and advances				
Individual impairment	48.7	1.1	1.6	51.4
Collective impairment	0.6	4.5	-	5.1
	49.3	5.6	1.6	56.5
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.4)	-	-	(0.4)
Charge for the year	36.4	5.6	1.6	43.6
At 31 December 2009				
Individual impairment	50.8	1.8	2.9	55.5
Collective impairment	24.3	5.3	-	29.6
	75.1	7.1	2.9	85.1

16. Impairment losses on loans and advances (continued)

Society

	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans £m	Total £m
At 1 January 2010				
Individual impairment	3.8	1.8	2.4	**8.0**
Collective impairment	7.3	5.3	-	**12.6**
	11.1	**7.1**	**2.4**	**20.6**
Transfer of engagements				
Collective impairment	0.5	0.1	-	**0.6**
	0.5	**0.1**	**-**	**0.6**
Amounts written off during the year				
Individual impairment	(3.0)	(0.5)	-	**(3.5)**
	(3.0)	**(0.5)**	**-**	**(3.5)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	6.6	0.9	9.8	**17.3**
Collective impairment	(0.9)	(3.4)	-	**(4.3)**
	5.7	**(2.5)**	**9.8**	**13.0**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.4)	-	-	**(0.4)**
Charge for the year	**5.3**	**(2.5)**	**9.8**	**12.6**
At 31 December 2010				
Individual impairment	**7.0**	**2.2**	**12.2**	**21.4**
Collective impairment	**6.9**	**2.0**	**-**	**8.9**
	13.9	**4.2**	**12.2**	**30.3**
At 1 January 2009				
Individual impairment	2.7	0.7	1.4	4.8
Collective impairment	3.3	0.8	-	4.1
	6.0	1.5	1.4	8.9
Transfer of engagements				
Collective impairment	4.0	-	-	4.0
	4.0	-	-	4.0
Amounts written off during the year				
Individual impairment	(2.7)	-	-	(2.7)
	(2.7)	-	-	(2.7)
Income Statement				
Impairment losses on loans and advances				
Individual impairment	4.2	1.1	1.0	6.3
Collective impairment	-	4.5	-	4.5
	4.2	5.6	1.0	10.8
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.4)	-	-	(0.4)
Charge for the year	3.8	5.6	1.0	10.4
At 31 December 2009				
Individual impairment	3.8	1.8	2.4	8.0
Collective impairment	7.3	5.3	-	12.6
	11.1	7.1	2.4	20.6

16. Impairment losses on loans and advances (continued)

Included within the charge to the Income Statement is the impact of the change in impairment charge due to the time value of money. For the Group this amounted to £1.1m (2009: £1.1m); for the Society it amounted to £0.6m (2009: £0.4m).

17. Investments in group undertakings

a) Subsidiary undertakings

Investments in subsidiary undertakings are recorded at cost, which includes an estimate of the remaining liability to purchase the non-controlling shareholdings at a future date (where applicable), which is the fair value of the consideration paid less impairment and dividends paid out of pre-acquisition reserves.

The net movement in investments in subsidiary undertakings during the year is as follows:

Society	**Shares in subsidiary undertakings**		**Loans to subsidiary undertakings**		**Total**	
	2010	2009	**2010**	2009	**2010**	2009
	£m	£m	**£m**	£m	**£m**	£m
Cost						
At 1 January	**156.1**	78.0	**3,171.8**	2,580.7	**3,327.9**	2,658.7
Acquired on transfer of engagements	**-**	79.8	**-**	837.7	**-**	917.5
Additions	**31.2**	1.5	**75.4**	33.5	**106.6**	35.0
Repayments	**-**	-	**(180.8)**	(280.1)	**(180.8)**	(280.1)
Disposals	**(1.2)**	(3.2)	**(1.3)**	-	**(2.5)**	(3.2)
At 31 December	**186.1**	156.1	**3,065.1**	3,171.8	**3,251.2**	3,327.9
Provisions						
At 1 January	**2.8**	-	**2.5**	-	**5.3**	-
Provided in the year	**36.9**	2.8	**0.8**	2.5	**37.7**	5.3
Utilised in the year	**(0.6)**	-	**(2.5)**	-	**(3.1)**	-
At 31 December	**39.1**	2.8	**0.8**	2.5	**39.9**	5.3
Net book value at 31 December	**147.0**	153.3	**3,064.3**	3,169.3	**3,211.3**	3,322.6

The Society reviews the carrying value of its investments in subsidiary undertakings at each reporting date. During the year £30m of excess share capital held in North Yorkshire Mortgages was converted to distributable reserves and paid to the Society by way of dividend and is shown in the Society's Income Statement as such. At the same time the Society provided £35.1m against the carrying value of investment in the specialist lending companies Amber Homeloans and North Yorkshire Mortgages. A further £1.8m has been provided against the cost of investment of a number of smaller businesses within the Financial Advice and Investment Portfolio divisions based upon our assessment of the carrying value and recoverable amounts of these businesses.

17. Investments in group undertakings (continued)

At 31 December 2010, the Group held a controlling interest in the following principal trading subsidiary undertakings:

Name of subsidiary undertaking	Principal business activity	Percentage of ownership interest 2010	2009
Advance Mortgage Funding Limited T/A Pink Home Loans	Provider of mortgage packaging services	**-**	97.5
Amber Homeloans Limited	Lending body	**100.0**	100.0
Bailey Computer Services Limited	Provider of IT services	**100.0**	100.0
Baseline Capital Limited #	Provider of data analysis solutions	**-**	100.0
Connells Limited and subsidiary undertakings	Estate agency and related businesses	**100.0**	96.7
Homeloan Management Limited and subsidiary undertakings	Provider of mortgage services	**100.0**	100.0
Jade Software Corporation Limited and subsidiary undertakings	Provider of software development services	**56.7**	54.2
Mutual One Limited *	Provider of support services	**82.5**	82.5
North Yorkshire Mortgages Limited	Lending body	**100.0**	100.0
Northwest Investments NZ Limited	Provider of software development services	**100.0**	100.0
Parnell Fisher Child Holdings Limited #		**-**	79.0
Pearson Jones Plc *	Independent financial adviser	**99.7**	100.0
Skipton Business Finance Limited	Provider of debt factoring services	**100.0**	100.0
Skipton Covered Bonds Limited Liability Partnership	Mortgage acquisition and guarantor of covered bonds	**(See below)**	(See below)
Skipton Financial Services Limited	Financial adviser	**100.0**	100.0
Skipton Group Holdings Limited ('SGHL')	Intermediate holding company	**100.0**	100.0
Scarborough Investment Services Limited	Intermediate holding company	**100.0**	100.0
Skipton International Limited (formerly Skipton Guernsey Limited)	Offshore deposit taker and lender	**100.0**	100.0
Skipton Trustees Limited	Provider of will writing services	**100.0**	100.0
Skipton Premises Limited	Property developer	**100.0**	100.0
Scarborough Properties Limited	Property developer	**100.0**	100.0
Sterling International Brokers Limited *	Money broker	**97.4**	97.4
The Private Health Partnership Limited *	Medical insurance broker	**88.7**	88.7
Thomson Shepherd Limited *	Financial adviser	**84.2**	75.0
Torquil Clark Holdings Limited *	Financial adviser	**89.1**	86.6

During the year Baseline Capital Limited was sold to Homeloan Management Limited at book value, and Parnell Fisher Child Holdings Limited was 'hived-up' into Pearson Jones Plc.

* Indicates where an option to purchase non-controlling interests in the future exists.

The Group holds a majority stake in these subsidiary undertakings, and the non-controlling shareholders have options to require SGHL to purchase the remaining shareholding at some future date. Under IAS 32, *Financial Instruments: Presentation* and IAS 39, *Financial Instruments: Recognition and Measurement*, these options are designated as 'financial instruments'. As such, the net present value of the estimated future payments under such put options are shown as a financial liability. In subsequent periods, any adjustment to the Group's estimation of the present value of the liability will result in an adjustment to goodwill for existing put options or a profit or loss in the Income Statement for new put options from 1 January 2010, in accordance with IFRS 3 (2008 revised) and IAS 27 (2008) (see note 36). The estimate of liability is principally dependent on the forecast performance of the businesses and the estimated timing of the exercise of the option. The change in fair value of the financial liability due to the accretion of the discount on the liability is expensed in the Income Statement. At 31 December 2010 this financial liability was £9.3m (2009: £17.3m).

17. Investments in group undertakings (continued)

The remaining subsidiary undertakings are 100% owned except for Jade Software Corporation Limited where the Group holds a 56.7% interest (2009: 54.2%) and no put options exist.

The Society's interests in Skipton Covered Bonds Limited Liability Partnership is, in substance, no different than if it was a 100% held subsidiary undertaking and consequently it is consolidated in the Group Accounts.

All the above bodies are incorporated and registered in the United Kingdom except for Skipton International Limited, which is incorporated and registered in Guernsey, and operates in Guernsey and Jersey, and Jade Software Corporation Limited and Northwest Investments NZ Limited, which are both incorporated, registered and operate in New Zealand.

All the above subsidiary undertakings have prepared accounts to 31 December 2010 and their audited results have been included in the Group Accounts.

On 9 July 2010 Connells Limited acquired a 75% shareholding in Vibrant Energy Matters Limited, an energy assessor firm, at a nominal cost. The net liabilities acquired had a book value of £0.3m, and a fair value of £0.7m, generating £0.7m of goodwill.

The goodwill includes £0.1m of purchased goodwill, the remaining £0.6m is attributable to the fair value of the liabilities of Vibrant Energy Matters Limited which were acquired by Connells Limited on acquisition.

In addition to this acquisition, during the year the Group increased its shareholdings in a number of existing subsidiary undertakings at a total cost of £20.9m (2009: £6.9m). Together with the reassessment of the expected future payments under the put option agreements and adjustments to contingent consideration, this resulted in a further £15.7m (2009: reduction of £0.2m) of goodwill being recognised.

b) Disposals

During the year the Group disposed of its entire holding in the following subsidiary undertaking:

Name of subsidiary undertaking	Principal business activity	Date of disposal	Cash received £m	Profit on disposal £m
Advance Mortgage Funding Limited T/A Pink Home Loans	Provider of mortgage packaging services	30 November 2010	1.6	1.2
			1.6	**1.2**

As a result of this disposal £0.2m of goodwill was eliminated.

During the period of ownership Pink Home Loans contributed a £0.1m loss (2009: £4.9m loss) to the Group's profit before taxation. Due to its relative size to the Group, the disposal of Pink Home Loans has not been disclosed as a discontinued operation.

The Society recognised a profit on disposal of £1.9m, whilst the Group profit on disposal was £1.2m.

During 2009 the Group disposed of its entire holding in Callcredit Information Group generating a profit on disposal of £39.7m.

17. Investments in group undertakings (continued)

c) Joint ventures and associates

The Group's interests relate to a joint venture where Connells Limited owns 33.3% (2009: 33.3%) of TMG Holdings Limited, a property search provider.

	Group 2010 £m	Group 2009 £m
Share of joint ventures and associates		
Gross assets	**2.7**	2.6
Gross liabilities	**(1.2)**	(0.9)
At 31 December	**1.5**	1.7
Share of joint ventures and associates		
Income	**10.6**	11.0
Expense	**(10.2)**	(10.7)
Taxation	**(0.1)**	(0.1)
Share of joint ventures' profit after tax	**0.3**	0.2

Joint ventures and associates are recognised within the Group's financial statements using the equity accounting method. The joint ventures and associates are incorporated in England and Wales.

18. Intangible assets

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Software, databases and customer contracts	**22.4**	22.4	**3.4**	4.0
Goodwill	**168.5**	159.8	**-**	-
	190.9	182.2	**3.4**	4.0

Software, databases and customer contracts	**Group 2010 £m**	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Cost				
At 1 January	**55.9**	75.2	**11.2**	8.0
Acquired on transfer of engagements	**0.7**	2.9	**0.7**	2.3
Additions	**8.9**	11.7	**1.0**	1.1
Disposals	**(0.2)**	(0.4)	**(0.1)**	(0.2)
Disposals of subsidiary undertakings	**(0.1)**	(33.5)	**-**	-
At 31 December	**65.2**	55.9	**12.8**	11.2
Amortisation and impairment				
At 1 January	**33.5**	43.6	**7.2**	5.2
Charge for the year – continuing operations	**9.2**	8.5	**2.2**	2.1
Charge for the year – discontinued operations	**-**	2.7	**-**	-
Write offs	**0.6**	-	**-**	-
Disposals	**(0.4)**	(0.3)	**-**	(0.1)
Disposal of subsidiary undertakings	**(0.1)**	(21.0)	**-**	-
At 31 December	**42.8**	33.5	**9.4**	7.2
Net book value at 1 January	**22.4**	31.6	**4.0**	2.8
Net book value at 31 December	**22.4**	22.4	**3.4**	4.0

18. Intangible assets (continued)

Goodwill	Group 2010 £m	Group 2009 £m
Cost less amortisation to 1 January 2004		
At 1 January	**181.0**	222.4
Acquisitions of subsidiary undertakings and business units	**0.7**	0.2
Acquired on transfer of engagements	**-**	0.3
Additions and revaluations of put options	**15.7**	(0.2)
Disposals	**(7.2)**	(41.7)
At 31 December	**190.2**	181.0
Impairment losses		
At 1 January	**21.2**	11.5
Provisions for impairment loss in the year	**7.5**	12.0
Disposals	**(7.0)**	(2.3)
At 31 December	**21.7**	21.2
Net book value at 1 January	**159.8**	210.9
Net book value at 31 December	**168.5**	159.8

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating unit (operating segment) that is expected to benefit from that business combination. Before recognition of impairment losses, the cost of goodwill before impairment had been allocated as follows:

Operating segment	Group 2010 £m	Group 2009 £m
Mortgage Services	**2.9**	2.9
Estate Agency	**120.5**	104.3
Financial Advice	**36.9**	36.9
Investment Portfolio	**29.9**	36.9
Cost of goodwill	**190.2**	181.0

The recoverable amounts of the operating segments are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the cash flows, discount rates and growth rates.

The Group prepares cash flow forecasts on the assumption that the subsidiary undertakings within each operating segment are held for long-term investment. The cash flows are derived from the most recent financial budgets for the next three years, which take into account the risks inherent in the businesses, and extrapolates cash flows for subsequent years (up to an additional 12 years) based on a long-term growth rate of 2.5% (2009 2.0%) or specific where circumstances dictate.

During the year, the Group has refined the methodology used to estimate discount rates. The Group now estimates discount rates based upon the weighted average cost of capital of each operating segment which takes into account the risks inherent in each cash generating unit. Previously these were calculated based on the Society's current cost of capital and adjusted for risks inherent in each cash generating unit.

The pre-tax discount rates are as follows:

Operating segment	Group 2010 %	Group 2009 %
Mortgage Services	**12%**	12%
Estate Agency	**15%**	12%
Financial Advice	**12%-14%**	10%
Investment Portfolio	**12%-19%**	10%-12%

The Investment Portfolio includes holding companies and a number of other small trading companies which operate in different markets.

18. Intangible assets (continued)

At 31 December 2010, to the extent that discount rates were to increase by 10%, the impairment charge would increase by £1.0m (2009: £0.2m).

At 31 December 2010, impairment of £21.7m (2009: £21.2m) was allocated to cash generating units as follows to reduce the goodwill to its estimated recoverable amount, based upon current revised forecasts:

Operating segment	**Group 2010 £m**	Group 2009 £m
Estate Agency	**3.4**	3.3
Financial Advice	**8.0**	3.8
Investment Portfolio	**10.3**	14.1
Impairment of goodwill	**21.7**	21.2

At 31 December 2010, before impairment testing, goodwill of £33.1m was allocated to the Financial Advice segment. Following a revision in future cashflows and based upon our assessment of recoverable amounts, £4.2m impairment has been recognised during the year against a number of subsidiary undertakings in the Financial Advice division.

At 31 December 2010, before impairment testing, goodwill of £22.8m was allocated to a number of subsidiary undertakings within the Investment Portfolio operating segment. Due to a reduction in business volumes the Group has revised its cash flows for some of these subsidiary undertakings. As a result, an impairment of £3.2m has been recognised.

On 1 June 2010 the Society merged with the Chesham Building Society and £3.1m of negative goodwill was created which was immediately credited to the Income Statement (see note 38).

19. Property, plant and equipment

Group		**2010**			2009	
	Land and buildings £m	**Equipment, fixtures and fittings £m**	**Total £m**	Land and buildings £m	Equipment, fixtures and fittings £m	Total £m
Cost						
At 1 January	89.8	106.8	**196.6**	68.8	111.5	180.3
Acquisitions	-	0.1	**0.1**	-	-	-
Acquired on transfer of engagements	1.0	-	**1.0**	6.0	-	6.0
Additions	4.1	7.1	**11.2**	17.1	6.4	23.5
Disposals	(5.7)	(12.1)	**(17.8)**	(0.4)	(3.1)	(3.5)
Disposal of subsidiary undertakings	(0.7)	(2.3)	**(3.0)**	(1.7)	(8.0)	(9.7)
Transfer from investment property	2.3	-	**2.3**	-	-	-
At 31 December	**90.8**	**99.6**	**190.4**	89.8	106.8	196.6
Depreciation						
At 1 January	18.9	89.0	**107.9**	17.5	88.5	106.0
Charge for the year – continuing operations	2.9	7.1	**10.0**	2.2	8.3	10.5
Charge for the year – discontinued operations	-	-	**-**	0.2	1.0	1.2
Disposals	(4.1)	(11.2)	**(15.3)**	(0.2)	(2.4)	(2.6)
Disposal of subsidiary undertakings	(0.2)	(2.2)	**(2.4)**	(0.8)	(6.4)	(7.2)
Transfer from investment property	0.8	-	**0.8**	-	-	-
At 31 December	**18.3**	**82.7**	**101.0**	18.9	89.0	107.9
Net book value at 1 January	70.9	17.8	**88.7**	51.3	23.0	74.3
Net book value at 31 December	**72.5**	**16.9**	**89.4**	70.9	17.8	88.7

19. Property, plant and equipment (continued)

Sale proceeds from fixed asset disposals were £2.5m (2009: £0.9m), resulting in a profit on sale of £1.0m (2009: loss of £0.2m). In addition, sale proceeds from the sale and leaseback of land and buildings were £7.3m (2009: nil) resulting in a profit of £5.7m (2009: nil) which has been included in the Income Statement in other income.

Society	**2010**			2009		
	Land and buildings £m	**Equipment, fixtures and fittings £m**	**Total £m**	Land and buildings £m	Equipment, fixtures and fittings £m	Total £m
Cost						
At 1 January	45.8	28.9	**74.7**	24.0	28.9	52.9
Acquired on transfer of engagements	1.0	-	**1.0**	5.0	-	5.0
Additions	18.0	0.2	**18.2**	16.8	0.5	17.3
Disposals	(5.7)	(0.1)	**(5.8)**	-	(0.5)	(0.5)
Transfer to investment property	(8.8)	-	**(8.8)**	-	-	-
At 31 December	**50.3**	**29.0**	**79.3**	45.8	28.9	74.7
Depreciation						
At 1 January	10.5	26.8	**37.3**	9.4	26.3	35.7
Charge for the year	1.8	0.7	**2.5**	1.1	0.9	2.0
Disposals	(4.1)	(0.1)	**(4.2)**	-	(0.4)	(0.4)
Transfer to investment property	0.9	-	**0.9**	-	-	-
At 31 December	**9.1**	**27.4**	**36.5**	10.5	26.8	37.3
Net book value at 1 January	35.3	2.1	**37.4**	14.6	2.6	17.2
Net book value at 31 December	**41.2**	**1.6**	**42.8**	35.3	2.1	37.4

Sale proceeds from fixed asset disposals were £2.3m (2009: £0.1m), resulting in a profit on sale of £1.4m (2009: loss of £0.1m). In addition, sale proceeds from the sale and leaseback of land and buildings were £7.3m (2009: nil) resulting in a profit of £5.7m (2009: nil) which has been included in the Income Statement in other income.

The net book value of land and buildings comprises:

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Freehold	**67.3**	65.5	**37.1**	31.1
Long leasehold	**2.5**	2.9	**2.0**	2.5
Short leasehold	**2.7**	2.5	**2.1**	1.7
	72.5	70.9	**41.2**	35.3

20. Investment property

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Cost				
At 1 January	**13.5**	12.0	**21.8**	20.3
Acquired on transfer of engagements	**0.1**	1.1	**0.1**	1.1
Additions	**-**	0.4	**3.0**	0.4
Disposals	**(1.6)**	-	**(1.6)**	-
Transfer (to) / from property, plant and equipment	**(2.2)**	-	**8.8**	-
At 31 December	**9.8**	13.5	**32.1**	21.8
Depreciation				
At 1 January	**3.2**	2.9	**3.9**	3.6
Charge for the year	**0.1**	0.3	**0.1**	0.3
Impairment	**1.4**	-	**1.4**	-
Disposals	**(0.9)**	-	**(0.9)**	-
Transfer to property, plant and equipment	**(0.8)**	-	**(0.9)**	-
At 31 December	**3.0**	3.2	**3.6**	3.9
Net book value at 1 January	**10.3**	9.1	**17.9**	16.7
Net book value at 31 December	**6.8**	10.3	**28.5**	17.9

The aggregate estimated market value of investment properties is set out in the table below:

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Market value of investment property	**11.0**	10.7	**32.1**	18.5

The estimated market value of the investment properties were determined by an appropriately qualified internal valuer in accordance with RICS Appraisal and Valuation Standards.

The £8.8m of investment property transferred by the Society from property, plant and equipment relates primarily to the transfer of HML's principal office on completion of the building during the year. Prior to completion the Society had recognised this asset in property, plant and equipment as work in progress.

21. Other assets

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Trade receivables	**58.3**	61.2	**-**	0.5
Prepayments and accrued income	**23.1**	28.7	**5.3**	7.6
Other	**6.4**	7.7	**1.1**	1.5
	87.8	97.6	**6.4**	9.6

21. Other assets (continued)

The ageing of the Group's trade receivables at the reporting date was:

	2010			2009		
	Gross £m	**Impairment £m**	**Past due but not impaired £m**	Gross £m	Impairment £m	Past due but not impaired £m
Not past due	**42.2**	**-**	**-**	41.8	-	-
Past due:						
Up to 30 days	**10.0**	**(0.1)**	**9.9**	12.4	(0.2)	12.2
30 to 120 days	**6.4**	**(1.3)**	**5.1**	6.6	(1.5)	5.1
Over 120 days	**4.8**	**(3.7)**	**1.1**	5.5	(3.4)	2.1
	63.4	**(5.1)**	**16.1**	66.3	(5.1)	19.4

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

	Group 2010 £m	Group 2009 £m
At 1 January	**(5.1)**	(5.4)
Provisions made during the year	**(1.4)**	(1.5)
Receivables written off during the year	**1.0**	1.1
Provisions no longer required	**0.4**	0.7
At 31 December	**(5.1)**	(5.1)

Trade receivables that are neither past due nor impaired arise in the ordinary course of business, £27.2m (2009: £24.6m) of which relates to the debtors of our debt factoring clients and therefore the primary risk of non-payment is borne by the client.

In determining whether trade receivables are impaired, the ageing of the debtor is a key factor.

22. Shares

	Group and Society	
	2010 £m	2009 £m
Held by individuals	**9,363.7**	10,457.6
Other shares	**2.2**	3.9
Fair value adjustment for hedged risk	**22.6**	8.7
	9,388.5	10,470.2
Shares are repayable from the reporting date in the ordinary course of business as follows:		
On demand	**2,871.1**	3,042.0
In not more than three months	**2,983.2**	3,508.8
In more than three months but not more than one year	**202.9**	1,354.9
In more than one year but not more than five years	**2,461.2**	1,880.0
In more than five years	**870.1**	684.5
	9,388.5	10,470.2

23. Amounts owed to credit institutions

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Amounts owed to subsidiary undertakings	-	-	279.2	429.3
Other	853.6	942.2	853.6	942.2
	853.6	942.2	1,132.8	1,371.5
Amounts owed to credit institutions are repayable from the date of the Statement of Financial Position in the ordinary course of business as follows:				
Repayable on demand	18.7	23.5	297.9	452.8
In not more than three months	138.9	231.2	138.9	231.2
In more than three months but not more than one year	598.9	1.0	598.9	1.0
In more than one year but not more than five years	97.1	686.5	97.1	686.5
	853.6	942.2	1,132.8	1,371.5

Included in amounts owed to credit institutions is £306.0m (2009: £285.2m) relating to securities sold under agreements to repurchase, the carrying and market value of the related securities is £328.8m (2009: £392.2m) and £323.8m (2009: £375.4m) respectively.

All sale and repurchase transactions are conducted in line with market standard terms and conditions as defined in ISMA PSA Global Master Repurchase Agreements.

24. Amounts owed to other customers

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Amounts owed to subsidiary undertakings	-	-	1,038.4	991.1
Other	1,088.8	1,203.9	339.5	348.8
	1,088.8	1,203.9	1,377.9	1,339.9
Amounts owed to other customers are repayable from the date of the Statement of Financial Position in the ordinary course of business as follows:				
Repayable on demand	306.6	453.0	1,075.6	991.1
In not more than three months	511.7	575.6	186.8	249.9
In more than three months but not more than one year	173.0	100.1	101.9	77.3
In more than one year but not more than five years	97.5	75.2	13.6	21.6
	1,088.8	1,203.9	1,377.9	1,339.9

25. Debt securities in issue

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Certificates of deposit	**71.1**	135.7	**71.1**	135.7
Other debt securities	**738.0**	1,168.5	**738.0**	1,168.5
Fair value adjustment for hedged risk	**37.1**	101.4	**37.1**	101.4
	846.2	1,405.6	**846.2**	1,405.6
Debt securities in issue are repayable from the date of the Statement of Financial Position in the ordinary course of business as follows:				
In not more than one year	**96.7**	605.1	**96.7**	605.1
In more than one year	**749.5**	800.5	**749.5**	800.5
	846.2	1,405.6	**846.2**	1,405.6

Included in Group and Society other debt securities are six (2009: 19) floating rate notes issued to the capital markets totalling £69.2m (2009: £395.5m).

26. Other liabilities

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Trade payables	**6.7**	7.0	**0.6**	0.3
Tax deducted at source from interest paid	**3.3**	3.5	**3.0**	2.6
Fair value of put option obligation	**9.3**	17.3	**-**	-
Debt factoring liabilities	**27.2**	24.6	**-**	-
Other	**23.1**	37.3	**3.8**	3.7
	69.6	89.7	**7.4**	6.6

The movement within the fair value of the put option obligation is summarised below:

	Group 2010 £m	Group 2009 £m
At 1 January	**17.3**	28.7
Unwind of the discount factor	**0.9**	-
Exercise of put options by non-controlling shareholders	**(6.9)**	(8.1)
Revaluation of market value and future exercise dates	**1.3**	3.2
Disposal of subsidiary undertakings during the year	**-**	(2.7)
Dividends paid to non-controlling shareholders	**(3.3)**	(3.8)
At 31 December	**9.3**	17.3

27. Provisions for liabilities

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Provision for the costs of closed branches	**7.3**	5.7	**0.4**	0.2
Financial Services Compensation Scheme	**8.1**	11.1	**7.4**	11.1
Regulatory and other provisions	**15.9**	2.5	**0.4**	0.5
	31.3	19.3	**8.2**	11.8

Movements in provisions during the year:

Group	Provision for the costs of closed branches 2010 £m	2009 £m	Financial Services Compensation Scheme 2010 £m	2009 £m	Regulatory and other 2010 £m	2009 £m	Total 2010 £m	2009 £m
At 1 January	**5.7**	5.3	**11.1**	16.3	**2.5**	2.4	**19.3**	24.0
Acquired on transfer of engagements	**-**	0.8	**0.2**	2.7	**-**	-	**0.2**	3.5
Reclassified from other liabilities and accruals	**0.4**	-	**-**	-	**16.9**	-	**17.3**	-
Charge / (release) for the year	**1.7**	0.2	**0.9**	(4.3)	**(1.5)**	0.1	**1.1**	(4.0)
Utilised during the year	**(0.5)**	(0.6)	**(4.1)**	(3.6)	**(2.0)**	-	**(6.6)**	(4.2)
At 31 December	**7.3**	5.7	**8.1**	11.1	**15.9**	2.5	**31.3**	19.3

At 31 December 2010 £9.4m of Group provisions previously reported in other liabilities and £7.9m previously reported in accruals and deferred income have been reclassified.

Society	Provision for the costs of closed branches 2010 £m	2009 £m	Financial Services Compensation Scheme 2010 £m	2009 £m	Regulatory and other 2010 £m	2009 £m	Total 2010 £m	2009 £m
At 1 January	**0.2**	-	**11.1**	16.3	**0.5**	0.4	**11.8**	16.7
Acquired on transfer of engagements	**-**	0.8	**0.2**	2.7	**-**	-	**0.2**	3.5
Charge / (release) for the year	**0.3**	-	**-**	(4.3)	**(0.1)**	-	**0.2**	(4.3)
Utilised during the year	**(0.1)**	(0.6)	**(3.9)**	(3.6)	**-**	0.1	**(4.0)**	(4.1)
At 31 December	**0.4**	0.2	**7.4**	11.1	**0.4**	0.5	**8.2**	11.8

The provision for the costs of closed branches is expected to reverse over the remaining life of the leases or period to anticipated date of disposal, if sooner.

The Society FSCS provision reflects market participation up to the reporting date. Following the payment of the 2009/2010 scheme year levy in August, the £7.4m provision at the year end relates to the estimated levy for scheme years 2010/2011 and 2011/2012. The Society's provision does not include management expense levies for any further scheme years, nor for any compensation levies which may arise from any ultimate payout on the claims.

27. Provisions for liabilities (continued)

In addition to the standard FSCS levy, a specific FSCS levy relative to the Financial Advice division occurred in 2010 due to the demise of Keydata, and the subsequent nil value rating of investments placed in the Lifemark counterparty. This had the effect of exhausting the FSCS fund within the Investment Intermediation class. Whilst none of the companies within Skipton Group had advised on any such plans, the specific levy placed on us in relation to this totalled £0.7m.

For further details on the Financial Services Compensation Scheme see note 32(b).

28. Deferred tax

Deferred taxes are calculated on timing differences under the liability method using an effective tax rate of 27% (2009: 28%) as this is the enacted rate that is expected to apply when the temporary differences reverse.

The movement in deferred tax during the year is as follows:

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
At 1 January	**31.2**	21.0	**12.1**	11.4
Income Statement (note 11)	**(6.4)**	2.6	**5.1**	1.6
Items taken directly to reserves	**(10.5)**	(3.7)	**(9.5)**	(3.2)
Acquired on transfer of engagements	**2.0**	11.9	**2.0**	2.3
Acquisitions / disposals	**-**	(0.6)	**-**	-
At 31 December	**16.3**	31.2	**9.7**	12.1

Deferred tax assets and liabilities are attributable to the following items:

Deferred tax assets	**Group 2010 £m**	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Fixed asset temporary differences	**2.4**	2.8	**-**	-
Pension benefits	**6.1**	13.3	**2.6**	5.5
Provisions for loan impairment	**1.2**	1.4	**0.5**	0.5
Corporation tax losses	**9.6**	4.1	**8.2**	2.7
Derivatives and loans	**5.4**	20.6	**5.1**	10.9
Other	**1.5**	2.8	**-**	-
	26.2	45.0	**16.4**	19.6

Deferred tax liabilities	**Group 2010 £m**	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Fixed asset temporary differences	**2.0**	4.0	**1.9**	1.6
Derivatives and loans	**7.7**	9.0	**4.8**	5.9
Other	**0.2**	0.8	**-**	-
	9.9	13.8	**6.7**	7.5
Net deferred tax asset	**16.3**	31.2	**9.7**	12.1

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

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Fixed asset temporary differences	**8.8**	(0.6)	**(0.1)**	(0.4)
Provisions	**-**	(7.6)	**-**	-
Unwind of merger fair value adjustments	**1.3**	6.4	**-**	(0.8)
Other	**(3.7)**	(0.8)	**(5.0)**	(0.4)
	6.4	(2.6)	**(5.1)**	(1.6)

There is no unrecognised deferred tax relating to trading losses brought forward at 31 December 2010 (2009: £Nil).

29. Subordinated liabilities

	Group		Society	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Subordinated floating rate notes	**-**	-	**11.4**	11.3
Subordinated fixed rate notes 2014	**15.2**	15.2	**15.2**	15.2
Subordinated fixed rate notes 2015	**20.2**	19.5	**20.2**	19.5
Subordinated fixed rate notes 2017	**10.3**	9.9	**10.3**	9.9
Subordinated fixed rate notes 2018	**128.1**	128.1	**128.1**	128.1
Subordinated fixed rate notes 2019	**10.2**	10.2	**10.2**	10.2
Subordinated fixed rate notes 2022	**31.2**	31.2	**31.2**	31.2
	215.2	214.1	**226.6**	225.4
Unamortised discount on issue	**(1.0)**	(1.1)	**(1.0)**	(1.1)
	214.2	213.0	**225.6**	224.3

All the fixed rate notes are denominated in Sterling. Coupons are paid on a fixed basis annually except for the notes repayable in 2014, the notes repayable in 2017, £75.0m (2009: £75.0m) of the notes repayable in 2018 and the notes repayable in 2019 where coupons are paid on a fixed basis semi-annually.

All the notes are repayable at maturity or earlier, at the option of the Society. In each case the option for early repayment may only be exercised with the prior consent of the Financial Services Authority. The note holders' rights are subordinate to those of the depositors and other payables.

The £11.4m (2009: £11.3m) Society Floating Rate Notes in the above table relates to a floating rate subordinated debt issue from Scarborough Building Society to Scarborough Channel Islands Limited which was acquired by the Society as a result of the merger. Scarborough Channel Islands and Skipton Guernsey amalgamated in September 2009 to form Skipton International. The variable rate coupons on this issue are paid on a quarterly basis.

All of the values in the above table have been calculated using the face value plus accrued interest with the exception of the 'Unamortised discount on issue' values which are the difference between the associated face values and current book values.

30. Subscribed capital

	Group and Society	
	2010	2009
	£m	£m
6.875% Permanent Interest Bearing Shares	**43.1**	42.0
8.500% Permanent Interest Bearing Shares	**15.2**	15.3
12.875% Permanent Interest Bearing Shares	**26.4**	26.3
	84.7	83.6

All Permanent Interest Bearing Shares are unsecured and rank pari passu with each other. They are deferred shares of the Society and rank behind the claims against the Society of all subordinated note holders, depositors, payables and investing members of the Society. These shares are measured at amortised cost.

31. Tax effects relating to each component of other comprehensive income

Group

	2010			2009		
	Before-tax amount £m	**Tax (expense) / benefit £m**	**Net-of-tax amount £m**	Before-tax amount £m	Tax (expense) / benefit £m	Net-of-tax amount £m
Available-for-sale financial assets	**(0.5)**	**(0.2)**	**(0.7)**	9.4	(2.4)	7.0
Cash flow hedges	**22.6**	**(6.3)**	**16.3**	7.1	(1.9)	5.2
Actuarial gains / (loss) on retirement benefit obligations	**9.7**	**(3.2)**	**6.5**	(17.9)	5.0	(12.9)
Translation of foreign operations	**1.4**	**-**	**1.4**	2.6	-	2.6
Movement of reserves attributable to non-controlling interests	**(0.1)**	**-**	**(0.1)**	(1.1)	-	(1.1)
Non-controlling interests share restructure	**-**	**-**	**-**	0.5	-	0.5
Other comprehensive income	**33.1**	**(9.7)**	**23.4**	0.6	0.7	1.3

Society

	2010			2009		
	Before-tax amount £m	**Tax (expense) / benefit £m**	**Net-of-tax amount £m**	Before-tax amount £m	Tax (expense) / benefit £m	Net-of-tax amount £m
Available-for-sale financial assets	**1.3**	**(0.3)**	**1.0**	8.7	(2.5)	6.2
Cash flow hedges	**23.1**	**(6.4)**	**16.7**	6.6	(1.8)	4.8
Actuarial gains / (loss) on retirement benefit obligations	**4.6**	**(1.7)**	**2.9**	(9.3)	2.7	(6.6)
Other comprehensive income	**29.0**	**(8.4)**	**20.6**	6.0	(1.6)	4.4

32. Other financial commitments and contingent liabilities

a) The Society is obliged under Section 22 of the Building Societies Act 1986 to discharge the liabilities of its subsidiary undertakings incurred prior to 11 June 1996 when this section was repealed. Additionally, the Society has given a legal undertaking agreeing to discharge the liabilities of Skipton International Limited in so far as it is unable to discharge them out of its own assets whilst it remains a subsidiary of Skipton Building Society. Furthermore, the Society has confirmed it will provide continuing support to those subsidiary undertakings that have net liabilities at 31 December 2010.

b) In common with all regulated UK deposit takers, the Society pays levies to the Financial Service Compensation Scheme ('FSCS') to enable the FSCS to meet claims against it. The FSCS levy consists of two parts: a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it. During 2008 and 2009 claims have been triggered against the FSCS in relation to Bradford and Bingley Plc, Kaupthing Singer & Friedlander, Heritable Bank Plc, Landsbanki Islands hf, London Scottish Bank Plc and Dunfermline Building Society.

The FSCS will meet these current claims by way of loans received from HM Treasury. The terms of these loans are interest only for the first three years, and the FSCS will seek to recover the interest cost, together with ongoing management expenses, by way of annual management expenses levies on member firms over this period. Subsequently, should there be insufficient funds from the realisation of the failed banks' assets to fully extinguish the FSCS' loans from HM Treasury, this may result in the FSCS raising a compensation levy on member firms. The three year initial term expires in September 2011 but refinancing is expected to occur.

In addition to the annual levies to the FSCS, the Financial Advice division is also subject to one-off levies for particular market events, such as the failure of Keydata and its counterparty Lifemark.

32. Other financial commitments and contingent liabilities (continued)

c) The Group is taking action to reduce risk in relation to its pension schemes and to address the pension scheme deficits. As part of this work, the Group initiated a number of exercises in 2010, including an early retirement exercise and an enhanced pension transfer exercise. The enhanced transfer exercise gave members the opportunity to transfer their benefits out of the schemes to other registered pension arrangements of their choosing. The offer enhanced the standard transfer values available to members and allowed members to take this enhancement as either an enhanced transfer value into a new pension arrangement or as a cash payment to the member.

The enhanced pension transfer exercise was made to eligible deferred members in the Connells Scheme, the Sequence 1997 Scheme and the Skipton Scheme. Offer letters were issued to members before the end of the year which gave members a 12 week offer period, ending in February 2011, in which to take up the offer.

In accordance with IAS19, the offer is recognised on settlement of the transaction, when an eligible member accepts the offer and a transfer is made. At the year end no transfers had been made but the offer period was still open. If 50% of members took up the offer this would result in transfer payments of £18.9m being paid by the pension schemes with a further enhancement of £5.8m being paid by Connells, Sequence and the Society in total. The IAS19 liability would reduce by £23.0m with an expected reduction in the deficit of £2.0m and a £2.1m charge to the Income Statement.

d) The Society's mortgage servicing subsidiary, HML, is in correspondence with the FSA following a thematic review. Investigations have been ongoing for some time and the issues involved are complex, particularly with regard to the application of the existing regulatory framework. It is possible that a liability may crystallise, whether from a fine, redress or both. At present the likelihood and quantum of any contingent liability is impossible to determine.

e) Capital commitments at 31 December for which no provision has been made are as follows:

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Contracted but not provided for	**0.6**	2.1	**-**	1.2

f) Total commitments under non-cancellable operating leases are as follows:

	Land and buildings 2010 £m	**Other 2010 £m**	Land and buildings 2009 £m	Other 2009 £m
Group				
Amounts falling due:				
Within one year	**15.3**	**4.7**	18.0	4.9
Within two to five years inclusive	**46.4**	**6.8**	56.0	7.8
Over five years	**33.8**	**1.7**	40.5	0.3
	95.5	**13.2**	114.5	13.0
Society				
Amounts falling due:				
Within one year	**5.2**	**3.3**	5.8	3.7
Within two to five years inclusive	**19.6**	**2.7**	22.6	5.5
Over five years	**19.4**	**-**	19.7	-
	44.2	**6.0**	48.1	9.2

33. Financial instruments

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity of another entity. The Society is a retailer of financial instruments, mainly in the form of mortgages and savings.

The Group uses wholesale financial instruments to invest liquid asset balances and raise wholesale funding, and to manage the risks arising from its operations. The Group does not run a trading book.

Instruments used for risk management purposes include derivative financial instruments ('derivatives'). Derivatives are instruments whose value is derived from one or more underlying price, rate or index (such as interest rates, exchange

33. Financial instruments (continued)

rates or stock market indices) but tend to have a smaller or no initial net investment relative to financial assets / liabilities offering the same risk / return as cash flows and are generally settled at a future date.

The Board has authorised the use of derivatives by the Group to reduce the risk of loss arising from changes in market risks in accordance with Section 9A (4) of the Building Societies Act 1986 and are used by the Group for economic hedging purposes only.

Types of derivatives

The principal derivatives used by the Group are interest rate swaps, interest rate options, forward rate agreements and foreign exchange contracts that are used to hedge Group Statement of Financial Position exposures.

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 also be managed using Statement of Financial Position instruments as part of an integrated approach to risk management

Activity	Risk	Type of hedge
Fixed rate savings products	Sensitivity to falls in interest rates	Receive fixed interest rate swaps (fair value hedge)
Variable rate funding	Sensitivity to increases in interest rates	Pay fixed interest rate swaps (cash flow hedge)
Fixed rate mortgage lending	Sensitivity to increases in interest rates	Pay fixed interest rate swaps (fair value hedge)
Variable rate liquidity	Sensitivity to falls in interest rates	Receive fixed interest rate swaps (cash flow hedge)
Fixed rate funding	Sensitivity to falls in interest rates	Receive fixed interest rate swaps (fair value hedge)
Fixed rate asset investments	Sensitivity to increases in interest rates	Pay fixed interest rate swaps (fair value hedge)
Mortgage and savings products with embedded options	Sensitivity to changes in interest rates	Interest rate swaps, caps and floors and other options
Equity linked investment products	Sensitivity to changes in equity indices	Equity linked interest rate swaps
Investment and funding in foreign currencies	Sensitivity to changes in foreign exchange rates	Cross currency interest rate swaps and foreign exchange contracts (fair value hedge)

Derivative products, which are combinations of more basic derivatives, are used only in circumstances where the underlying position being hedged contains similar risk features.

In such cases the derivative used will be designed to minimise the risks of the underlying asset or liability.

Controls over financial instruments

The Group has a formal structure of managing risk, including established risk limits, reporting requirements, mandates and other control procedures. This structure is reviewed regularly by the Asset and Liability Committee ('ALCO'), which is charged with the responsibility for managing and controlling the Statement of Financial Position exposures of the Group.

Credit exposures arising on derivative contracts with certain counterparties are collaterised with cash deposits, to mitigate credit exposures. All derivative activity is contracted with OECD financial institutions.

The accounting policies for derivatives are described in note 1 to the Accounts.

Hedge accounting

A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. For each main class of fair value hedge documentation is produced in accordance with the requirements of IAS 39.

A cash flow hedge is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss.

33. Financial instruments (continued)

Cash flow hedging is used primarily for interest rate swaps taken out to pre-hedge fixed mortgage completions and pre-hedge fixed savings products prior to receipt of funds. The weighted average maturity of interest rate swaps being cash flow hedged at 31 December 2010 was approximately 2.0 years (2009: 2.9 years); the amounts held in the cash flow hedging reserve will be recognised in the Income Statement over this period.

Financial risks

The principal financial risks to which the Group is exposed are liquidity risk, market risk and credit risk. Each of these is considered below. An overview of how the Group manages the risks it faces is also disclosed in the 'Principal risks and uncertainties' section of the Business Review.

Liquidity risk

Liquidity risk is the risk that the Group is not able to meet its financial obligations as they fall due or can do so only at excessive cost.

The Group's liquidity policy is to maintain sufficient liquid resources to cover imbalances and fluctuations in funding, to retain full public confidence in the solvency of the Group and to enable the Group to meet its financial obligations as they fall due. This is achieved through maintaining a prudent level of liquid assets, maintaining an appropriate mix between savings and deposit funding balances and through rigorous management control of the growth of the business. In practice this is achieved by ensuring the prudential liquidity ratio (prudential liquidity as a percentage of share and deposit liabilities) is held within a certain range at all times, by ensuring reliance on deposit funding is not excessive and through the planning, implementation and management control and review of business flows.

The Board is responsible for setting limits over the level, composition and maturity of liquidity and deposit funding balances. Such limits are reviewed by the Board at least annually. Compliance against these limits is monitored daily by Finance and Risk personnel (i.e. independent of Treasury staff).

In addition a series of liquidity stress tests are performed weekly by Market Risk personnel, and formally reported to ALCO monthly, to ensure the Group maintains adequate liquidity for business purposes even under stressed conditions.

Development of liquidity stress testing and forecast modelling continues as part of the Group's risk management to address the standards set out by the FSA in PS09/16 Strengthening Liquidity Standards. A wide range of scenarios are considered in addition to the idiosyncratic, market-wide and combined stress scenarios prescribed by the FSA. An analysis of the liquidity portfolio is set out in the table below:

	Group 2010		Group 2009	
	£m	**%**	£m	%
Cash in hand and balances with the Bank of England	**664.6**	**19.7**	1,272.1	31.3
Cash with banks and building societies	**294.6**	**8.7**	437.4	10.8
Gilts	**200.8**	**5.9**	152.7	3.8
Treasury bills	**749.4**	**22.2**	-	-
Certificates of deposit	**205.4**	**6.1**	903.6	22.3
Local authority investments	**0.5**	**-**	10.4	0.2
Fixed rate bonds	**452.6**	**13.4**	283.8	7.0
Floating rate notes	**530.8**	**15.7**	684.8	16.9
Residential mortgage backed securities	**233.3**	**6.9**	255.9	6.3
Commercial mortgage backed securities	**47.7**	**1.4**	58.2	1.4
	3,379.7	**100.0**	4,058.9	100.0

During the year the liquidity balances have reduced from £4,058.9m at 31 December 2009 to £3,379.7m at 31 December 2010 as part of the planned reduction in the overall size of the balance sheet. Expressed as a proportion of our combined shares and deposit liabilities this represents a decrease from 28.95% to 27.75%.

The Society has reduced the proportion of its liquidity held within its Bank of England Reserve Account. The reduction in liquid assets held in the Reserve Account has been more than offset by investment in supranational bonds and further treasury bills which are also counted as core liquidity buffer eligible assets. The residential and commercial mortgage backed securities have been in run-off during 2010.

33. Financial instruments (continued)

The following table is an analysis of gross contractual cash flows payable under financial liabilities (which is not expected to differ significantly to the expected maturity):

Group 2010

Liabilities	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	**5,857.1**	**211.4**	**2,554.4**	**932.2**	**9,555.1**
Amounts owed to credit institutions, customers and debt securities in issue	**618.9**	**527.8**	**837.8**	**-**	**1,984.5**
Derivative financial instruments	**38.8**	**99.9**	**216.3**	**108.1**	**463.1**
Subordinated liabilities	**4.0**	**11.9**	**97.6**	**223.9**	**337.4**
Subscribed capital	**1.6**	**6.3**	**31.7**	**100.1**	**139.7**
	6,520.4	**857.3**	**3,737.8**	**1,364.3**	**12,479.8**

Group 2009

Liabilities	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	6,551.6	1,369.6	1,909.1	684.5	10,514.8
Amounts owed to credit institutions, customers and debt securities in issue	1,236.7	151.1	1,271.4	-	2,659.2
Derivative financial instruments	46.9	116.3	239.0	102.1	504.3
Subordinated liabilities	4.0	11.9	78.5	259.0	353.4
Subscribed capital	1.6	6.3	31.7	103.5	143.1
	7,840.8	1,655.2	3,529.7	1,149.1	14,174.8

Society 2010

Liabilities	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	**5,857.1**	**211.4**	**2,554.4**	**932.2**	**9,555.1**
Amounts owed to credit institutions, customers and debt securities in issue	**939.2**	**530.2**	**843.2**	**-**	**2,312.6**
Derivative financial instruments	**39.2**	**100.6**	**218.0**	**108.1**	**465.9**
Subordinated liabilities	**4.1**	**12.0**	**98.5**	**228.6**	**343.2**
Subscribed capital	**1.6**	**6.3**	**31.7**	**100.1**	**139.7**
	6,841.2	**860.5**	**3,745.8**	**1,369.0**	**12,816.5**

Society 2009

Liabilities	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	6,551.6	1,369.6	1,909.1	684.5	10,514.8
Amounts owed to credit institutions, customers and debt securities in issue	1,712.8	167.3	1,277.0	-	3,157.1
Derivative financial instruments	47.1	116.8	239.0	102.2	505.1
Subordinated liabilities	4.1	12.0	79.7	264.4	360.2
Subscribed capital	1.6	6.3	31.7	103.5	143.1
	8,317.2	1,672.0	3,536.5	1,154.6	14,680.3

For each material class of financial liability a maturity analysis is provided in notes 22 to 25.

33. Financial instruments (continued)

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk and other price risk. These risks are measured and managed at a Group level.

Interest rate risk

The main market risk faced by the Group is interest rate risk. Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The net interest income and market value of the Group is exposed to movements in interest rates. This exposure is managed on a continuous basis, within limits set by the Board, using financial instruments.

The Group uses a number of different metrics to monitor interest rate risk and details of these are set out below.

The primary interest rate risk metrics employed by the Group incorporate earnings-at-risk, market value and value-at-risk methodologies, which calculate interest rate risk exposure positions based on 250 historical data observations going back over approximately the last seven years. Three monthly observation periods are used, with equal weight being applied to all observations. All of these approaches employ 95% confidence intervals and are multi-currency. These advanced interest rate risk measurement exposures, which are compared to Board and Operational limits weekly and formally reported to ALCO and the Board monthly, are used to guide interest rate risk management decisions.

Although these measures provide valuable insights to the market risk to which the Group is exposed, they need to be viewed in the context of the following limitations:

- historical data is not necessarily a good guide to future events;
- the use of 95% confidence levels, by definition, does not take account of changes that may occur beyond this level of confidence and therefore may not fully take into account extreme events;
- exposures are calculated on static Statement of Financial Position positions and therefore future changes in the structure of the Statement of Financial Position are ignored.

In addition, the Group also monitors interest rate risk exposure against limits by determining the effect on the Group's current net notional value of assets and liabilities for a parallel shift in interest rates equivalent to 2% for all maturities.

The levels of Group interest rate risk exposures through the reporting period were as follows:

	As at 31 December 2010 £m	Average 2010 £m	High 2010 £m	Low 2010 £m	As at 31 December 2009 £m
Static Earnings-at-Risk	1.8	3.4	5.4	1.7	2.9
Historical Value-at-Risk	1.0	0.9	2.4	0.1	0.7
2% Parallel interest rate shift	11.1	6.5	19.1	-	1.6

Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics – say LIBOR and Bank of England Base Rate) are also monitored closely and regularly reported to ALCO.

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Both at the year end and during the year, the Group had no material direct exposure to foreign currency exchange fluctuations. The currency risk appetite of the Group is low and any issuance denominated in foreign currency is immediately swapped into GBP. The exception to this is the Group's equity investments in Jade Software Corporation Limited and Northwest Investments NZ Limited which are denominated in New Zealand Dollars. The foreign currency fluctuations in relation to these equity investments are not material and are not hedged, but are recognised in the Group's translation reserve.

33. Financial instruments (continued)

The Group has a small exposure to foreign currency interest rates at the year end arising from a hedging mismatch on a Sterling mortgage product whose rate is linked to US Dollar interest rates. In addition, the Group has Euro debt issuances, however due to the effect of cross currency swaps the net exposure is immaterial.

Other price risk

As at 31 December 2010, the Group had a small amount of issued equity savings products outstanding. Derivative contracts to eliminate this exposure are taken out by the Group which exactly match the terms of the savings products and the market risk on such contracts is therefore fully hedged. The book and fair values of equity swaps are shown in note 14.

Credit risk

Credit risk is defined as the current or prospective loss to earnings and impact to capital arising from lending as a result of counterparties defaulting on their obligations due to the Group.

The Group faces this risk in respect of:

- individual customers (retail mortgages);
- businesses (through historic commercial lending). The Society ceased new commercial lending in November 2008 when we concluded that the outlook for commercial property was poor; and
- other financial institutions (wholesale lending). Credit risk within our treasury portfolio assets arises from the investments held by the Group in order to meet liquidity requirements and for general business purposes.

Changes in the credit quality and the recoverability of loans and amounts due from counterparties influence the Group's exposure to credit risk. Adverse changes in the credit quality of counterparties, collateral values or deterioration in the wider economy, including rising unemployment, deterioration in household finances and further contraction in the UK property market leading to falling property values, could affect the recoverability and value of the Group's assets and influence its financial performance. A reversal of the economic recovery and continuation of the falls in house prices and commercial property values could affect the level of impairment losses.

The Group has embedded a comprehensive and robust risk management framework with clear lines of accountability and oversight as part of its overall governance framework. The Group has effective processes and policies to monitor, control, mitigate and manage credit risk within the Group's conservative Risk Appetite.

Retail mortgage lending to customers

The Group actively lends in the prime residential (inclusive of buy-to-let) UK mortgage market through the Society and via Skipton International in the Channel Islands.

Retail credit risk is managed in accordance with Board approved lending policies which define the Board's approach to credit granting and risk appetite. The risk appetite defines a series of Board approved limits regarding customer and collateral credit quality which all lending activity must adhere to. Lending policies and risk appetite are subject to regular review and annual Board approval.

The credit decision process is achieved by automated credit scoring and policy rules with lending policy criteria supporting manual underwriting. All aspects of the credit decision process are subject to regular independent review and development ensuring they support decisions in line with Board expectations.

The Group also has credit exposures through Amber and NYM which comprises residential (inclusive of buy-to-let) UK mortgages across prime and sub-prime markets. These portfolios are closed to new lending and are subject to ongoing monitoring of credit performance supporting effective management of customer interests and creation of maximum value for the Group.

Commercial lending to customers and businesses

The Society retains a commercial mortgage portfolio which is UK based and is closed to new lending. This portfolio is subject to ongoing monitoring of credit performance supporting the effective management of counterparty interests and creation of maximum value for the Group.

33. Financial instruments (continued)

Other loans

The majority of these loans have an original maturity of less than one year and include a number of individual loans and loans made by our factored debt and invoice discounting business.

GRCC provides oversight to the effectiveness of all credit management across the Group and the controls in place to ensure lending is within Board approved credit risk appetite.

Wholesale lending to other financial institutions

The wholesale credit markets remain volatile, particularly in the Eurozone, and a further deterioration could lead to additional fair value adjustments in the Group's portfolio of available-for-sale assets coupled with further impairment of our treasury investments portfolio. This element of credit risk is managed by the Treasury and Market Risk teams.

Wholesale credit risk is managed in line with Board approved risk appetite and wholesale credit policies. Wholesale credit policies and risk appetite are subject to regular review and annual Board approval.

ALCO provides oversight to the effectiveness of wholesale credit risk management.

The most significant credit risk which the Group is exposed to is in relation to Loans and advances to customers (note 15), Debt securities (note 13), Loans and advances to credit institutions (note 12) and Derivative financial instruments (note 14). The maximum exposure to credit risk is represented by the carrying amount of each financial asset, except for loans and advances to customers where a fair value adjustment for hedged risk of £206.0m (2009: £185.3m) is included.

Credit risk - Loans and advances to customers

The table below shows the mix of the Group's loans and advances to customers:

Loans and advances to customers	Group			
	2010		2009	
	£m	**%**	£m	%
Total residential mortgages	**9,092.7**	**93.9**	10,112.0	94.4
Commercial loans	**501.2**	**5.2**	523.9	4.9
Other lending:				
Debt factoring loans	**39.5**	**0.4**	32.7	0.3
Other loans	**54.7**	**0.5**	44.5	0.4
Gross balances	**9,688.1**	**100.0**	10,713.1	100.0
Impairment provisions	**(79.4)**		(85.1)	
Fair value adjustment	**206.0**		185.3	
	9,814.7		10,813.3	

33. Financial instruments (continued)

a) Residential mortgages

The majority of loans and advances to customers are secured on UK residential properties with no particular geographic concentrations. By their nature, our residential lending books are comprised of a large number of smaller loans, and historically have a low volatility of credit risk outcomes.

The Group's portfolio of loans fully secured on residential property includes the specialist mortgage lending in Amber Homeloans and North Yorkshire Mortgages. Amber Homeloans balances outstanding at the year end were £1,235.7m (2009: £1,330.6m) of which £142.3m (2009: £148.5m) were in respect of buy-to-let. North Yorkshire Mortgages balances outstanding at the year end were £760.4m (2009: £828.9m) of which £203.9m (2009: £219.3m) were in respect of buy-to-let.

Loan-to-value information on the Group's residential loan portfolio is set out as follows:

Indexed loan-to-value analysis	**Group**		**Society**	
	2010	2009	**2010**	2009
	%	%	**%**	%
Total book:				
<70%	**44.1**	43.9	**52.7**	52.7
70% - 80%	**13.8**	12.7	**15.3**	13.9
80% - 90%	**14.9**	13.8	**15.2**	14.2
>90%	**27.2**	29.6	**16.8**	19.2
Average indexed loan-to-value	**55.5**	54.4	**50.6**	49.5

The indexed loan-to-value is updated on a quarterly basis to reflect changes in the Halifax house price index.

The table below provides further information on residential loans and advances by payment due status:

	Group				**Society**			
	2010		2009		**2010**		2009	
	£m	**%**	£m	%	**£m**	**%**	£m	%
Neither past due nor individually impaired	**8,542.2**	**93.9**	9,502.1	94.0	**6,454.3**	**97.3**	7,410.1	97.9
Past due but not individually impaired:								
Up to 3 months	**91.1**	**1.0**	82.3	0.8	**74.9**	**1.1**	65.7	0.9
3 to 6 months	**15.1**	**0.2**	12.8	0.1	**9.4**	**0.2**	7.5	0.1
6 to 9 months	**4.8**	**0.1**	5.8	0.1	**3.1**	**-**	3.6	-
9 to 12 months	**3.3**	**-**	1.4	-	**2.2**	**-**	0.8	-
Over 12 months	**4.3**	**-**	4.9	-	**1.8**	**-**	2.4	-
Total	**8,660.8**	**95.2**	9,609.3	95.0	**6,545.7**	**98.6**	7,490.1	98.9
Individually impaired	**406.6**	**4.5**	463.4	4.6	**87.7**	**1.3**	75.3	1.0
Possessions	**25.3**	**0.3**	39.3	0.4	**5.3**	**0.1**	6.2	0.1
	9,092.7	**100.0**	10,112.0	100.0	**6,638.7**	**100.0**	7,571.6	100.0

33. Financial instruments (continued)

Loans in the analysis above which are less than one month past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears. For details refer to note 16.

Loans are classed as renegotiated when their terms have changed during the year. Those renegotiated loans that would have been past due or impaired had their terms not been renegotiated *in the period* are as follows:

	2010 £m	2009 £m
Society	**41.2**	34.7
Amber Homeloans	**52.2**	43.8
North Yorkshire Mortgages	**20.4**	10.2
Skipton International	**1.1**	5.6
	114.9	94.3

The *cumulative balance* of loans that would have been past due or impaired had their terms not been renegotiated are as follows:

	2010 £m	2009 £m
Society	**70.7**	41.5
Amber Homeloans	**92.2**	51.3
North Yorkshire Mortgages	**27.2**	10.2
Skipton International	**8.4**	11.0
	198.5	114.0

The level of capitalised arrears is built into the loan impairment models utilised by the Group.

Fair value of collateral held:	**Group**		**Society**	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Not individually impaired	**15,946.5**	18,098.9	**13,025.1**	15,210.0
Impaired	**413.4**	465.7	**92.6**	84.0
Possessions	**22.1**	36.2	**4.6**	5.6
	16,382.0	18,600.8	**13,122.3**	15,299.6

The collateral held consists predominantly of residential houses. The use of such collateral is in line with terms that are usual and customary to standard lending activities.

Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In subsequent periods, the fair value is updated by reference to market price or indices of similar assets.

33. Financial instruments (continued)

b) Commercial loans

Loans secured on commercial property are well diversified by industry type and an analysis is provided below:

	Group and Society			
	2010		2009	
	£m	**%**	£m	%
Leisure and hotel	**47.7**	**9.5**	51.3	9.8
Retail	**17.6**	**3.5**	18.0	3.4
Nursing / residential homes	**32.7**	**6.5**	35.0	6.7
Offices	**17.5**	**3.5**	16.4	3.1
Commercial investment and industrial units	**358.9**	**71.6**	373.9	71.4
Miscellaneous	**26.8**	**5.4**	29.3	5.6
	501.2	**100.0**	523.9	100.0

The table below provides further information on commercial loans and advances by payment due status:

	Group and Society			
	2010		2009*	
	£m	**%**	£m	%
Neither past due nor individually impaired	**475.1**	**94.9**	507.3	96.9
Past due but not individually impaired:				
Up to 3 months	**5.4**	**1.1**	7.3	1.4
3 to 6 months	**1.7**	**0.3**	0.2	-
6 to 9 months	**1.6**	**0.3**	0.2	-
9 to 12 months	**-**	**-**	-	-
Over 12 months	**-**	**-**	-	-
Total	**483.8**	**96.6**	515.0	98.3
Individually impaired	**17.2**	**3.4**	8.9	1.7
Possessions	**0.2**	**-**	-	-
	501.2	**100.0**	523.9	100.0

Loans in the analysis above which are less than three months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears.

£6.2m (2009: £11.1m) of loans would be past due or impaired had their terms not been renegotiated in the period.

The cumulative balance of loans that would be past due or impaired had their terms not been renegotiated is £19.0m (2009: £14.0m).

Fair value of collateral held:	Group and Society	
	2010	2009*
	£m	£m
Not individually impaired	**650.4**	682.3
Individually impaired	**14.6**	7.2
Possessions	**0.1**	-
	665.1	689.5

* Prior year comparatives have been re-presented.

The collateral held consists of properties held within the above categories. The use of such collateral is in line with terms that are usual and customary to standard lending activities.

33. Financial instruments (continued)

c) Other lending

	Group				Society			
	2010		2009		**2010**		2009	
	Gross £m	**Impairment £m**	Gross £m	Impairment £m	**Gross £m**	**Impairment £m**	Gross £m	Impairment £m
Factored debt and invoice discounting	**39.5**	**(0.7)**	32.7	(0.4)	**-**	**-**	-	-
Other loans	**54.7**	**(12.2)**	44.5	(2.5)	**23.9**	**(12.2)**	26.1	(2.5)
	94.2	**(12.9)**	77.2	(2.9)	**23.9**	**(12.2)**	26.1	(2.5)

The majority of these loans have an original maturity of less than one year. There are no loans which are past due but not individually impaired.

The balances of those assets within our factored debt and invoice discounting business which are deemed to be individually impaired amount to £2.2m (2009: £0.6m). The factors considered in determining whether these assets are impaired include the existence of objective evidence to doubt ultimate recoverability of the company's net exposure, due to client insolvency.

The balances of those assets within other loans which are deemed to be individually impaired amount to £22.6m (2009: £2.6m) in both Group and Society. The factors considered in determining whether these assets are impaired include the existence of objective evidence that the customer is unable to honour their obligations as they fall due.

The loans in the 'Other lending' category are predominantly secured by way of a floating charge over book debts or other securities.

Credit risk – debt securities, loans and advances to credit institutions and derivative financial instruments

The Group holds treasury investments in order to meet the liquidity requirements and for general business purposes. The credit risk arising from these investments is closely monitored and managed by the Group.

As at 31 December 2010 £7.4m (2009: £7.4m) of the Group's treasury portfolio exposure was either past due or impaired. There are no assets that would otherwise be past due or impaired whose terms have been renegotiated. In assessing the potential impairment of its treasury assets, the Group among other factors, considers objective evidence of deterioration in the financial health of the investee, the normal volatility in valuation, and industry and sectorial performance.

As at 31 December 2010, 98% (2009: 98%) of the Group's treasury investment assets were rated A3 or better. The Group continues to have no exposure to emerging markets and only limited exposure to non-investment grade debt.

The table below provides further details of the ratings of the Group's treasury investment portfolio.

Rating	**2010**		2009	
	£m	**%**	£m	%
Aaa	**2,572.6**	**76.2**	2,277.1	56.1
Aa1	**82.6**	**2.4**	205.9	5.1
Aa2	**171.5**	**5.1**	276.4	6.8
Aa3	**307.3**	**9.1**	881.0	21.7
A1	**153.5**	**4.5**	188.1	4.6
A2	**9.3**	**0.3**	93.0	2.3
A3	**25.1**	**0.7**	54.3	1.3
Baa1	**6.3**	**0.2**	37.5	0.9
Baa2	**6.7**	**0.2**	6.7	0.2
Baa3	**34.7**	**1.0**	3.5	0.1
Ba3	**-**	**-**	3.5	0.1
Caa1	**6.6**	**0.2**	-	-
Caa2	**-**	**-**	3.9	0.1
Unrated:				
Building societies	**3.0**	**0.1**	17.6	0.4
Local authorities	**0.5**	**-**	10.4	0.3
	3,379.7	**100.0**	4,058.9	100.0

33. Financial instruments (continued)

The Group also monitors exposure concentrations against a variety of criteria including industry sector / asset class and country of risk.

Industry sector / asset class	2010		2009	
	£m	%	£m	%
Cash in hand and balances with the Bank of England	**664.6**	**19.7**	1,272.1	31.3
Cash with banks and building societies	**294.6**	**8.7**	437.4	10.8
Gilts	**200.8**	**5.9**	152.7	3.8
Treasury bills	**749.4**	**22.2**	-	-
Certificates of deposit	**205.4**	**6.1**	903.6	22.3
Local authority investments	**0.5**	**-**	10.4	0.3
Fixed rate bonds	**452.6**	**13.4**	283.8	7.0
Floating rate notes	**530.8**	**15.7**	684.8	16.9
Residential mortgage backed securities	**233.3**	**6.9**	255.9	6.3
Commercial mortgage backed securities	**47.7**	**1.4**	58.2	1.3
	3,379.7	**100.0**	4,058.9	100.0

The Group does not hold any mortgage backed securities with US institutions as collateral.

Geographical exposure	2010		2009	
	£m	%	£m	%
UK	**2,631.0**	**77.9**	3,032.6	74.7
Rest of Europe	**622.4**	**18.4**	765.5	18.9
North America	**81.2**	**2.4**	129.8	3.2
Australasia	**42.2**	**1.2**	96.2	2.4
Far East	**2.9**	**0.1**	34.8	0.8
	3,379.7	**100.0**	4,058.9	100.0

Within the treasury investments portfolio, the Group has no direct sovereign exposure to Greece, Ireland, Italy, Portugal and Spain ('GIIPS') as at 31 December 2010. The Group does have £38m of senior debt exposure to financial institutions based in Ireland. However, whilst the economic environment in Ireland remains very challenging, we do not currently expect any impairment to be required for these investments.

Collateral held for treasury assets is determined by the nature of the instrument. Loans and debt securities are generally unsecured with the exception of asset backed securities which are secured by pools of financial assets. The International Swaps and Derivatives Association ('ISDA') Master Agreement is the Group's preferred agreement for documenting derivative activity. In addition, a Credit Support Annex ('CSA') has been executed with certain counterparties in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between parties to mitigate the market contingent counterparty risk inherent in outstanding derivative positions. The posting of collateral is also used to reduce the credit exposure arising on sale and repurchase transactions and guaranteed equity bonds.

Netting arrangements do not generally result in an offset of Statement of Financial Position assets and liabilities, as transactions are usually settled on a gross basis. The Group's legal documentation for derivative transactions does grant legal rights of set-off for those transactions. Accordingly the credit risk associated with such contracts is reduced to the extent that negative mark to market valuations on derivatives will offset positive mark to market values on derivatives, subject to an absolute exposure of zero.

33. Financial instruments (continued)

Fair values of financial instruments

The tables below are a comparison of the book and fair values of the Group and Society's financial instruments by category as at the reporting date. Where available, market values have been used to determine fair values. Where market values are not available, fair values have been calculated for options by using option-pricing models and for other financial instruments by discounting cash flows at prevailing interest rates.

Group	**2010**				
	Positive book value £m	**Positive fair value £m**	**Negative book value £m**	**Negative fair value £m**	**Notional value / principal £m**
Cash and cash equivalents	664.6	664.6	-	-	664.6
Debt securities	2,421.2	2,417.1	-	-	2,412.7
Loans and advances to customers	9,814.7	9,966.4	-	-	9,885.0
Loans and advances to credit institutions	293.9	293.9	-	-	195.5
Trade receivables	58.3	58.3	-	-	58.3
Shares	-	-	(9,388.5)	(9,388.5)	9,283.1
Amounts owed to credit institutions	-	-	(853.6)	(853.6)	851.4
Amounts owed to other customers	-	-	(1,088.8)	(963.6)	1,078.3
Debt securities in issue	-	-	(846.2)	(814.9)	800.5
Subordinated liabilities and subscribed capital	-	-	(298.9)	(271.8)	300.0
Trade payables	-	-	(6.7)	(6.7)	6.7
Derivatives designated as fair value hedges	80.4	80.4	(143.6)	(143.6)	4,474.0
Derivatives designated as cash flow hedges	18.3	18.3	(10.3)	(10.3)	1,701.9
Other derivatives and embedded derivatives	41.9	41.9	(106.9)	(106.9)	3,875.5
	13,393.3	**13,540.9**	**(12,743.5)**	**(12,559.9)**	

Group	2009				
	Positive book value £m	Positive fair value £m	Negative book value £m	Negative fair value £m	Notional value / principal £m
Cash and cash equivalents	1,272.1	1,272.1	-	-	1,272.1
Debt securities	2,339.3	2,308.8	-	-	2,365.5
Loans and advances to customers	10,813.3	10,986.3	-	-	11,590.6
Loans and advances to credit institutions	447.5	447.5	-	-	308.7
Trade receivables	61.2	61.2	-	-	61.2
Shares	-	-	(10,470.2)	(10,461.5)	10,342.2
Amounts owed to credit institutions	-	-	(942.2)	(942.2)	601.2
Amounts owed to other customers	-	-	(1,203.9)	(1,082.1)	1,199.1
Debt securities in issue	-	-	(1,405.6)	(1,299.5)	1,303.2
Subordinated liabilities and subscribed capital	-	-	(296.6)	(247.2)	300.0
Trade payables	-	-	(7.0)	(7.0)	7.0
Derivatives designated as fair value hedges	234.4	234.4	(166.8)	(166.8)	5,820.1
Derivatives designated as cash flow hedges	2.5	2.5	(25.3)	(25.3)	1,424.1
Other derivatives and embedded derivatives	28.6	28.6	(71.6)	(71.6)	3,489.6
	15,198.9	15,341.4	(14,589.2)	(14,303.2)	

33. Financial instruments (continued)

Society	2010				
	Positive book value £m	**Positive fair value £m**	**Negative book value £m**	**Negative fair value £m**	**Notional value / principal £m**
Cash and cash equivalents	664.5	664.5	-	-	664.5
Debt securities	2,391.7	2,387.6	-	-	2,381.2
Loans and advances to customers	7,330.6	7,488.9	-	-	7,351.8
Loans and advances to credit institutions	191.0	191.0	-	-	190.7
Shares	-	-	(9,388.5)	(9,388.5)	9,283.1
Amounts owed to credit institutions	-	-	(1,132.8)	(1,132.8)	1,130.1
Amounts owed to other customers	-	-	(1,377.9)	(1,266.0)	1,376.2
Debt securities in issue	-	-	(846.2)	(814.9)	800.5
Subordinated liabilities and subscribed capital	-	-	(310.3)	(283.2)	312.5
Trade payables	-	-	(0.6)	(0.6)	0.6
Derivatives designated as fair value hedges	80.3	80.3	(134.0)	(134.0)	4,789.3
Derivatives designated as cash flow hedges	18.2	18.2	(10.3)	(10.3)	1,714.4
Other derivatives and embedded derivatives	71.1	71.1	(106.9)	(106.9)	3,875.5
	10,747.4	**10,901.6**	**(13,307.5)**	**(13,137.2)**	

Society	2009				
	Positive book value £m	Positive fair value £m	Negative book value £m	Negative fair value £m	Notional value / principal £m
Cash and cash equivalents	1,272.0	1,272.0	-	-	1,272.0
Debt securities	2,273.6	2,243.1	-	-	2,298.5
Loans and advances to customers	8,273.1	8,470.5	-	-	8,273.1
Loans and advances to credit institutions	309.1	309.1	-	-	308.5
Trade receivables	0.5	0.5	-	-	0.5
Shares	-	-	(10,470.2)	(10,461.5)	10,342.2
Amounts owed to credit institutions	-	-	(1,371.5)	(1,371.5)	1,370.1
Amounts owed to other customers	-	-	(1,339.9)	(1,220.7)	1,335.1
Debt securities in issue	-	-	(1,405.6)	(1,299.5)	1,303.2
Subordinated liabilities and subscribed capital	-	-	(307.9)	(258.5)	312.5
Trade payables	-	-	(0.3)	(0.3)	0.3
Derivatives designated as fair value hedges	233.9	233.9	(154.6)	(154.6)	6,216.8
Derivatives designated as cash flow hedges	2.0	2.0	(25.3)	(25.3)	1,442.3
Other derivatives and embedded derivatives	79.5	79.5	(71.2)	(71.2)	3,519.4
	12,443.7	12,610.6	(15,146.5)	(14,863.1)	

The fair value of mortgages has been determined at a unit of account level of the individual mortgage and is based on the present value of future cash flows. These cash flows represent the expected future interest flows adjusted for credit risk, and may include prepayment speeds and default rates. However, were the Society to dispose of portfolio mortgages, it is likely that the fair value would be lower than that shown above, as there is currently no active market for the sale of mortgage books.

33. Financial instruments (continued)

The tables below summarise the Group's main financial instruments by financial asset type:

	2010			
	Amortised cost £m	**Held at fair value as available-for-sale assets £m**	**Fair value through profit or loss £m**	**Total £m**
Cash and cash equivalents	664.6	-	-	664.6
Trade receivables	58.3	-	-	58.3
Loans and advances to credit institutions	293.9	-	-	293.9
Loans and advances to customers	9,814.7	-	-	9,814.7
Debt securities	281.8	2,139.4	-	2,421.2
Derivative financial instruments	-	-	140.6	140.6
Shares	(9,388.5)	-	-	(9,388.5)
Amounts owed to credit institutions and other customers	(1,942.4)	-	-	(1,942.4)
Trade payables	(6.7)	-	-	(6.7)
Debt securities in issue	(846.2)	-	-	(846.2)
Subordinated liabilities	(214.2)	-	-	(214.2)
Derivative financial instruments	-	-	(260.8)	(260.8)
	(1,284.7)	**2,139.4**	**(120.2)**	

	2009			
	Amortised cost £m	Held at fair value as available-for-sale assets £m	Fair value through profit or loss £m	Total £m
Cash and cash equivalents	1,272.1	-	-	1,272.1
Trade receivables	61.2	-	-	61.2
Loans and advances to credit institutions	447.5	-	-	447.5
Loans and advances to customers	10,813.3	-	-	10,813.3
Debt securities	314.1	2,025.2	-	2,339.3
Derivative financial instruments	-	-	265.5	265.5
Shares	(10,470.2)	-	-	(10,470.2)
Amounts owed to credit institutions and other customers	(2,146.1)	-	-	(2,146.1)
Trade payables	(7.0)	-	-	(7.0)
Debt securities in issue	(1,405.6)	-	-	(1,405.6)
Subordinated liabilities	(213.0)	-	-	(213.0)
Derivative financial instruments	-	-	(263.7)	(263.7)
	(1,333.7)	2,025.2	1.8	

33. Financial instruments (continued)

The tables below summarise the Society's main financial instruments by financial asset type:

	2010			
	Amortised cost £m	**Held at fair value as available-for-sale assets £m**	**Fair value through profit or loss £m**	**Total £m**
Cash and cash equivalents	664.5	-	-	664.5
Loans and advances to credit institutions	191.0	-	-	191.0
Loans and advances to customers	7,330.6	-	-	7,330.6
Debt securities	281.8	2,109.9	-	2,391.7
Derivative financial instruments	-	-	169.6	169.6
Shares	(9,388.5)	-	-	(9,388.5)
Amounts owed to credit institutions and other customers	(1,479.4)	-	(1,031.3)	(2,510.7)
Trade payables	(0.6)	-	-	(0.6)
Debt securities in issue	(846.2)	-	-	(846.2)
Subordinated liabilities	(225.6)	-	-	(225.6)
Derivative financial instruments	-	-	(251.2)	(251.2)
	(3,472.4)	**2,109.9**	**(1,112.9)**	

	2009			
	Amortised cost £m	Held at fair value as available-for-sale assets £m	Fair value through profit or loss £m	Total £m
Cash and cash equivalents	1,272.0	-	-	1,272.0
Trade receivables	0.5	-	-	0.5
Loans and advances to credit institutions	309.1	-	-	309.1
Loans and advances to customers	8,273.1	-	-	8,273.1
Debt securities	314.1	1,959.5	-	2,273.6
Derivative financial instruments	-	-	315.4	315.4
Shares	(10,470.2)	-	-	(10,470.2)
Amounts owed to credit institutions and other customers	(1,718.5)	-	(992.9)	(2,711.4)
Trade payables	(0.3)	-	-	(0.3)
Debt securities in issue	(1,405.6)	-	-	(1,405.6)
Subordinated liabilities	(224.3)	-	-	(224.3)
Derivative financial instruments	-	-	(251.1)	(251.1)
	(3,650.1)	1,959.5	(928.6)	

33. Financial instruments (continued)

The tables below summarise the fair value measurement basis used for assets and liabilities held at fair value:

Group	**2010**			
	Quoted prices in active markets (Level 1) £m	**Valuation techniques using observable inputs (Level 2) £m**	**Valuation techniques using significant unobservable inputs (Level 3) £m**	**Total £m**
Financial assets				
Financial assets held at fair value as available-for-sale:				
Debt securities	**1,934.0**	**205.4**	**-**	**2,139.4**
Financial assets at fair value through profit and loss:				
Derivative financial instruments	**-**	**140.6**	**-**	**140.6**
	1,934.0	**346.0**	**-**	**2,280.0**
Financial liabilities				
Financial liabilities at fair value through profit and loss:				
Derivative financial instruments	**-**	**260.8**	**-**	**260.8**
	-	**260.8**	**-**	**260.8**

Group	2009			
	Quoted prices in active markets (Level 1) £m	Valuation techniques using observable inputs (Level 2) £m	Valuation techniques using significant unobservable inputs (Level 3) £m	Total £m
Financial assets				
Financial assets held at fair value as available-for-sale:				
Debt securities	1,121.6	903.6	-	2,025.2
Financial assets at fair value through profit and loss:				
Derivative financial instruments	-	265.5	-	265.5
	1,121.6	1,169.1	-	2,290.7
Financial liabilities				
Financial liabilities at fair value through profit and loss:				
Derivative financial instruments	-	263.7	-	263.7
	-	263.7	-	263.7

33. Financial instruments (continued)

Society	**2010**			
	Quoted prices in active markets (Level 1) £m	**Valuation techniques using observable inputs (Level 2) £m**	**Valuation techniques using significant unobservable inputs (Level 3) £m**	**Total £m**
Financial assets				
Financial assets held at fair value as available-for-sale:				
Debt securities	**1,904.5**	**205.4**	**-**	**2,109.9**
Financial assets at fair value through profit and loss:				
Derivative financial instruments	**-**	**169.6**	**-**	**169.6**
	1,904.5	**375.0**	**-**	**2,279.5**
Financial liabilities				
Financial liabilities at fair value through profit and loss:				
Derivative financial instruments	**-**	**251.2**	**-**	**251.2**
Amounts owed to credit institutions and other customers	**-**	**1,031.3**	**-**	**1,031.3**
	-	**1,282.5**	**-**	**1,282.5**

Society	2009			
	Quoted prices in active markets (Level 1) £m	Valuation techniques using observable inputs (Level 2) £m	Valuation techniques using significant unobservable inputs (Level 3) £m	Total £m
Financial assets				
Financial assets held at fair value as available-for-sale:				
Debt securities	1,055.9	903.6	-	1,959.5
Financial assets at fair value through profit and loss:				
Derivative financial instruments	-	315.4	-	315.4
	1,055.9	1,219.0	-	2,274.9
Financial liabilities				
Financial liabilities at fair value through profit and loss:				
Derivative financial instruments	-	251.1	-	251.1
Amounts owed to credit institutions and other customers	-	992.9	-	992.9
	-	1,244.0	-	1,244.0

33. Financial instruments (continued)

Valuation techniques

Fair values are determined using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1

The most reliable fair values of derivative financial instruments and available-for-sale assets are quoted market prices in an actively traded market.

Level 2

These are valuation techniques for which all significant inputs are taken from observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed either when no active market exists or when there are quoted prices available for similar instruments in active markets.

In considering which similar instruments to use, Group Market Risk take into account the sensitivity of the instrument to changes in market rates and the credit quality of the instrument.

Basis risk derivatives are valued using discounted cash flow models, using observable market data and will be sensitive to benchmark interest rate curves.

Level 3

These are valuation techniques for which any one or more significant input is not based on observable market data. None of the Group's financial assets or liabilities are valued using this technique.

Valuation techniques include net present value and discounted cashflow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and other valuation models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, foreign currency exchange rates, equity index prices and expected price volatilities. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's-length.

Observable prices are those that have been seen either from counterparties or from market pricing sources including Bloomberg. The use of these depends upon the liquidity of the relevant market.

34. Group segmental reporting

The Group's operating results are regularly reviewed by the chief operating decision maker in the following reportable segments. Each segment offers different products and services and is managed separately based on the Group's management and internal reporting structure.

- Mortgages and Savings – principally the Society, but also includes specialist mortgage businesses Amber Homeloans and North Yorkshire Mortgages, and deposit taking and lending in Jersey and Guernsey through Skipton International.
- Mortgage Services – mortgage administration services, principally Homeloan Management, also includes Specialist Mortgage Services and Baseline Capital.
- Estate Agency – including survey and valuations, conveyancing, lettings, asset management and mortgage broking carried out through the Connells group.
- Financial Advice – provision of financial advice and broking services through four separate financial advice companies.
- Investment Portfolio – includes holding companies and a number of other small trading companies that do not fall within the core operating segments.

The Group disposed of its Credit & Marketing Solutions division in December 2009.

These segments reflect how internal reporting is provided to management and how management allocate resources and assess performance.

Transactions between the segments are on normal commercial terms and conditions. The accounting policies of the reportable segments are consistent with the Group's accounting policies.

No geographical analysis is presented because substantially all of the Group's activities are conducted within the UK. Of the total external income, £21.2m (2009: £11.9m) was generated outside of the UK.

A more detailed breakdown of the allocation of goodwill to each segmental area is given within note 18.

34. Group segmental reporting (continued)

2010	Mortgages and Savings £m	Mortgage Services £m	Estate Agency £m	Financial Advice £m	Investment Portfolio £m	Inter-company adjustments £m	Continuing operations £m	Discontinued operation £m	Total £m
Income									
Interest receivable and similar income	522.9	-	0.7	0.1	2.9	(163.0)	363.6	-	363.6
Interest payable and similar charges	(468.2)	-	0.3	(0.2)	(3.1)	162.5	(308.7)	-	(308.7)
Fair value gains on financial instruments	2.0	-	-	-	-	-	2.0	-	2.0
Fees and commissions receivable	14.3	78.2	208.1	51.6	44.9	(15.4)	381.7	-	381.7
Fees and commissions payable	(8.6)	(1.9)	(3.1)	(8.9)	(12.3)	14.0	(20.8)	-	(20.8)
Profit on disposal of subsidiary undertakings	1.9	-	-	-	1.1	(1.8)	1.2	-	1.2
Share of profits from joint ventures	-	-	0.3	-	-	-	0.3	-	0.3
Other income	17.2	0.6	1.7	0.1	7.7	(3.2)	24.1	-	24.1
Total income	81.5	76.9	208.0	42.7	41.2	(6.9)	443.4	-	443.4
Employee and pension costs	38.5	47.7	105.5	27.6	30.8	-	250.1	-	250.1
Depreciation and amortisation	6.4	4.6	4.2	1.8	4.3	-	21.3	-	21.3
Negative goodwill arising on merger	(3.1)	-	-	-	-	-	(3.1)	-	(3.1)
Impairment losses / provisions for liabilities	17.5	0.1	(3.7)	3.4	5.5	(6.8)	16.0	-	16.0
Other admin expenses	28.8	24.4	53.9	8.9	9.2	(1.1)	124.1	-	124.1
Total expenses	88.1	76.8	159.9	41.7	49.8	(7.9)	408.4	-	408.4
(Loss) / profit before tax	(6.6)	0.1	48.1	1.0	(8.6)	1.0	35.0	-	35.0
Taxation	5.0	(0.1)	(13.8)	(0.8)	2.2	(2.3)	(9.8)	-	(9.8)
Profit after tax	(1.6)	-	34.3	0.2	(6.4)	(1.3)	25.2	-	25.2
Total assets	16,624.7	27.5	137.5	23.8	246.2	(3,320.2)	13,739.5	-	13,739.5
Total liabilities	15,812.4	4.2	50.2	2.1	155.2	(3,105.7)	12,918.4	-	12,918.4
Capital expenditure (note 1)	22.3	5.4	5.4	1.0	5.7	(19.7)	20.1	-	20.1

Notes

1. During the year, the Society's Principal Office was transferred from Skipton Premises Limited to the Society at book value. This is shown as an addition for the Society and is included in the capital expenditure of the Mortgages and Savings division above. As no additional expenditure has actually been incurred on a Group basis, this is reversed through the inter-company adjustment.

34. Group segmental reporting (continued)

Performance by segment is reported to the chief operating decision maker based on the Group's interpretation of items which are routine and non-routine as follows:

	2010								
	Mortgages and Savings £m	Mortgage Services £m	Estate Agency £m	Financial Advice £m	Investment Portfolio £m	Inter-company adjustments £m	Continuing operations £m	Discontinued operation £m	Total £m
Reported profit before tax	(6.6)	0.1	48.1	1.0	(8.6)	1.0	35.0	-	35.0
Non-routine items:									
Profit on sale of subsidiary companies	(1.9)	-	-	-	(1.1)	1.8	(1.2)	-	(1.2)
Financial Services Compensation Scheme levy	-	-	-	0.9	-	-	0.9	-	0.9
Loss on sale of investment securities	0.1	-	-	-	-	-	0.1	-	0.1
Provisions against loans and investment in subsidiary undertakings	2.6	-	-	-	4.3	(6.9)	-	-	-
Impairment of goodwill	-	-	0.1	1.9	-	5.5	7.5	-	7.5
Negative goodwill arising on merger	(3.1)	-	-	-	-	-	(3.1)	-	(3.1)
Net gains from fair value volatility	(2.0)	-	-	-	-	-	(2.0)	-	(2.0)
Profit on sale and leaseback	(5.7)	-	-	-	-	-	(5.7)	-	(5.7)
Merger expenses	0.4	2.5	-	-	-	-	2.9	-	2.9
Profit before tax before non-routine items	(16.2)	2.6	48.2	3.8	(5.4)	1.4	34.4	-	34.4

Total income can be analysed as follows:

	2010								
	Mortgages and Savings £m	Mortgage Services £m	Estate Agency £m	Financial Advice £m	Investment Portfolio £m	Inter-company adjustments £m	Continuing operations £m	Discontinued operation £m	Total £m
Income from other segments	3.0	4.5	1.9	(4.8)	2.7	(7.3)	-	-	-
External income	78.5	72.4	206.1	47.5	38.5	0.4	443.4	-	443.4
Total income	81.5	76.9	208.0	42.7	41.2	(6.9)	443.4	-	443.4

34. Group segmental reporting (continued)

2009	Mortgages and Savings £m	Mortgage Services £m	Estate Agency £m	Financial Advice £m	Investment Portfolio £m	Inter-company adjustments £m	Continuing operations £m	Discontinued operation £m	Total £m
Income									
Interest receivable and similar income	550.6	0.2	1.1	0.2	2.4	(132.7)	421.8	-	421.8
Interest payable and similar charges	(498.1)	-	(0.2)	(0.3)	(2.8)	132.9	(368.5)	(0.3)	(368.8)
Fair value gains on financial instruments	3.9	-	-	-	-	-	3.9	-	3.9
Fees and commissions receivable	13.1	84.2	214.8	43.1	44.1	(10.3)	389.0	48.7	437.7
Fees and commissions payable	(2.6)	-	(2.2)	(5.4)	(13.9)	4.7	(19.4)	-	(19.4)
Profit on disposal of subsidiary undertakings	-	-	-	-	-	-	-	39.7	39.7
Share of profits from joint ventures	-	-	0.2	-	-	-	0.2	-	0.2
Profit on disposal of associate	-	-	-	-	-	-	-	-	-
Other income	7.6	2.2	0.4	0.1	8.6	(5.9)	13.0	-	13.0
Total income	74.5	86.6	214.1	37.7	38.4	(11.3)	440.0	88.1	528.1
Employee and pension costs	29.3	50.1	100.2	25.4	25.6	-	230.6	22.6	253.2
Depreciation and amortisation	4.6	5.4	4.2	1.3	3.8	-	19.3	4.0	23.3
Impairment losses / provisions for liabilities	37.6	-	0.2	-	0.5	-	38.3	-	38.3
Other admin expenses	36.3	27.8	55.4	9.9	25.2	(20.8)	133.8	16.0	149.8
Total expenses	107.8	83.3	160.0	36.6	55.1	(20.8)	422.0	42.6	464.6
(Loss) / profit before tax	(33.3)	3.3	54.1	1.1	(16.7)	9.5	18.0	45.5	63.5
Taxation	12.3	(1.3)	(15.8)	(0.5)	1.0	-	(4.3)	(1.6)	(5.9)
Profit after tax	(21.0)	2.0	38.3	0.6	(15.7)	9.5	13.7	43.9	57.6
Total assets	18,588.4	33.1	139.1	25.2	253.8	(3,470.8)	15,568.8	-	15,568.8
Total liabilities	17,828.4	9.7	58.6	1.1	154.9	(3,250.3)	14,802.4	-	14,802.4
Capital expenditure	18.9	6.1	1.6	1.1	4.0	-	31.7	3.9	35.6

34. Group segmental reporting (continued)

Performance by segment is reported to the chief operating decision maker based on the Group's interpretation of items which are routine and non-routine as follows:

	2009								
	Mortgages and Savings £m	Mortgage Services £m	Estate Agency £m	Financial Advice £m	Investment Portfolio £m	Inter-company adjustments £m	Continuing operations £m	Discontinued operation £m	Total £m
Reported profit before tax	(33.3)	3.3	54.1	1.1	(16.7)	9.5	18.0	45.5	63.5
Non-routine items:									
Profit on sale of subsidiary companies	-	-	-	-	-	-	-	(39.7)	(39.7)
Financial Services Compensation Scheme levy	(4.3)	-	-	-	-	-	(4.3)	-	(4.3)
Recoveries of investment securities	(1.3)	-	-	-	-	-	(1.3)	-	(1.3)
Curtailment gain on closure of pension schemes	(10.4)	-	-	-	-	-	(10.4)	-	(10.4)
Provisions against loans and investment in subsidiary undertakings	5.3	0.5	-	-	12.5	(18.3)	-	-	-
Impairment of goodwill	-	-	-	0.8	1.3	9.9	12.0	-	12.0
Net gains from fair value volatility	(3.9)	-	-	-	-	-	(3.9)	-	(3.9)
Merger expenses	3.9	0.9	-	-	-	-	4.8	-	4.8
Profit before tax before non-routine items	(44.0)	4.7	54.1	1.9	(2.9)	1.1	14.9	5.8	20.7

Total income can be analysed as follows:

	2009								
	Mortgages and Savings £m	Mortgage Services £m	Estate Agency £m	Financial Advice £m	Investment Portfolio £m	Inter-company adjustments £m	Continuing operations £m	Discontinued operation £m	Total £m
Income from other segments	7.0	5.5	1.5	(2.1)	1.9	(13.8)	-	-	-
External income	67.5	81.1	212.6	39.8	36.5	2.5	440.0	88.1	528.1
Total income	74.5	86.6	214.1	37.7	38.4	(11.3)	440.0	88.1	528.1

35. Pensions

Defined contribution schemes

The amount charged to the Income Statement in respect of contributions to the Group's defined contribution and stakeholder pension arrangements is the contribution payable in the year. The total pension cost charged to the Income Statement amounted to Group: £7.1m (2009: £6.5m) and Society: £1.7m (2009: £2.0m).

Defined benefit schemes

The Group has five funded defined benefit arrangements, all of which are now closed to new members and to the future accrual of benefits:

- The Skipton Building Society Pension & Life Assurance Scheme ('the Skipton Scheme')
- The Connells Limited Pension & Life Assurance Scheme ('the Connells Scheme')
- The Sequence (UK) Limited (1997) Pension & Life Assurance Scheme ('the Sequence 1997 Scheme')
- The Sequence (UK) Limited (South) Staff Pension Scheme ('the Sequence Staff Scheme')
- The Scarborough Building Society Group Pension and Death Benefits Scheme ('the Scarborough Scheme').

The Schemes provide benefits based on final salary for employees (although for benefits accruing after 1 January 2003 for the Skipton Scheme, 30 April 2006 for the Connells Scheme and 1 September 2006 for the Sequence 1997 Scheme, Career Average Revalued Earnings applies). The Scarborough Scheme closed to future accrual of benefits on 1 May 2007, the Connells Scheme, Sequence 1997 Scheme and Sequence Staff Scheme all closed to future accrual of benefits on 1 January 2009, and the Skipton Scheme closed to future accrual of benefits on 1 January 2010, at which point all active members left pensionable service and became entitled to deferred benefits.

The assets of the Schemes are held in separate trustee-administered funds. Contributions to the Schemes are assessed in accordance with the advice of an independent qualified actuary using the projected unit method.

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 Recognised Income and Expense.

The aggregate costs of the five schemes are recognised in accordance with IAS 19 (Amended). The Skipton Scheme is operated by a number of Group companies. Each of the participating entities, except for the Society, accounts on the basis of contributions paid by that company. The Society accounts for the difference between the aggregate IAS 19 (Amended) costs of the scheme and the aggregate contributions paid by the other entities.

A qualified independent actuary carried out the last full actuarial valuations of the schemes as at the following dates:

- 1 April 2008 for the Skipton Scheme
- 30 April 2008 for the Connells Scheme
- 5 April 2008 for the Sequence 1997 Scheme
- 1 April 2010 for the Sequence Staff Scheme
- 31 December 2007 for the Scarborough Scheme

35. Pensions (continued)

The main financial assumptions used in the actuarial valuation are as follows:

	Group and Society 2010 %	2009 %
Retail price inflation	**3.50**	3.50
Consumer price inflation	**3.00**	N/A
Discount rate	**5.50**	5.75
Expected return on assets	**6.25-7.58**	6.81-7.75
Rate of increase in pay	**N/A***	N/A*
Increases to pension payment:		
RPI max 5%	**3.30**	3.40
RPI min 3% max 5%	**3.80**	3.80
RPI max 2.5%	**2.40**	2.40
CPI max 5%	**2.80**	N/A
CPI min 3% max 5%	**3.30**	N/A
CPI max 2.5%	**2.40**	N/A
Rate of increase deferred pensions (RPI link)	**3.50**	3.50
Rate of increase deferred pensions (CPI link)	**3.00**	N/A

*Note - The one exception to this is for the Scarborough Scheme, where a salary link applies in respect of accrued benefits for those members who have remained in employment since the scheme closed to future accrual on 1 May 2007. The real earnings inflation assumption adopted as at 31 December 2010 to reflect this was 2% per annum subject to the 5% cap.

The most significant non-financial assumption is the assumed rate of longevity. For the year-ending 31 December 2010, this has been based on mortality rates that are 105% of the PNMA00 tables for males (or PNFA00 tables for females) with an allowance for projected improvements in mortality in line with long cohort improvements. This is the same mortality assumption used as at 31 December 2009. The tables adopted assume that, when a member who is 15 years from retirement reaches age 65, the life expectancy from age 65 is as follows:

Non-retired members	**2010**	2009
Males	**24.1**	24.0
Females	**26.3**	26.3

The table below shows the net pension liability which is recognised in the Statement of Financial Position:

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Fair value of plan assets	**166.2**	148.8	**86.7**	76.4
Present value of defined benefit obligations	**(198.0)**	(196.2)	**(96.4)**	(95.9)
Total amount of surplus not recoverable	**-**	-	**-**	-
Net pension liability	**(31.8)**	(47.4)	**(9.7)**	(19.5)

As all actuarial gains and assets are recognised, the deficits shown above are those recognised in the Statement of Financial Position.

The table below sets out the reconciliation of the fair value of scheme assets for the year:

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
At 1 January	**148.8**	115.7	**76.4**	54.2
Expected return on assets	**10.7**	8.8	**5.4**	4.3
Actuarial gains	**6.0**	13.6	**3.2**	6.8
Contributions by employer	**6.3**	6.0	**5.3**	4.9
Contributions by employees	**-**	0.5	**-**	0.4
Benefits paid	**(5.6)**	(5.4)	**(3.6)**	(3.8)
Assets acquired on transfer of engagements	**-**	9.6	**-**	9.6
At 31 December	**166.2**	148.8	**86.7**	76.4

35. Pensions (continued)

The table below sets out a reconciliation of the present value of the defined benefit obligation for the year:

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
At 1 January	**196.2**	153.6	**95.9**	72.3
Current service cost	**-**	0.8	**-**	0.8
Past service costs	**-**	-	**-**	-
Curtailments	**-**	(10.4)	**-**	(10.4)
Interest cost	**11.1**	10.2	**5.4**	5.2
Contributions by employees	**-**	0.5	**-**	0.4
Actuarial (gains) / losses	**(3.7)**	31.5	**(1.3)**	16.0
Actual benefit payments	**(5.6)**	(5.4)	**(3.6)**	(3.8)
Liabilities assumed on transfer of engagements	**-**	15.4	**-**	15.4
At 31 December	**198.0**	196.2	**96.4**	95.9

The difference between the expected return and the actual return on scheme assets is recognised in the Statement of Comprehensive Income and is reconciled below:

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Actual return on assets	**16.7**	22.4	**8.6**	11.1
Expected return on assets	**(10.7)**	(8.8)	**(5.4)**	(4.3)
Actuarial gain on assets	**6.0**	13.6	**3.2**	6.8

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, which is provided in the next table, reflects a combination of historical performance analysis, the forward looking views of the financial markets (as suggested by the yields available), and the views of investment organisations. The table also sets out the fair value of the scheme assets by each major category:

Group	**2010**		2009	
	£m	**% pa**	£m	% pa
Equities	**100.0**	**7.95**	96.2	8.25
Property	**5.2**	**6.25**	5.3	6.55
Corporate bonds	**21.9**	**5.50**	17.3	5.75
Government bonds	**25.6**	**4.20**	26.7	4.50
Cash	**13.5**	**3.00**	3.3	3.00
	166.2	**6.60**	148.8	7.11

The actual return on the scheme assets over the year ended 31 December 2010 was estimated as 12% (2009: 19%).

Society	**2010**		2009	
	£m	**% pa**	£m	% pa
Equities	**47.3**	**7.95**	45.7	8.25
Property	**2.6**	**6.25**	2.8	6.55
Corporate bonds	**13.3**	**5.50**	10.2	5.75
Government bonds	**16.1**	**4.20**	15.1	4.50
Cash	**7.4**	**3.00**	2.6	3.00
	86.7	**6.42**	76.4	6.94

The actual return on the scheme assets over the year ended 31 December 2010 was estimated as 10% (2009: 16%).

35. Pensions (continued)

The service costs and curtailments for the year are recognised in 'Administrative expenses', whilst the interest cost and expected return on assets are recognised within 'Other income'. An analysis of the charge is set out below:

	Group 2010 £m	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Current service cost	**-**	0.8	**-**	0.8
Past service cost	**-**	-	**-**	-
Curtailments	**-**	(10.4)	**-**	(10.4)
Interest on liabilities	**11.1**	10.2	**5.4**	5.2
Expected return on assets	**(10.7)**	(8.8)	**(5.4)**	(4.3)
Total pension (income) / expense	**0.4**	(8.2)	**-**	(8.7)

The tables below sets out the actuarial gains and losses which have been recognised within the Statement of Comprehensive Income:

Group	**2010 £m**	2009 £m	2008 £m	2007 £m	2006 £m
Experience gains / (losses) on scheme assets	**6.0**	13.6	(37.5)	(1.3)	2.7
Experience gains / (losses) on defined benefit obligation	**0.9**	(0.7)	(1.6)	(4.4)	5.3
Gains / (losses) from change in assumptions	**2.8**	(30.8)	13.5	15.9	6.0
Total amount of surplus not recoverable	**-**	-	1.5		-
Total gains / (losses) recognised in Statement of Comprehensive Income during the year	**9.7**	(17.9)	(24.1)	8.7	14.0
Cumulative actuarial (losses) / gains recognised at end of year	**(28.7)**	(38.4)	(20.5)	3.6	(5.1)

Society	**2010 £m**	2009 £m	2008 £m	2007 £m	2006 £m
Experience gains / (losses) on scheme assets	**3.2**	6.8	(16.0)	(0.6)	1.3
Experience gains / (losses) on defined benefit obligation	**0.4**	(0.1)	(1.5)	(3.6)	5.1
Gains / (losses) from change in assumptions	**1.0**	(16.0)	5.8	5.4	2.7
Total gains / (losses) recognised in Statement of Comprehensive Income during the year	**4.6**	(9.3)	(11.7)	1.2	9.1
Cumulative actuarial (losses) / gains recognised at end of year	**(14.8)**	(19.4)	(10.1)	1.6	0.4

As a result of changes in Government legislation, where there is no legal or constructive obligation to pay RPI increase for certain benefits of the Group's schemes, these benefits are now linked to increases in CPI rather than RPI. This change in inflation assumption has resulted in a reduction in liabilities of around £13.3m for the Group and £6.2m for the Society at 31 December 2010 which was recognised in equity. The impact of this is shown in the gains / (losses) from change in assumptions captions above.

The present value of the defined benefit obligation and the fair value of the scheme assets are as follows:

Group	**2010 £m**	2009 £m	2008 £m	2007 £m	2006 £m
Fair value of plan assets	**166.2**	148.8	115.7	140.2	120.4
Present value of defined benefit obligations	**(198.0)**	(196.2)	(153.6)	(161.0)	(163.8)
Total amount of surplus not recoverable	**-**	-	-	(1.5)	-
Net pension liability	**(31.8)**	(47.4)	(37.9)	(22.3)	(43.4)

Society	**2010 £m**	2009 £m	2008 £m	2007 £m	2006 £m
Fair value of plan assets	**86.7**	76.4	54.2	63.7	48.1
Present value of defined benefit obligations	**(96.4)**	(95.9)	(72.3)	(71.5)	(69.4)
Net pension liability	**(9.7)**	(19.5)	(18.1)	(7.8)	(21.3)

35. Pensions (continued)

The table below sets out the Group's best estimate, of the aggregate contributions expected to be paid to the schemes during the year ending 31 December 2011:

	Group 2011 £m	Society 2011 £m
Estimated employer contributions	**3.2**	**2.2**
Estimated employee contributions	**-**	**-**
Estimated total contributions	**3.2**	**2.2**

36. Adoption of new and revised International Financial Reporting Standards

Disclosed below are new standards and interpretations which have been adopted during the year.

- IFRS 3, *Business Combinations (Revised)*. This standard replaces IFRS 3, Business Combinations (2004) and is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. The main changes in this standard in addition to the inclusion of mutual entities, are that the cost of investment will comprise the consideration paid to the vendors for equity with acquisition costs being expensed immediately; goodwill will be accounted for only upon the acquisition of a subsidiary as subsequent changes in interest will be recognised in equity and only upon the loss of control will any profit or loss be recognised in the Income Statement. Further, any pre-existing holding within the acquired entity will, where control is subsequently gained, be revalued with any profit or loss arising being credited / charged through the Income Statement.

  As part of the Group's acquisition strategy, within a number of subsidiary undertakings which have less than 100% ownership, there is an option for non-controlling shareholders to sell their shares to the Group at some point in the future. In accordance with IAS 32, *Financial Instruments: Disclosure and Presentation*, the Group recognises the present value of the non-controlling options as a financial obligation. For existing put options, IFRS 3 2004 applies. IFRS 3 2008 revised applies to put options on business combinations post 1 January 2010.

- IAS 27, *Consolidated and Separate Financial Statements (2008)*. The amended standard must be applied for annual periods beginning on or after 1 July 2009. The amendments to this standard require the effects of all transactions with non-controlling interests to be recorded in equity if there has been no change in control. The changes also specify the accounting where control of an entity is lost.

- Eligible Hedged Items (Amendment to IAS 39 *Financial Instruments: Recognition and Measurement*). The amended standard must be applied for annual periods beginning on or after 1 July 2009. The amendment clarifies how the existing principles underlying hedge accounting should be applied in the designation of a one-sided risk in a hedged item and inflation in a financial hedged item.

37. Subsequent events

There have been no other material subsequent events between 31 December 2010 and the approval of this Report and Accounts by the Board.

38. Transfer of engagements

On 1 June 2010 the Society merged with the Chesham Building Society ('Chesham') under section 42B(3)(b) of the Building Societies Act on the basis of a board resolution of Skipton as permitted by a direction given by the FSA. The merger was approved by Chesham members on 31 March 2010.

The Board of Chesham independently reached a conclusion that merging with Skipton was in the best interests of its members, given the current uncertain economic environment and the financial position of their building society. From the Skipton's perspective, the merger provided an opportunity to build on our strong position within the financial services sector by adding attractive customer franchises to our existing operations.

The assets and liabilities acquired and the associated accounting adjustments are set out below:

	Notes	Cessation accounts Audited £m	IFRS adjustments £m	Fair value adjustments £m	**Take-on balances £m**
Assets					
Cash in hand and balances with the Bank of England		0.1	-	-	**0.1**
Loans and advances to credit institutions	f	37.6	-	(0.1)	**37.5**
Debt securities		13.0	-	-	**13.0**
Derivative financial instruments	n	-	0.1	-	**0.1**
Loans and advances to customers	g	162.6	0.2	(5.3)	**157.5**
Deferred tax asset	h	-	-	2.0	**2.0**
Intangible assets	i	-	-	0.7	**0.7**
Property, plant and equipment	j	1.5	-	(0.5)	**1.0**
Investment property	j	0.1	-	-	**0.1**
Other assets	k	0.3	-	(0.3)	**-**
Total assets		215.2	0.3	(3.5)	**212.0**
Liabilities					
Shares	l	187.7	-	0.2	**187.9**
Amounts owed to credit institutions		13.8	-	-	**13.8**
Amounts owed to other customers		0.4	-	-	**0.4**
Debt securities in issue		-	-	-	**-**
Derivative financial instruments	n	-	0.1	-	**0.1**
Other liabilities		0.4	-	-	**0.4**
Deferred tax liability		-	-	-	**-**
Provisions for liabilities	m	0.1	-	0.1	**0.2**
Retirement benefit obligations		-	-	-	**-**
Subordinated liabilities		-	-	-	**-**
Subscribed capital		-	-	-	**-**
Total liabilities		202.4	0.1	0.3	**202.8**
Reserves		12.8	0.2	(3.8)	**9.2**
Total members' interests and liabilities		215.2	0.3	(3.5)	**212.0**
Goodwill					
Fair value of net assets					**9.2**
Purchase consideration	o				**(6.1)**
Negative Goodwill	p				**3.1**

38. Transfer of engagements (continued)

Notes and adjustments

a. The income and expenditure account for Chesham for the period to 1 June 2010 is reported in the table below for information only and is not included in these financial statements.

b. The cessation accounts of Chesham have been prepared in accordance with UK Generally Accepted Accounting Principles (UK GAAP).

c. The assets and liabilities of Chesham Building Society have been included within the accounts of the Skipton Building Society at fair value. Some balance sheet reclassifications have been made to conform with International Financial Reporting Standards (IFRS) as endorsed by the EU. Balances have been adjusted in accordance with IFRS 3, *Business Combinations (Revised).*

d. Financial assets and liabilities which, following the Group's accounting policies, would be carried at amortised cost, are brought on to the balance sheet at their fair value at acquisition and are subsequently carried at amortised cost using the effective interest rate method.

e. The cessation accounts of Chesham have been reclassified in line with the Skipton Group accounting policies and IFRS.

f. Included within liquid assets is a £0.1m adjustment in relation to our expected recovery on Chesham's investment in Heritable Bank.

g. The entry method of mortgage valuation has been used. This method considers the rates at which new lending would be made in the market by comparison to the rates applied at the origination of the mortgage book. The acquisition fair value adjustment reflects both the credit and interest rate risk associated with these assets. The conversion to IFRS has resulted in an EIR adjustment being created and part release of the mortgage loss provision.

h. Corporation and Deferred tax assets have been provided where subsequent tax benefits or charges will arise from the fair value adjustments.

i. A £0.7m core deposit intangible has been recognised representing the intrinsic value of the retail savings book.

j. The fair value of land and buildings has been reduced by £0.5m based on an independent valuation, assessing current market value rather than value in use. Properties ancillary to branches and not used by the business are held as investment properties.

k. A fair value adjustment of £0.3m has been calculated reflecting the write off of deferred IT expenditure.

l. The fair value adjustment for shares and deposits reflect the interest rate risk associated with these liabilities.

m. The £0.1m fair value adjustment aligns the Financial Services Compensation Scheme charge relating to the Chesham balances transferred to the Group.

n. Derivative financial instruments were previously carried at amortised cost and these are now included at fair value based on discounted future cashflows, with market inputs valued consistently with the Group.

o. Imputed consideration represents the fair value of members' interests transferred. The combination of the two societies did not involve the transfer of any cash consideration. The value of the consideration has been calculated by measuring the fair value of the business of Chesham. The calculation was made with reference to publicly available valuations of quoted financial services organisations, adjusted to reflect the financial status, unquoted nature, relative size and economic diversification of the business. This resulted in a value of £6.1m attributed to the imputed consideration.

p. Net identifiable assets in excess of consideration transferred results in a gain on acquisition. IFRS 3 (Revised) requires that, where the fair value of the acquired assets exceeds the consideration transferred, the acquirer should reassess the identification and measurement of the assets, liabilities and contingent liabilities and the measurement of the consideration. After completing this additional review, in accordance with the requirements of IFRS 3 (Revised), this gain has been recognised in the Income Statement. The gain represents the fact that, in the distressed market conditions at the acquisition date, the value of net assets acquired was greater than the value of the ongoing business on a standalone basis, represented by imputed consideration.

38. Transfer of engagements (continued)

Income and expenditure account of Chesham Building Society For the period 1 December 2009 to 1 June 2010

	£000
Net interest receivable	**(22)**
Other income and charges	**49**
Administrative expenses	**(1,756)**
Provision for Financial Services Compensation Scheme Levy	**(14)**
Loss for the period before taxation	**(1,743)**
Taxation	**11**
Loss for the period ^	**(1,732)**

^ The above income and expenditure relates to the cessation accounts of Chesham and these amounts have not been included in the Income Statements of the Society or the Group. They are reported here for information only.

From 1 January 2010 to 31 May 2010, Chesham would have contributed £22,500 to the Group's net income and a loss before tax of £1.4m.

Following the merger, Chesham ceased to exist, being incorporated within Skipton Building Society. It is therefore not possible to separate its results post the transfer of engagements.

39. Capital structure

The Financial Services Authority ('FSA') regulates the Group which is required to manage its capital in accordance with the rules and guidance issued by the FSA. The capital requirements of the Group are monitored on a monthly basis and the results of this monitoring are reported to the Group Capital Committee and the Board. Capital is ultimately held for the protection of retail depositors. The internal level of capital is set with the aim of ensuring that the business has sufficient levels of capital for current and projected future activities, to withstand downturn stresses and, to ensure that the minimum regulatory requirement is always met. Throughout 2010, the Group has operated comfortably in excess of the minimum capital levels set by the FSA.

The following table shows the composition of the Group's capital at 31 December 2010:

	2010 £m	2009 £m
Tier 1		
Reserves	**809.6**	752.2
Permanent Interest Bearing Shares (note 1)	**90.0**	90.0
Pension fund deficit add back (note 2)	**3.7**	8.7
Deductions from Tier 1 capital (note 3)	**(190.9)**	(182.2)
Unrealised losses on available-for-sale debt securities	**6.9**	6.2
Unrealised losses on cash flow hedges	**(0.3)**	16.0
Total Tier 1 capital	**719.0**	690.9
Tier 2		
Subordinated debt (note 1)	**204.4**	207.8
Collective impairment allowance	**21.2**	29.6
Total Tier 2 capital	**225.6**	237.4
Total capital	**944.6**	928.3

Notes

1. Under FSA rules Permanent Interest Bearing Shares ('PIBS') and subordinated debt are included in the solvency calculation in accordance with UK GAAP rather than IFRS. The PIBS and subordinated debt are disclosed at par value therefore the associated merger fair value adjustments are recognised in the general reserve.
2. The regulatory capital rules allow the pension fund deficit to be 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.
3. Under FSA rules intangible assets must be deducted from regulatory capital.

1. Statutory percentages

	As at 31 December 2010 %	Statutory limit %
Lending limit	**10.44**	25.00
Funding limit	**17.63**	50.00

These percentages form part of the audited accounts.

Explanation

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. Business assets are defined as the total assets of the Group plus provisions for impairment losses on loans and receivables less liquid assets, intangible assets, property, plant and equipment and investment properties as shown in the Group Statement of Financial Position.

The funding limit measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. We have taken advantage of the relief set out in SI 2007/No 860, effective from April 2007, to exclude retail offshore deposits from the total of wholesale funds.

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:		
(i) Gross capital	**9.20**	7.58
(ii) Free capital	**7.01**	5.79
(iii) Liquid assets	**27.75**	28.95
As a percentage of mean total assets:		
(i) Group profit after taxation	**0.17**	0.39
(ii) Group management expenses	**2.70**	2.63
(iii) Society management expenses	**0.45**	0.35

These percentages form part of the audited accounts.

Explanation

The above percentages have been calculated from the Group and Society Statements of Financial Position.

Shares and borrowings represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest and the fair value adjustment for hedged risk.

Gross capital represents the general reserve together with the available-for-sale reserve, cash flow reserve, translation reserve, subordinated liabilities, subscribed capital, and non-controlling interests, as shown in the Group Statement of Financial Position.

Free capital represents gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment, investment properties and intangible assets as shown in the Group Statement of Financial Position.

Liquid assets represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.

Mean total assets are the average of the 2010 and 2009 total assets.

Management expenses represent administrative expenses.

3. Information relating to Directors and other officers at 31 December 2010

The Board of Directors at 31 December 2010, their dates of birth and dates of appointment as Director were:

	Date of Birth	Date of Appointment
D J Cutter*	1 January 1962	1 January 2000
A I Findlay	1 April 1952	12 June 2006
P R Hales	21 October 1946	29 May 2007
C N Hutton	4 November 1949	28 June 2004
A B E Kinney	30 May 1958	15 July 2003
P J S Thompson	28 September 1946	1 April 2009
R J Twigg*	12 February 1965	1 March 2002
W R Worsley	12 September 1956	24 April 2009

*Executive Directors

Documents may be served on any of the above named Directors at the following address: Addleshaw Goddard, Sovereign House, Sovereign Street, Leeds, LS1 1HQ.

The Society's officers at 31 December 2010 and their business occupations were:

M Adamson	Head of IT Shared Services
W J Barron	Property Services Manager
E A Blythe	General Manager, Audit Services
P M Craddock	Director of Financial Services
G M Davidson	Group Secretary
J J Gibson	Director of Group Risk and Compliance
L Horwell	General Manager, Asset & Liability Management
E N Law	Commercial Director
R S P Litten	Director of Retail Services
B Ndawula	General Manager, Group Finance
A C Robinson	Commercial Director

The Directors' business occupations and other Directorships at 31 December 2010 were:

D J Cutter	Building Society Group Chief Executive	Admiral Mortgage Company Limited Amber Homeloans Limited Bailey Computer Services Limited Baseline Capital Limited BDS Mortgage Group Limited Cashflow4Business.com Limited Chesham Mortgage Services Number 1 Limited Connells Limited Homeloan Management Limited Incresco Limited KB Analytics Limited Leeds Share Shop Limited Life Policies Direct Limited Malsis School Trust Mortgage Systems Limited North East Trustees Limited North West Investments NZ Limited North Yorkshire Mortgages Limited Pace Financial Solutions Limited Pace Mortgage Solutions Limited Parnell Fisher Child & Co. Limited Parnell Fisher Child Holdings Limited Pearson Jones Plc PS Employee Benefits Limited RED ARC Assured Ltd Savings Management Limited Sequence (UK) Limited

D J Cutter (continued)		Scarborough Properties Limited Skipton Business Finance Limited Skipton Financial Services Limited Skipton Group Holdings Limited Skipton Group Limited Skipton Investments Limited Skipton Limited Skipton Mortgages Limited Skipton Mortgages Corporation Limited Skipton Premier Mortgages Limited Skipton Premises Limited Skipton Share Dealing Services Limited Skipton Trustees Limited Specialist Investment Services Limited Specialist Mortgage Services Limited The Independent Mortgage Shop Limited The Mortgage Helper Limited The Private Health Partnership Limited Thomson Shepherd Limited Thomson Shepherd Holdings Limited Torquil Clark Holdings Limited Torquil Clark Limited Torquil Clark Pension Trustees Limited Torquil Clark Professional Connections Limited TQ Management Services Limited Yorkshire Factors Limited
A I Findlay	Company Director	Countess of Chester Hospital NHS Foundation Trust Skipton Group Holdings Limited
P R Hales	Chartered Insurer	Skipton Group Holdings Limited UNUM Limited UNUM Select Limited
C N Hutton	Retired Solicitor	Ben Rhydding Sports Club Limited Skipton Group Holdings Limited
A B E Kinney	Retired Partner of a Leading Firm of Chartered Accountants and Consultants	Financial Services Compensation Scheme Gradient Finance Limited Irish Life & Permanent Public Limited Company Irish Life & Permanent Group Holdings Public Limited Company Skipton Group Holdings Limited
P J S Thompson	Non-Practising Solicitor	Bailey Electrical Ltd Denney O'Hara Limited Giggleswick School Henderson Employee Benefits Limited Henderson Insurance Brokers Limited Judicium Business Services Limited Judicium Consulting Limited Judicium Plc NG Bailey Limited NG Bailey and Company (Overseas) Limited Rushbond Plc Skipton Group Holdings Limited TEP Electrical Distributors Limited

R J Twigg	Group Finance Director	Amber Homeloans Limited Bailey Computer Services Limited Baseline Capital Limited Cashflow4Business.com Limited Chesham Mortgages Services Number 1 Limited Connells Limited Connell Financial Services Limited Homeloan Management Limited KB Analytics Limited Leeds Share Shop Limited MBO 1994 Limited Mortgage Systems Limited North West Investments NZ Limited North Yorkshire Mortgages Limited Savings Management Limited Sequence (UK) Limited Scarborough Properties Limited Skipton Limited Skipton Building Society Charitable Foundation Skipton Business Finance Limited Skipton Covered Bonds Finance (Holdings) Limited Skipton Covered Bonds LLP Skipton Financial Services Limited Skipton International Limited Skipton Group Limited Skipton Group Holdings Limited Skipton Investments Limited Skipton Mortgage Corporation Limited Skipton Mortgages Limited Skipton Premier Mortgages Limited Skipton Premises Limited Skipton Share Dealing Services Limited Skipton Trustees Limited Specialist Mortgage Services Limited Specialist Investment Services Limited Sterling Brokers Limited Sterling International Brokers Limited Yorkshire Factors Limited
W R Worsley	Chartered Surveyor	The Brunner Investment Trust Plc 61 Cadogan Square Tenants Limited Copefringe Limited Country Land & Business Association Limited Skipton Group Holdings Limited

Messrs Cutter and Twigg have service contracts entered into on 1 January 2000 and 1 March 2002 respectively which may be terminated by either party giving one year's notice.

Directorships of the Society's officers at 31 December 2010 were as follows:

W J Barron	Skipton Premises Limited
P M Craddock	Association of Independent Financial Advisers Incresco Limited Life Policies Direct Limited North East Trustees Limited Pace Financial Solutions Limited Pace Mortgage Solutions Limited Parnell Fisher Child & Co. Limited Parnell Fisher Child Holdings Limited Pearson Jones Plc PS Employee Benefits Limited Skipton Financial Services Limited Skipton Group Holdings Limited Skipton Pension Trustees Limited The Independent Mortgage Shop Limited Thomson Shepherd Limited Thompson Shepherd Holdings Limited Torquil Clark Holdings Limited Torquil Clark Limited Torquil Clark Pension Trustees Limited Torquil Clark Professional Connections Limited TQ Management Services Limited
G M Davidson	Skipton Pension Trustees Limited Skipton Premises Limited Skipton Trustees Limited Mutual One Limited
J J Gibson	Connell Financial Services Limited Skipton Pension Trustees Limited
E N Law	MBO 1994 Limited Skipton Group Holdings Limited Sterling International Brokers Limited Thomson Shepherd Holdings Limited Thomson Shepherd Limited
R S P Litten	Amber Homeloans Limited North Yorkshire Mortgages Limited
A C Robinson	Admiral Mortgage Company Limited Alegra Fine Products Limited Bailey Computer Services Limited BDS Mortgage Solutions Limited Jade Software Corporation Limited MBO 1994 Limited Medical Care Direct Limited Mutual One Limited Pearson Jones Plc Red Arc Assured Limited Skipton Business Finance Limited Skipton Group Holdings Limited Sterling Brokers Ltd Sterling International Brokers Limited The Mortgage Helper Limited The Private Health Partnership Limited Torquil Clark Holdings Limited

No other officers held any Directorships.

Glossary

Set out below are the definitions of the terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue.
Asset backed securities	An asset backed security is a security whose value and income payments are derived from and collateralised (or 'backed') by a specified pool of underlying assets. Typically these assets are pools of residential or commercial mortgages.
Basel II	Basel II is the second of the Basel Accords, issued by the Basel Committee on Banking supervision, which defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook.
Commercial lending	Loans secured on commercial property.
Commercial mortgage backed securities (CMBS)	Securities that represent interests in a pool of commercial mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal).
Contractual maturity	The final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal and interest is due to be paid.
Core Tier 1 capital	Defined by the FSA as Tier 1 capital less hybrid capital instruments (innovative Tier 1 securities and permanent interest bearing shares for building societies) and certain regulatory adjustments.
Covered bonds	Debt securities backed by a portfolio of mortgages that is segregated from the issuer's other on-balance sheet assets solely for the benefit of the holders of the covered bonds. The Group issues covered bonds as part of its funding activities.
Credit risk	This is the risk that a customer or counterparty is unable to honour their obligations as they fall due.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Delinquency	A debt or financial obligation is considered to be in a state of delinquency when payments are overdue.
Derivative financial instruments	A derivative financial instrument is a type of financial instrument (or an agreement between two parties) that has a value based on the underlying asset, index or reference rate it is linked to. The Group uses derivative financial instruments to hedge its exposures to market risks such as interest rate, equity and currency risk.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period.
Fair value	Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FSA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.

Free capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment, investment properties and intangible assets.
Funding limit	Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement.
Gross capital	The aggregate of general reserve, translation reserve, available-for-sale reserve, cash flow reserve, subscribed capital, subordinated liabilities and non-controlling interests.
Goodwill	Goodwill arises on the acquisition of subsidiary undertakings, joint ventures, associates or businesses and represents the excess of the fair value of consideration over the fair value of identifiable net assets and contingent liabilities acquired at the date of acquisition.
Impaired loans	Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.
Individually / collectively assessed	Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be realised.
Internal capital adequacy assessment process (ICAAP)	The Group's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of the risks it faces under a business as usual scenario and a variety of stress scenarios.
International Swaps and Derivatives Association (ISDA) master agreement	A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property. The calculation of the lending limit is explained in the Annual Business Statement.
Liquid assets	Total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.
Liquidity risk	The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash inflows and outflows.
Loan-to-value ratio (LTV)	A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI).
Loans past due / past due loans	Loans on which payments are overdue including those on which partial payments are being made.
Management expenses	Management expenses represent administrative expenses. The management expense ratio is management expenses expressed as a percentage of mean total assets.
Market risk	The risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and customer-driven factors will reduce income or portfolio values.
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
Medium-term notes (MTN)	Corporate notes continuously offered by a company to investors through a dealer.
Member	A person who has a share investment or a mortgage loan with the Society.

Mortgage backed securities (MBS)	Assets which are referenced to underlying mortgages.
Net interest income	The difference between interest received on assets and interest paid on liabilities.
OECD	Used to refer to member countries of the OECD (Organisation for Economic Co-operation and Development). The OECD is an international organisation of countries with highly developed economies and democratic governments. The OECD has 31 member countries including (but not limited to) key European countries, the United States, Canada and Japan.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems or from external events.
Permanent Interest Bearing Shares (PIBS)	Unsecured, deferred shares that are a form of Tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing members of Skipton Building Society.
Prime	Prime mortgages are those granted to the most credit worthy category of borrower.
Put option	Where the Group acquires a majority shareholding in a subsidiary undertaking, but grants the non-controlling shareholders an option to sell their shares to the Group at some future date, a put option obligation exists.
Renegotiated loans	Loans are classed as renegotiated with the customer's consent, when their terms have changed during the year. Loans and advances are generally renegotiated either as part of an on-going customer relationship or in response to an adverse change in the circumstances of the borrower.
Repo / Reverse repo	Short-to medium-term funding agreements which allow a borrower to sell a financial asset, such as ABS or Government bonds as security for cash. As part of the agreement the borrower agrees to repurchase the security at some later date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future), it is a reverse repurchase agreement or reverse repo.
Residential mortgage backed securities (RMBS)	A category of ABS that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal).
Risk appetite	The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Society's members whilst achieving business objectives.
Risk-weighted asset (RWA)	The value of assets, after adjustment, under Basel II rules to reflect the degree of risk they represent.
Residential loans	Money loaned to individuals rather than institutions. Residential mortgage lending is secured against residential property.
Shares	Money deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.
Shares and borrowings	The total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest and fair value adjustments for hedged risk.
Subordinated debt / liabilities	A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors, and investing members (other than holders of PIBS).
Sub-prime	Loans to borrowers typically having weakened credit histories that include payment delinquencies and in some cases potentially more severe problems such as court judgements and discharged bankruptcies.

Tier 1 capital	A measure of financial strength. Tier 1 capital is divided into Core Tier 1 and other Tier 1 capital. Core Tier 1 capital comprises general reserves from retained profits. The book values of goodwill and intangible assets are deducted from Core Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as PIBS are included in other Tier 1 capital (i.e. not Core Tier 1).
Tier 2 capital	Comprises the Group's qualifying subordinated debt and collective impairment allowance (for exposures treated on a Basel II standardised basis). Certain regulatory deductions may be made for the purposes of assessing capital adequacy.
Wholesale funding	The total of amounts owed to credit institutions, amounts owed to other customers and debt securities in issue less balances deposited by offshore customers.

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