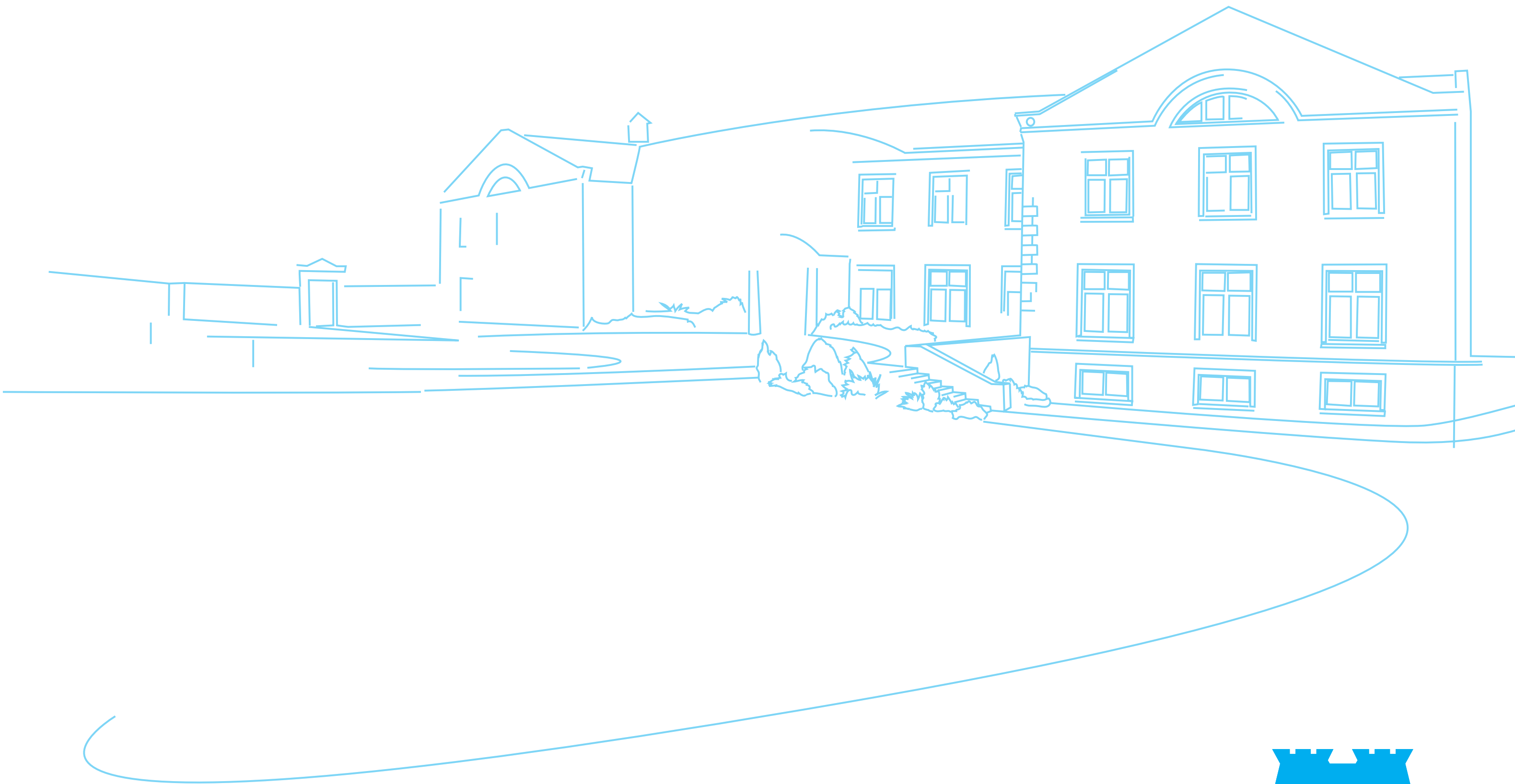
Skipton Building Society



Annual Report & Accounts 2011



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Key Financial Highlights

- Group profit before tax **£22.2m (2010: £35.0m)**
- Group net interest margin **up 41% to 0.52% (2010: 0.37%)**
- Operating profit before impairment losses and provisions **£65.7m (2010: £47.9m)**
- Total assets increased by **1.2% to £13.9bn (2010: £13.7bn)**
- Total capital ratio **15.5% (2010: 16.6%)**
- Core Tier One capital ratio **10.5% (2010: 11.1%)**
- Gross mortgage advances **up more than threefold to £1,699.7m (2010: £492.8m)**
- Group retail funding as a percentage of total funding **80% (2010: 82%)**

Five Year Summary

Group Income Statements

	2007 £m	2008 £m	2009 £m	2010 £m	**2011 £m**
Net interest receivable	110.7	87.5	53.3	54.9	**71.2**
Other income	433.1	351.7	386.5	387.0	**377.7**
Share of profits from joint ventures and associates	3.7	3.9	0.2	0.3	**0.7**
Profit on disposals of subsidiary undertakings and associates	36.0	31.4	-	1.2	**0.9**
Total income	583.5	474.5	440.0	443.4	**450.5**
Administrative expenses	(416.2)	(389.7)	(383.7)	(395.5)	**(384.8)**
Operating profit before impairment losses and provisions	167.3	84.8	56.3	47.9	**65.7**
Negative goodwill arising on merger	-	-	-	3.1	**-**
Impairment losses on loans and advances	(5.4)	(34.6)	(43.6)	(14.8)	**(30.0)**
Impairment (losses) / recoveries on debt securities	-	(11.5)	1.3	(0.1)	**-**
Provisions for liabilities	(0.8)	(20.8)	4.0	(1.1)	**(13.5)**
Profit before tax from continuing operations	161.1	17.9	18.0	35.0	**22.2**
Tax (expense) / income	(36.3)	2.8	(4.3)	(9.8)	**(6.7)**
Profit from continuing operations	124.8	20.7	13.7	25.2	**15.5**
Operating profit from discontinued operation (net of tax)	1.8	3.1	4.2	-	**-**
Profit on disposal of discontinued operation	-	-	39.7	-	**-**
Profit for the financial year	126.6	23.8	57.6	25.2	**15.5**
Attributable to:					
Members of Skipton Building Society	125.5	22.8	57.4	25.5	**15.4**
Non-controlling interests	1.1	1.0	0.2	(0.3)	**0.1**
	126.6	23.8	57.6	25.2	**15.5**
As at 31 December					
Total assets	12,531	13,647	15,569	13,740	**13,910**

The Group's capital resources profile

	2007	2008	2009	2010	**2011**
Core Tier 1 ratio (%)	8.67	8.61	9.37	11.06	**10.53**
Total capital ratio (%)	12.30	12.28	14.48	16.60	**15.53**
Tier 1 ratio (%)	9.09	9.03	10.77	12.64	**12.02**
Tier 1 capital (before deductions[1]) (£m)	771	780	873	910	**923**
Tier 1 capital (after deductions) (£m)	541	537	691	719	**726**
Gross capital (£m)	935	918	1,063	1,120	**1,117**
Free capital (£m)	631	606	811	854	**842**

Notes

1. Intangible assets.

Chairman's Statement

It is my pleasure to provide my first review as Chairman of Skipton Building Society, having taken on the role last May.

During 2011, the pressures imposed on the Society by the external operating environment and general market conditions stubbornly refused to abate. Tentative signs of recovery in the early part of the year - a slow return to economic growth, small improvements in house prices and a gradual easing of the wholesale markets - receded later on as fears over the financial stability of the Eurozone reared their head.

As I write, the immediate threats to the UK economy appear very real and have extended expectations as to when we can realistically hope to see a return to anything like normality. The uncertainty surrounding the Eurozone, coupled with domestic issues such as the impact of the Government's austerity measures and rising unemployment will necessitate cautious financial management for all businesses, individuals and families in the UK for some time to come.

Against this unsettled backdrop, the Society has continued to fare well, combining prudent financial management with an unfaltering focus for the members for whom we exist, through the products and services we offer. Specific details of our financial performance follow in the ensuing pages. However, I am pleased to summarise here by saying that, on all of our key success measures - profitability, capital, high quality liquidity and funding - we remain in good health and well placed to continue building an even stronger business in the year ahead and beyond. The additional value provided by our diversified Group of subsidiaries has stood us in good stead and once again helped us to weather the economic storms.

> ...we remain in good health and well placed to continue building an even stronger business in the year ahead and beyond.

Ongoing challenges facing the Society, our Group businesses and our members in the year ahead are likely to include the maintenance of an historically low Bank of England Base Rate; a stagnant housing market; a continuing squeeze on household incomes and high unemployment, heightening the possibility of increased arrears as people struggle to maintain their mortgage payments. Our proactive approach to managing arrears cases, coupled with fairness and forbearance for individuals, will ensure we maintain a prudent approach to debt management in the interests of all concerned.

Our members and customers can continue to expect competitive products through whichever channel they choose to do business with us, be it branch, telephone, internet or intermediaries. They tell us that it is the friendly, helpful and personal service we offer that they value most about their relationship with Skipton. We are absolutely committed to ensuring this special value continues to differentiate us from the pack.

As a responsible business, we also strongly believe in helping to enhance the communities to which we and our members belong. In 2011, we did this by investing £297,000 in communities close to our national branch network and Yorkshire Head Office. The Skipton Building Society Charitable Foundation donated £111,000 to charities across the UK which primarily help children and older people in need. And 151 grassroots good causes contributing to the Arts, sport, education and general community enhancement, benefited from Society funding to the tune of £186,000.

At this point, I will take the opportunity to summarise a number of other changes we have made to the Society's Board of Directors over the past 12 months, beginning by extending my thanks to my predecessor as Society Chairman, Alastair Findlay, who stepped down last April after serving five years as a Non-Executive Director. Former Scarborough Chairman and Skipton Non-Executive Director William Worsley also retired from our Board, having completed his term of office, and I would like to thank him too for his valuable contribution. We have recently welcomed two new Non-Executive Directors. In November, Robert East joined our Board. Robert has worked in the industry for more than three decades, holding a variety of senior roles within Barclays before recently being appointed Group Chief Executive of Cattles Limited. And, in January 2012, Graham Picken was appointed. He has also had a distinguished financial services career spanning more than 30 years, including a number of senior roles within HSBC. We expect both Robert and Graham will make a major contribution to the Society's development in the years to come.

We also appointed a new Executive Director in December 2011, Mark Fleet. He brings considerable experience to the Board in his role of Distribution Director and is responsible for the branch network, Skipton Direct, HML and our three IFA businesses.

I must also pay tribute to our skilled and dedicated team of Executives and senior managers, who continue to work tirelessly to ensure a positive ongoing performance for our business. Thanks to this, our members, counterparties and other stakeholders can be confident in our prospects for ongoing success and financial strength.

In fact, none of this would be possible without the entire Skipton team - all our employees - whose unwavering commitment, professionalism and enthusiasm are the key ingredients in the vitality of the Society and wider Group.

All of this means that, whatever issues emerge in the coming months, we will face them with confidence and I look forward to updating you on another year of progress in 12 months' time.

M H Ellis

Chairman

28 February 2012

Group Chief Executive's Report

Introduction

I am pleased to report that the Society recorded another robust performance during 2011, despite the continuation of unprecedented market conditions, while maintaining an unwavering focus on delivering for our members.

As I write, the ongoing economic volatility has resulted in the Bank of England maintaining its Base Rate at an historically low 0.5% for a previously unthinkable three years. While this restorative measure undoubtedly provides some welcome relief for the nation's borrowers, we understand that it is not such good news for savers - including many of our own members who rely on interest from their nest eggs as a top-up retirement income. We have therefore placed great emphasis over the past 12 months on making saving still worthwhile, with a varied and innovative range of accounts offering some of the best returns available.

At the same time, we increased our new lending more than threefold to help more people to achieve their home ownership aspirations, playing our part in supporting the mortgage market. We take pride in our role in offering our customers trusted, expert and individual lifelong financial advice and concentrate on maintaining and enhancing the outstanding personal service we know our members have come to expect from us.

Blueprint for success

The Society entered 2011 with a clear plan centred on maintaining our financial strength, managing the business prudently, ensuring steady growth and offering the best possible value and service to our members. Whilst Group pre-tax profit fell year-on-year, primarily as a result of lower profits from our estate agency business and higher loss provision charges, we further improved our net interest margin during the year as we continued to build a platform for future growth. We have remained profitable throughout one of the longest and deepest financial crises ever known and expect the positive trend to continue as we ensure that the pursuit of appropriate financial returns is balanced with looking after the interests of our members.

...we have remained profitable throughout one of the longest and deepest financial crises ever known...

Our level of high quality liquidity remains a key strength, retaining an optimal amount as a protective cushion against potential market shocks while being careful to manage the costs associated with doing so. Over 80% of our funding comes from retail deposits and we will continue to nurture and develop our savings customer base as our prime source of stable funding. We have reduced our reliance on short term wholesale funds in favour of more prudent medium term secured options and successfully raised over £1bn through our inaugural securitisation issue and other secured wholesale funding initiatives during the year.

Our key financial highlights were as follows:

Profitability

- Pre-tax profits of £22.2m (2010: £35.0m);
- Operating profit before impairment losses and provisions £65.7m (2010: £47.9m);
- £16.3m improvement in our net interest margin (2011: 52bps, 2010: 37bps);

Financial strength

- New mortgage lending up more than threefold to £1.7bn (2010: £0.5bn);
- Total assets up 1.2% to £13.9bn (2010: £13.7bn);
- Total capital ratio remains robust at 15.5% (2010: 16.6%);
- Core Tier 1 ratio was 10.5% (2010: 11.1%);
- Maintained appropriate levels of high quality, highly liquid assets - the proportion of liquidity to shares and deposit liabilities was 24.7% (2010: 27.8%);
- Arrears greater than 2.5% of the balance outstanding only 1.45% of the portfolio (2010: 1.42%).

Focused on members

Savings

Acutely conscious of the plight of savers in the continued high inflation, low interest rate environment, we worked tirelessly during 2011 on their behalf, offering them straightforward and consistent long term good value. The average rate we paid to customers increased by 0.14% to 2.56% (2010: 2.42%) during the year despite Bank Base Rate remaining unchanged at 0.5%.

We also played our part, as a mutual, in encouraging our investors to manage their finances responsibly, by offering innovative products such as our goal-based My Savings range. This allows our members to focus on achieving their personal savings goals and avoiding debt by putting money aside in badged accounts.

Thanks to our competitive and comprehensive ISA offering, we grew our ISA balances by 4.8% over the course of the year, so that even more people reap the benefits of tax-free saving as a key lynchpin of their portfolio. In recognition of our efforts, we won the Best Cash ISA accolade in the *Personal Finance Awards* for the second year running. Continuing this trend, we were also one of the first providers to offer the new government-backed Junior ISAs from 1 November, with a competitive, no strings account, now paying 3.02%. As a result of this strong savings performance, over 91% of our mortgages are now funded by retail deposits. The strength of our mortgage and savings product range as a whole

was further recognised by almost 1,000 independent media best buy table mentions and numerous editorial endorsements during the year.

At the same time, we have continued to cater for our members' general lifetime requirements, with a selection of products designed to provide them and their families with security and peace of mind, including wills and insurance. We are one of only a few building societies with our own, whole of market, advice offering through Skipton Financial Services ('SFS'). As a result, we can help members to navigate a course through the uncertainty posed by the current environment by assisting them with everything from stock market investments to inheritance tax planning. In particular, SFS's market leading investment service, Monitored Informed Investing (*M*II), offers customers peace of mind through proactive fund monitoring and fee refunds in cases of underperformance.

Lending

We significantly but prudently increased our lending levels to help borrowers, winning the "Best National Building Society" award from *What Mortgage* magazine. In line with our mutual commitment to enabling homeownership, we lent almost 50% more than our natural market share of 0.81% during the year, with gross new lending totalling £1,700m compared to £493m in 2010.

The 4.3% growth in our mortgage assets during 2011 compares to an industry (CML) figure of only 0.5%, hence we played our part in trying to stimulate the mortgage market with a range of products available for vital groups such as first time buyers and buy-to-let landlords. These complemented our varied suite of options for all circumstances, from short term fixed rate and tracker mortgages to longer term deals and alternative solutions such as switch-to-fix. The fact that we have been able to increase lending despite the continued market challenges is another powerful demonstration of both our robustness as a business and our confidence in the future.

While arrears have risen slightly, we have strategies in place to ensure effective debt management. We will continue to proactively manage arrears cases, balancing the need for a robust approach with fairness and forbearance for individuals who are experiencing payment difficulty.

Subsidiary performance

Our diversified Group structure continues to contribute to our ongoing financial health, with our range of subsidiary businesses ensuring a valuable contribution to the Group's profitability. Our Estate Agency division, Connells, recorded profits of £35.8m. Although down from £48.1m in 2010, this represents a fine performance in what continues to be an uncertain market.

Profits in our Financial Advice division, which includes SFS, have increased to £2.9m, compared to £1.0m the year before. Our IFA businesses are well prepared for the introduction of the Retail Distribution Review on 1 January 2013, with over 80% of SFS advisers already qualified to the required Diploma standard.

Meanwhile, in the Mortgage Services division, Homeloan Management Limited ('HML') made an operating profit of £0.2m. However, restructuring costs aimed at repositioning the business to take advantage of future opportunities resulted in a net pre-tax loss of £3.1m, compared to a £0.1m profit in 2010. The increased efficiency resulting from this restructuring will improve profitability going forward.

Outlook

The outlook for the markets in which we operate, and the economy in general, remains uncertain, with low GDP growth figures, continued fall-out from government austerity measures, rising unemployment, a flat housing market and the threat of contagion from the Eurozone. These things are likely to result in the continuation of an historically low UK Bank Base Rate for the foreseeable future.

However, for the reasons highlighted above, Skipton remains in a good position to withstand such unusual market conditions. We continue to concentrate on our clear strategy of prudent lending, while offering the best possible returns to our savers. Our goal remains to continue to drive our profit performance while keeping members' interests firmly at the heart of everything we do.

While we are not complacent and fully expect that there will be more challenges ahead of us, our members can continue to have confidence in Skipton as a safe haven for their funds and a source of trusted support for their families, as we continue our unwavering emphasis on them.

David Cutter

D J Cutter

Group Chief Executive

28 February 2012

The Board of Directors


1. Mike Ellis


2. David Cutter


3. Noel Hutton


4. Robert East


5. Mark Fleet


6. Peter Hales


7. Alexandra (Sandy) Kinney


8. Graham Picken


9. Peter (Nimble) Thompson


10. Richard Twigg

1. Mike Ellis — Chairman

Mike joined the Board as Non-Executive Chairman in May 2011 and is also Chairman of the Nominations Committee. Mike is an accountant and was previously Group Finance Director at HBOS plc having formerly been a Director of Halifax plc, where he held a number of senior executive positions, since joining its predecessor, Halifax Building Society, in 1987. Mike is also a Non-Executive Director and Chairman of the Audit Committee at WH Smith plc. In 2007, he was awarded the OBE for his contribution to UK financial services.

2. David Cutter — Group Chief Executive

David, 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 Retail Credit Committee and a member of the Asset & Liability Committee and Board Risk Committee. Externally, he is a Governor of Malsis Preparatory School.

3. Noel Hutton — Vice Chairman

Noel joined the Board as a Non-Executive Director in July 2004. He is a member of the Nominations Committee and 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.

4. Robert East — Non-Executive Director

Robert joined the Board as a Non-Executive Director in November 2011 and is a member of the Board Risk Committee, Nominations Committee and Remuneration Committee. Robert spent most of his professional career with Barclays PLC where he held a number of senior roles in retail and commercial banking and was Chief Risk Officer of its South African subsidiary, Absa. He is now Group Chief Executive of Cattles Limited. He does not hold any other Non-Executive positions.

5. Mark Fleet — Distribution Director

Mark joined Skipton subsidiary Skipton Financial Services as Managing Director in 2008, and joined the Society as Chief Distribution Officer in February 2011. He was appointed to the Board in December 2011 and has responsibility for the Society's distribution via the Branch network and Skipton Direct. He is a member of the Society's Executive Committee, Group Operational Risk Committee and is Chairman of our mortgage servicing division and our three financial advice businesses. Mark's career has been in distribution, customer services and credit management, and prior to joining Skipton he worked in subsidiaries of Standard Chartered Bank, Lloyds TSB and Bank of Ireland.

6. Peter Hales — Non-Executive Director

Peter 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. 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 Board of Trustees for the Chartered Insurance Pensions Scheme, and a member of the Advisory Board of Simply Biz plc.

7. Alexandra (Sandy) Kinney — Non-Executive Director

Sandy 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. During her career as an accountant, Sandy was a Financial Services partner of PricewaterhouseCoopers and was previously a Director at KPMG. She was appointed by the FSA as a Non-Executive Director of the Financial Services Compensation Scheme and served from 2005 until 2011. In September 2010, she joined Irish Life & Permanent Group Holdings plc as a Non-Executive Director, and in January 2012 she was appointed to the Board of MBNA Europe Bank Limited.

8. Graham Picken — Non-Executive Director

Graham was appointed to the Board on 17 January 2012 as a Non-Executive Director and is a member of the Board Audit Committee, Board Risk Committee and Nominations Committee. Graham spent his career in various roles with HSBC, which saw him hold positions as Executive Chairman of First Direct and Chief Executive of the Forward Trust Group. Between 2005 and 2009 he was a Non-Executive Director and then Chief Executive of the Derbyshire Building Society. Now retired, Graham is also a Non-Executive Director of HICL Infrastructure Limited.

9. Peter (Nimble) Thompson — Non-Executive Director

Having been on the Board of Scarborough Building Society for three years, Nimble joined the Skipton Board on its merger in April 2009, and sits on the Remuneration Committee, Audit Committee and Nominations Committee. 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, a Non-Executive Director of a number of other companies and Governor of Giggleswick School. In addition, he was Chairman of Leeds Metropolitan University for six years and Chairman of Eureka! until 2007. He was also Regional Chairman of the Institute of Directors in Yorkshire and the Humber until June 2009, and is a Non-Executive Director nationally.

10. Richard Twigg — Group Finance Director

Richard is a Chartered Accountant who joined the Skipton Group in 1993. He was appointed to the Board in 2002 as Group Finance Director, having previously been Finance Director of both HML and Connells. He chairs the Asset & Liability Committee and is a member of the Society's Executive Committee, Board Risk Committee and the Group's operational risk committees. Richard is also a trustee of the Society's Charitable Foundation and is a Governor of Ermysted's Grammar School, Skipton, and Menston Primary School.

Business Review

Group Structure

Skipton Building Society is the UK's fourth largest building society, with approximately 760,000 members, £13.9bn of assets, and a national presence of over 100 branches. It heads up the Skipton Group, which has 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 an investment portfolio of smaller businesses.

The Group's operating results are regularly reviewed by the Board (the 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'); deposit taking and mortgage lending in the Channel Islands through Skipton International ('SIL'); Skipton Covered Bonds LLP, Darrowby No 1 plc and Beckindale No 1 Limited, the Group's special purpose vehicles used to obtain funding in the wholesale markets; and the intermediate holding company Skipton Group Holdings ('SGHL').
- Estate Agency - including survey and valuations, conveyancing, lettings, asset management and mortgage broking carried out through the Connells group.
- Mortgage Services - mortgage administration services, principally Homeloan Management ('HML').
- Financial Advice - provision of financial advice and broking services through three separate financial advice businesses, Skipton Financial Services ('SFS'), Pearson Jones and Torquil Clark.
- Investment Portfolio - includes a number of small trading companies that do not fall within the core operating segments.

Overview

The Skipton Group has continued to demonstrate the strength of its diversified business model over the last 12 months and remains profitable despite the continuing challenge of the low interest rate environment.

The Group profit before tax in 2011 was £22.2m (2010: £35.0m). A key contributor to this fall in profits year-on-year was the performance of our estate agency business, Connells, which delivered a pre-tax profit of £35.8m (2010: £48.1m), a reduction of £12.3m, but nevertheless, a fine result and one which exceeded our expectations in a continuing difficult market. Our focus on improving the performance of the core Mortgages and Savings business through careful balance sheet management saw the Group net interest margin increase to 0.52% (2010: 0.37%), however this was offset by the Group charge for mortgage losses which increased from £14.8m to £30.0m as we increased provisions against specialist and other loans which we ceased lending on in 2008.

Our capital and liquidity position allowed us to return to controlled and prudent lending with gross mortgage advances in 2011 increasing to £1,699.7m (2010: £492.8m) and allowed us to increase total assets by 1.2% to £13,910.3m (2010: £13,739.5m). As a result of this increase in assets our Core Tier 1 capital ratio was 10.5% (2010: 11.1%).

Collectively, our subsidiaries continue to contribute to the Group's success and, while we remain committed to our diversified business model, we have prudently scaled back further acquisitions while the current economic conditions persist.

Financial performance

Total Group pre-tax profits for 2011 were £22.2m (2010: £35.0m) as set out in the table below:

	2011 £m	2010 £m
Net interest income	71.2	54.9
Other income	374.7	385.0
Fair value gains on financial instruments	3.0	2.0
Profits from sale of subsidiary undertakings	0.9	1.2
Share of profits from joint ventures and associates	0.7	0.3
Total income	450.5	443.4
Administrative expenses	(384.8)	(395.5)
Operating profit before impairment losses and provisions	65.7	47.9
Provisions for liabilities	(13.5)	(1.1)
Impairment losses on loans and advances	(30.0)	(14.8)
Impairment losses on debt securities	-	(0.1)
Negative goodwill on merger	-	3.1
Profit before tax	22.2	35.0
Taxation	(6.7)	(9.8)
Profit after tax	15.5	25.2

Net interest income

The net interest income is the amount earned on assets (mortgages, other loans and liquidity), less that paid on liabilities (retail savings and wholesale funding). The Group's net interest margin for the year increased to 0.52% from 0.37% in 2010 as a result of a continuing focus to widen the margin over the last two years.

The Group's net interest margin increased as a result of ongoing prudent management of the retail savings portfolio by offering appropriate levels of return for savers at rates which are sustainable for the Society. We have also widened the spread between new mortgage and savings business whilst remaining competitive. Finally, a number of previously low yielding mortgages written prior to 2008 have now reverted to the Society's Standard Variable Rate ('SVR') or other higher rates.

These actions have improved the net interest margin of the Group over the past five half-years 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**
Six months to 30 June 2011	**0.50**
Six months to 31 December 2011	**0.52**

Other income

The Group's other income represents the net non-margin revenue generated by the Society and its subsidiaries.

The Group's other income for the year was down 2.7% to £374.7m (2010: £385.0m). Despite a slow start to the year, estate agency income picked up in the second half and Connells saw a £5.0m increase in revenue year-on-year. Within the Mortgage Services division, continued run-off of the portfolios under management and reduced arrears management income, resulted in a fall in revenue of £11.4m. The remaining divisions' other income levels remained comparable with 2010, a creditable result in the uncertain market conditions.

Other income by division is set out below:

	2011 £m	2010 £m
Mortgages and Savings	**21.9**	21.1
Estate Agency	**211.7**	206.7
Mortgage Services	**65.5**	76.9
Financial Advice	**43.7**	42.8
Investment Portfolio	**38.9**	42.1
Inter-divisional adjustments	**(7.0)**	(4.6)
	374.7	385.0

Further details of the Group's performance by business area are set out on pages 16 to 17.

Fair value gains on financial instruments

All derivatives are recorded within the Statement of Financial Position at fair value with any valuation movements being taken to the Income Statement. Derivatives are only used to the extent to which the Group will be affected by changes in interest rates or other market indices and are therefore used solely to hedge risk exposures and not for speculative purposes.

The £3.0m (2010: £2.0m) credit relating to fair value gains and losses on financial instruments represents the net fair value adjustments on derivatives that are matching risk exposures on an economic basis. Some Income Statement volatility arises on these items due to accounting ineffectiveness of designated hedges or because hedge accounting has not been adopted or is not achievable. The credit is primarily due to timing differences in cash flows and interest rate reset dates between the derivative instrument and the hedged assets and liabilities. The impact can be volatile, especially so in current market conditions, but will trend towards zero over time.

Administrative expenses

Total administrative expenses fell by £10.7m, or 2.7%, during 2011 to £384.8m from £395.5m. Included in Group administrative expenses are restructuring costs (predominantly in the Mortgage Services division) of £5.1m (2010: £2.9m), without which the fall in costs would have increased to 3.3%, demonstrating the Group's focus on managing its cost base.

The Society has continued to manage costs and improve efficiencies and has improved its ratio of administrative expenses to mean assets to 0.44% (2010: 0.45%). At a Group level, this management expense ratio is less comparable, given the investments we have made in our trading businesses. However, a continuing focus on cost management across the Group saw the Group cost income ratio improve in the year from 89.26% to 85.55%.

	2011 %	2010 %
Society management expense ratio	**0.44**	0.45
Group management expense ratio	**2.78**	2.70
Group cost / income ratio*	**85.55**	89.26

* Administrative expenses as a percentage of total income before share of profits from joint ventures and associates.

Impairment losses on loans and advances

The Group's impairment charge on loans and advances increased year-on-year to £30.0m (2010: £14.8m) and is broken down as follows:

	2011 £m	2010 £m
Residential (Society)	**3.3**	5.3
Residential (Amber and NYM)	**14.3**	1.8
Commercial and other loans	**12.4**	7.7
	30.0	14.8

The performance of the prime residential mortgage book remains excellent and the continuing low emergence of arrears results in another low impairment charge for the year. Within our specialist portfolios in Amber and NYM, arrears levels have increased during 2011 which, coupled with a prudent approach to provisioning, has led to a higher loan impairment charge for the year. The impairment charge for commercial and other loans reflects legacy business written prior to 2009.

Business Review - continued

Provisions for liabilities

Provisions for liabilities include our share of the costs of the Financial Services Compensation Scheme ('FSCS') together with other amounts in respect of various customer claims. The charge for the year for the FSCS levy is based on our latest estimate of what HM Treasury will charge the FSCS for loans to finance depositor protection and amounted to £5.8m (2010: £0.9m). Other provisions made in the year amounted to £7.7m (2010: £0.2m) in respect of other matters including claims against Connells' survey and valuation division and customer redress within our IFA portfolio.

We expect substantially all these provisions to crystallise within the next two years.

Taxation

The Group's effective tax rate is 31.2% (2010: 28.2%) compared with the standard rate of Corporation tax of 26.5% (2010: 28.0%). The rate differential is mainly due to non-taxable profits arising on asset disposals, expenditure which is not deductible for tax purposes and the impact of the Corporation tax rate change on brought forward deferred tax asset balances.

The reduction of the UK Corporation tax rate from 26% to 25% from 1 April 2012 has resulted in a deferred tax charge arising from the reduction in the carrying value of the net deferred tax asset to reflect the anticipated rate of tax at which the asset is expected to reverse.

Performance by business area

The Group's results by business segment are as follows:

Business Area	2011 £m	2010* £m
Mortgages and Savings	**(13.5)**	(11.7)
Estate Agency	**35.8**	48.1
Mortgage Services	**(3.1)**	0.1
Financial Advice	**2.9**	1.0
Investment Portfolio	**1.3**	3.4
Inter-divisional adjustments**	**(1.2)**	(5.9)
Profit before tax	**22.2**	35.0

* In 2011, the Group reviewed its operating segments and 2010 figures have been represented accordingly. See note 34 for further details.

** Inter-divisional adjustments relate primarily to the elimination of intra-divisional trading.

Mortgages and Savings

The Group's Mortgages and Savings division made a loss before tax of £13.5m, after charging £5.4m for the FSCS levy (2010: £nil), compared to a loss of £11.7m in 2010. Excluding the impact of the FSCS levy, underlying performance improved by £3.6m. The performance improvement seen during the latter part of 2010 continued throughout 2011, and the division achieved a break even position in H2 2011 prior to the FSCS charge.

The key driver of the improved performance in the Mortgages and Savings division has been an improvement in its net interest margin, which has improved 14bps in 2011 to 0.51%, compared to 0.37% in 2010.

New lending volumes in the year were £1.7bn, compared to £0.5bn in 2010, driven by a strong presence in the intermediary mortgage market, and an enhanced range of mortgage products, whilst the retail savings proposition has been refined and now offers an attractive range of offerings across all our channels, providing a steady flow of competitively priced funding to the Society.

Tight cost control continues to be a key focus and, despite an environment of rising commodity prices fuelled by inflationary increases and the increase in the rate of VAT, administrative expenses in the period amounted to £72.9m, down from £76.1m in 2010.

The Society's controlled return to mortgage lending and refreshed savings proposition has also created opportunities to improve other income streams and the division increased its other income in 2011 to £21.9m (2010: £21.1m).

The focus for both Amber and NYM has been to manage the level of arrears through proactive collections processes as their mortgage books run off. The percentage of accounts in arrears more than 2.5% of the balance outstanding were 7.14% and 5.30% respectively at 31 December 2011 (2010: 6.39% and 4.11%), however we are pleased to note that the number of accounts in arrears fell in both portfolios during the last quarter of 2011. The aggregate size of these two portfolios has reduced to £1.86bn from £2.00bn at the end of 2010.

Our Channel Islands operation, SIL, made a profit before tax of £6.2m (2010: £4.1m). SIL has continued to grow its mortgage book with mortgage assets in Guernsey and Jersey increasing by £87.2m in the year to £569.9m (2010: £482.7m) and the quality of this book remains good.

Residential loan impairment and arrears levels across the division have been closely monitored during 2011, however, the total residential loan impairment charge for the division increased from £7.1m to £17.6m, with the majority of this increase being seen within the specialist lending book.

Commercial and other loan impairment also continues to be monitored closely, and a prudent position continues to be taken, resulting in a commercial provision charge of £11.9m (2010: £7.3m). The impairment charge for commercial and other loans reflects legacy business which ceased to be written in 2008.

Estate Agency

The Estate Agency division achieved a profit before tax of £35.8m (2010: £48.1m) in 2011. Following the slow down in house sales activity in the second half of 2010, Connells entered 2011 with a comparatively low sales pipeline, however, volumes gradually improved during the year. As a result of this improvement Connells' second half profit before tax increased to £20.9m, compared to £14.9m for the first six months.

The Estate Agency division continues to focus on improving revenues from property sales and ancillary activities and maintaining a tight control on costs. Small additional investments continue to be made in the core estate agency business, mortgage services and the wider Connells group, where opportunities are identified.

During the year, Connells increased its residential estate agency footprint through the acquisition of the Burchell Edwards chain, a 16-branch estate agency business. Investment continues in mortgage services where consultant numbers have risen significantly in 2011, the benefits of which will be seen in 2012.

Mortgage Services

HML remains the market leader in the UK third party mortgage administration services market, with a market share in the UK of circa 68% and total assets under management of £41.8bn (2010: £44.5bn).

HML recorded an operating profit before restructuring costs of £0.2m in 2011 (2010: £2.6m). After the costs associated with rationalising the business, HML recorded a net loss before tax of £3.1m compared to a profit of £0.1m in 2010. The difficult trading conditions that have been a feature of the market since the latter part of 2007 continued through 2011 and HML experienced further contraction in its portfolio of assets under administration, which impacted both its income and margin. A combination of HML's high quality credit management and a continuation of low interest rates saw client arrears reduce during the year which, whilst benefitting the client, does impact adversely on HML's income.

Consequently, HML continued to right-size its business model to better align it to prevailing market conditions. This was achieved following continued investment in IT systems and processes, which continue to drive productivity benefits and reduce errors.

HML has also continued to develop its appeal across the wider financial services market and, during the last quarter of 2011 on-boarded two significant new mortgage portfolios. These portfolios were in addition to 11 new standby servicing contracts that were signed during the year, including new clients in the Irish market.

Financial Advice

The Financial Advice division continues to offer high quality financial advice offering customers a range of services including wealth management, execution only investments, financial planning and employee benefits.

The division's trading performance improved in 2011, generating a profit before tax of £2.9m (2010: £1.0m) despite the uncertainty created by the volatility in the stock markets. Particularly pleasing are the performances of SFS with the implementation and growth of its Monitored Informed Investing service which is available via the Skipton branch network and the integration of Parnell Fisher Child into Pearson Jones in 2011.

On 30 May 2011, the Group sold the trade and assets of Thomson Shepherd Limited to its management team, the effect of the disposal of this small business is not material to the Group and coupled with the integration of Parnell Fisher Child into Pearson Jones has helped to streamline our advisory model.

All our Financial Advice businesses are well positioned to successfully transition through the Retail Distribution Review and have the potential to create good long term value for the Group.

Investment Portfolio

The Investment Portfolio division includes a range of other businesses for which the current economic environment has created opportunities for some but, equally, has been more challenging for others.

Skipton Business Finance (provider of invoice discounting) and The Private Health Partnership (specialising in private medical insurance and medical support) have both reported a healthy growth in profits in 2011. 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. In contrast, Mutual One (internal audit and compliance, risk and governance specialist) had a good year for new business and won a number of new clients. Jade (product and software provider) continued to develop and launched two key products. The first is a .net database (JOOB Data Store) and the second is a mobile enterprise multi-platform application (JOOB Mobile). JOOB Mobile was also selected as a finalist at Tech-Ed 2011 North America.

Financial position

Loans and advances to customers

After significantly scaling back lending during 2009 and early 2010 in order to manage the size of the balance sheet and maintain a strong capital position, we returned to controlled lending growth in 2011. Group gross mortgage advances increased to £1,699.7m (2010: £492.8m).

An analysis of gross mortgage advances is shown below:

	2011 £m	2010 £m
Society	**1,548.2**	353.6
Amber Homeloans*	**0.9**	1.1
North Yorkshire Mortgages*	**0.2**	0.3
Skipton International	**150.4**	137.8
	1,699.7	492.8

* Following the decision to cease new lending in 2008, these advances represent further loans to existing borrowers.

Business Review - continued

Society lending continues to be well diversified by product type and geographical distribution. As at 31 December 2011 the Society's average indexed loan-to-value ('LTV') for the residential mortgage book was 50.9% (2010: 50.6%). This well-managed spread of risk ensures that the quality of the Society's mortgage lending remains high.

Due to the specialist nature of the Amber and NYM portfolios, these mortgage books have a typically higher average indexed LTV of 82.1% (2010: 80.0%) and 81.7% (2010: 80.1%) respectively.

SIL grew its mortgage book in the year with gross residential mortgage advances totalling £150.4m (2010: £137.8m), however, the average indexed LTV has increased only marginally to 61.1% (2010: 59.8%) demonstrating our focus on managing our credit risk exposures.

Overall, the Group's average indexed LTV for the residential mortgage book remained at 55.5% (2010: 55.5%).

The Society launched a new range of buy-to-let fixed rate and base rate tracker loans up to 70% LTV in March 2011, however the Group's total new advances on buy-to-let products remained relatively low at £128m or 7.5% of the Group's gross mortgage lending (2010: £18m or 3.6%). 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 LTV ratios compared with our other residential lending, and the level of rental cover compared with the mortgage payments.

Overall, the Group's loans and advances have increased by 4% to £10,100.0m from £9,688.1m at the end of 2010 as set out in the table below:

	2011 £m	2010 £m
Residential mortgages	9,532.5	9,092.7
Commercial loans	467.1	501.2
Other lending:		
Debt factoring loans	42.0	39.5
Other loans	58.4	54.7
Gross balances	10,100.0	9,688.1
Impairment provisions	(88.1)	(79.4)
Fair value adjustments for hedged risk	240.9	206.0
	10,252.8	9,814.7

The Group continues to manage loans which have gone into arrears, supporting the borrower where possible whilst protecting the business for the benefit of all members. Arrears, where the arrears balance exceeds 2.5% of the capital balance were 1,377 cases (2010: 1,349), representing 1.45% (2010: 1.42%) of the book. An analysis of the Group's residential arrears is shown below:

Cases where arrears balance was greater than 2.5% of the total outstanding balance	2011	2010
Society		
Number of cases	474	513
% of Society book	0.60%	0.66%
Impairment provision on residential mortgages	£13.4m	£13.9m
Amber Homeloans		
Number of cases	625	602
% of Amber book	7.14%	6.39%
Impairment provision on residential mortgages	£32.2m	£33.8m
North Yorkshire Mortgages		
Number of cases	276	231
% of NYM book	5.30%	4.11%
Impairment provision on residential mortgages	£14.0m	£14.6m
Skipton International		
Number of cases	2	3
% of SIL book	0.07%	0.11%
Impairment provision on residential mortgages	-	-
Total		
Number of cases	1,377	1,349
% of total book	1.45%	1.42%
Impairment provision on residential mortgages (note 16)	£59.6m	£62.3m

The specialist nature of Amber and NYM mortgages means these subsidiary businesses typically have higher levels of arrears than those in the Society. However, action continues to be taken to manage arrears in these portfolios. These actions include ceasing new lending in Amber and NYM in March 2008 and implementing proactive collections processes, and forbearance processes where appropriate, for these closed portfolios. Whilst many of the collections activities have seen positive results we have seen a small number of customers fall back into arrears after a period of payment forbearance, partly due to increasing pressures on household expenditure, and we continue to provide prudently.

The Group also stopped offering commercial loans in November 2008 and the book continues to run off. The Society's commercial book remains strong with 19 (2010: 9) cases where the arrears balance was greater than 2.5% of the total outstanding balance. Whilst this represents an increase since December 2010, the capital value associated with these loans is only 1.18% (2010: 0.40%) of the commercial portfolio. Close monitoring of the credit performance of the commercial book continues and prudent loss impairment provisions are made where appropriate.

SIL continued to grow its Channel Islands mortgage book during the year, and mortgage balances stood at £569.9m at the year end (2010: £482.7m); the quality of this book remains excellent with few cases in arrears.

Where appropriate for customers' needs, we apply a policy of forbearance and may grant a concession to borrowers. This may be applied where actual or apparent financial stress of the customer is considered to be short term with a potential to be recovered. A concession may involve arrears capitalisation, a reduction in the monthly payment, a conversion to interest only or a mortgage term extension. These strategies are undertaken in order to achieve reduced long term arrears and allow the best outcome for both the customer and the business by dealing with arrears at an early stage. The customer accounts are monitored to ensure that these strategies remain appropriate. Further details on the forbearance strategies of the Group can be found within note 33 which details all account renegotiations regardless of whether or not our customer has experienced financial difficulty in repaying their loan with the Group. For clarity, the table in note 33 illustrates all balances which have had their terms renegotiated in the last two years, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms.

Liquidity

Whilst levels of liquidity have been managed down during the year, the Group continues to hold prudent, historically high, levels while uncertainty remains in the economy and to enable it to address forthcoming wholesale maturities. An analysis of the Group's liquidity position is shown below:

	2011	2010
Liquidity balance (£m)	**3,020.6**	3,379.7
As % of shares and deposit liabilities (%)	**24.74**	27.75
Core liquidity buffer*-eligible assets (£m)	**1,236.8**	1,902.4
Core liquidity buffer* as % of liquidity balance (%)	**40.95**	56.29

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

The Group's treasury investments are held to provide liquidity and 98% (2010: 98%) of the Group's treasury investments are rated A3 or better (as shown below):

Rating	2011 £m	2010 £m
Aaa	**2,082.9**	2,572.6
Aa1	**74.1**	82.6
Aa2	**279.0**	171.5
Aa3	**144.4**	307.3
A1	**126.4**	153.5
A2	**226.0**	9.3
A3	**33.6**	25.1
Baa1	**1.9**	6.3
Baa2	**4.5**	6.7
Baa3	**2.5**	34.7
Ba1	**1.7**	-
Ba2	**22.7**	-
Caa1	**6.6**	6.6
Caa2	**14.3**	-
Unrated:		
Building societies	**-**	3.0
Local authorities	**-**	0.5
	3,020.6	3,379.7

With the exception of some building societies and local authorities where separate credit analysis is undertaken, the Group's 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. All treasury 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 the Group Wholesale Credit Committee (a sub-committee of ALCO).

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

Within the treasury investments portfolio, the Group has no direct sovereign exposure to Greece, Ireland, Italy, Portugal or Spain (2010: £nil). At 31 December 2011, the Group had £38m of senior debt exposure to financial institutions based in Ireland, £23m of which was repaid in full after the year end, and the remainder is due to mature in June 2012. The Group also has some small derivative exposures to banks based in Spain and France. Whilst the political and economic environment in Europe remains very challenging, we do not currently expect any impairment to be required for these investments.

The Society regularly conducts an Individual Liquidity Adequacy Assessment ('ILAA') in accordance with the Financial Services Authority's ('FSA') liquidity guidelines and the Board remains satisfied that the Group has sufficient liquid assets at its disposal, even under stressed scenarios, to meet its obligations as they fall due.

Funding

As a mutual, the Group is required to obtain the majority of its funding through retail member deposits and the Society retains a strong retail savings base. As a result, less reliance is placed on wholesale markets.

Retail

The savings environment is increasingly competitive as institutions who have previously relied on wholesale funds continue to seek a larger share of the retail market and savers choose to pay down their debts or seek higher returns from equity-linked investment products. Our focus has been to retain our savings balances as the prime source of our stable funding base especially given the limited access we have to the unsecured wholesale markets.

At 31 December 2011, £9,280.4m (2010: £9,388.5m) of our funding comes from retail savings representing 80.2% (2010: 82.4%) of our total funding.

Business Review - continued

In addition to our UK retail funding above, the Group also accepts deposits through our Guernsey based subsidiary, SIL. The benefits of offshore funding have reduced under the FSA's new liquidity regime, so the Group has allowed some of this funding to gradually run off over the last two years. Offshore retail balances decreased in the year to £727.1m (2010: £749.3m).

Wholesale

The remainder of the Group's funding comes from the wholesale markets. At 31 December 2011 our wholesale funding balances amounted to £2,169.4m (2010: £2,002.2m), an increase of £167.2m during the year.

The Group successfully launched its inaugural securitisation transaction in March 2011 through Darrowby No 1 plc raising £800m of funds, some of which was secured through a subsequent repo transaction with a third party. Additionally, the Group raised £300m of secured term wholesale funding in November 2011 through a loan from a third party to the Society's subsidiary, Beckindale No 1 Limited. The funding raised through these longer term secured wholesale transactions allowed the Group to cancel its outstanding £750m covered bond issuance and further reduce its exposure to short term wholesale funding.

Consequently, the Group's wholesale funding ratio increased to 19.8% (2010: 17.6%).

The following tables analyse the change in the composition of our wholesale funding since December 2010 and the maturity of our wholesale funding. We have reduced our reliance on short term wholesale funds in favour of more prudent medium term secured options.

	2011 £m	2010 £m
Repo and other secured agreements	**1,064.9**	306.0
Deposits	**6.6**	887.1
Certificates of deposits	**19.1**	71.1
Medium term notes	**758.7**	738.0
Securitisation	**320.1**	-
	2,169.4	2,002.2

	2011 £m	2010 £m
Repayable on demand	**45.7**	56.0
In not more than three months	**163.4**	325.6
In more than three months but not more than one year	**893.8**	797.5
In more than one year but not more than five years	**1,066.5**	823.1
	2,169.4	2,002.2

The Society is assigned credit ratings by two major credit rating agencies, Fitch and Moody's. In October 2011 Moody's concluded its review of a number of UK banks and building societies' ratings, and downgraded our long term rating by three notches from Baa1 to Ba1. In November 2011, Fitch also announced the results of its own review and downgraded the Society two notches, moving our long term rating from A- to BBB. Whilst the ratings agencies' actions were disappointing, the impact on the Society was entirely manageable and planned for, as the Group's funding profile is now much less sensitive to our ratings.

Our securitisation through Darrowby No 1 plc retained its AAA rating from both agencies.

Capital

The 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 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.

The following table shows the composition of the Group's capital at 31 December 2011:

	2011 £m	2010 £m
Tier 1		
Reserves	**806.5**	809.6
Permanent Interest Bearing Shares (note 1)	**90.0**	90.0
Pension fund deficit add back (note 2)	**13.5**	3.7
Deductions from Tier 1 capital (note 3)	**(196.7)**	(190.9)
Unrealised (gains) / losses on available-for-sale debt securities	**(6.0)**	6.9
Unrealised losses / (gains) on cash flow hedges	**19.0**	(0.3)
Total Tier 1 capital	**726.3**	719.0
Tier 2		
Subordinated debt (note 1)	**197.4**	204.4
Collective impairment allowance	**14.9**	21.2
Total Tier 2 capital	**212.3**	225.6
Total capital	**938.6**	944.6
Risk weighted assets		
Retail mortgages	**3,944.9**	3,756.1
Commercial loans	**467.0**	432.7
Treasury assets	**441.7**	362.5
Other assets	**506.6**	469.8
Operational risk	**675.3**	662.6
Market risk	**7.5**	5.7
	6,043.0	5,689.4
Core Tier 1 (%) (note 4)	**10.53**	11.06
Tier 1 ratio (%) (note 4)	**12.02**	12.64
Total capital (%) (note 4)	**15.53**	16.60
Tier 2 to Tier 1 ratio (%)	**29.23**	31.38

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.

Business Review - continued

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 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 minimum capital resource requirements as at 31 December 2011. Both ratios are above the Pillar 1 requirement.

	UK consolidation group		Solo consolidation group	
	2011	2010	**2011**	2010
Capital resources (£m)	**921.6**	928.2	**842.1**	848.2
Minimum Pillar 1 capital resource requirement (£m)	**446.4**	419.2	**412.1**	388.6
Capital ratio (%)	**206.5**	221.4	**204.3**	218.3

During the year the Group has continued to regularly perform internal stress tests on its capital base, and these tests have consistently demonstrated a capital surplus after allowing for extreme stress scenarios.

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 schemes at 31 December 2011 resulted in a deficit of £43.6m (2010: £31.8m) using the methodology set out in IAS 19.

We continue to take steps to manage the deficit, and all the schemes are closed to new members and future accrual of benefit. In order to try and reduce the deficit, special contributions totalling £29.8m have been paid into the schemes in the last five years between 2007 and 2011.

Additionally, we have undertaken a number of other initiatives aimed at managing the funding deficit and associated long-tail risk including an early retirement exercise and an enhanced pension transfer exercise which has resulted in £20.8m of the liability being extinguished in early 2011.

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

Outlook

The UK's economic recovery still remains fragile and the pace of economic recovery is expected to be subdued in the short to medium term. As a result it is expected that the Bank of England is likely to keep official interest rates low for the next few years in order to offset the dampening impact of spending cuts and fiscal tightening.

Competition within the retail savings space is expected to continue unabated as banks and building societies compete aggressively for retail funds. The Society remains committed to offering value to members whilst also keeping the cost of retail funding at a sustainable level.

The availability of mortgage lending in the UK market will continue to be affected by the increasing price of marginal retail funding, liquidity and capital requirements as new and tougher regulation is implemented. This, together with the uncertain economic outlook is likely to see the current subdued housing markets continue for the foreseeable future, although, in the absence of a severe double dip recession, we believe that the continuing shortage of supply of housing in the UK will protect house prices from significant falls.

The regulatory landscape also continues to evolve at pace, 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 continued to trade profitably during 2011, and we are confident that we will continue to provide value to our members and customers.

R J Twigg

Group Finance Director

28 February 2012


SKIPTON BUILDING SOCIETY

Directors' Report

The Directors have pleasure in presenting their Annual Report and Accounts for the year ended 31 December 2011.

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 2011 and 2010 is set out in the Business Review on pages 14 to 22.

Business objectives

The Society's long term objectives remain to maximise the value it provides to its retail savings and borrowing members, to create rewarding employment for its employees and support the communities in which it operates. The Directors believe that our mutual status as a building society will continue to enable us to deliver attractive products and services to customers and we will continue to profitably develop the core mortgages and savings business, complemented by the returns generated by our subsidiary companies, in pursuit of our objectives.

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 22 report on the performance of the business and its future objectives.

Key performance indicators ('KPIs')

The Board and management use the following KPIs in monitoring business performance towards achievement of the Group's strategic objectives.

The Group's Financial KPIs are reviewed further in the Business Review on pages 14 to 22.

Key performance indicator	Why?	2011	2010
Group pre-tax profit	Provides the capital to enable the business to develop.	**£22.2m**	£35.0m
Group interest margin (% of mean assets)	Demonstrates the ongoing earning potential of the business.	**0.52%**	0.37%
Group cost income ratio	Managing costs is essential in ensuring that we increase efficiency across the business.	**85.55%**	89.26%
Group impairment charge	Indicates the level of delinquency within the loan portfolio.	**£30.0m**	£14.8m
Gross mortgage advances	Prudent controlled lending ensures the long term security of the business.	**£1,699.7m**	£492.8m
Group capital adequacy measures:	Maintaining a strong capital base ensures the Group remains financially strong.		
Core Tier 1 ratio		**10.53%**	11.06%
Tier 1 ratio		**12.02%**	12.64%
Tier 1 capital (before deductions)		**£923.0m**	£909.9m
Tier 1 capital (after deductions)		**£726.3m**	£719.0m
Group liquidity adequacy measures:	Maintaining appropriate levels of liquidity to ensure we can meet our financial obligations as they fall due.		
Liquidity as % of shares, deposits and liabilities		**24.74%**	27.75%
Core liquidity buffer		**£1,236.8m**	£1,902.4m
Group retail funding as a % of total funding	As a mutual, the Group is required to obtain the majority of its funding through retail member deposits.	**80.21%**	82.37%

Non-Financial KPIs

Customer measures

Developing the relationship with our customers and ensuring we meet their needs is vital to our success. We therefore measure levels of customer satisfaction through an ongoing research project which explores levels of satisfaction and advocacy, as well as gathering customer feedback on specific elements of service. Over four fifths of customers who responded (83%) rated Skipton Building Society as 4 or 5 out of 5 for overall satisfaction in 2011.

Employee measures

We know that delivering our strategy and improving the experience our customers have with us needs employees who are loyal, passionate and committed (i.e. engaged) to the Society and its aims. We therefore measure employee engagement, through the use of employee surveys, which also gives us feedback on our culture and how well we are living our values. The results of the latest survey showed that the employee engagement index in the Society in 2011 was 77% which is above the financial services benchmark of 70-75%.

Profits and capital

Total Group profit before tax was £22.2m (2010: £35.0m). The profit after tax transferred to the general reserve was £15.5m (2010: £25.5m).

Total Group reserves at 31 December 2011 were £813.7m (2010: £818.0m) including the available-for-sale reserve of £6.0m (2010: £(6.9)m) and the cash flow hedging reserve of £(19.0)m (2010: £0.3m).

Gross capital at 31 December 2011 was £1,116.5m (2010: £1,120.0m) including £214.2m (2010: £214.2m) of subordinated liabilities and £85.8m (2010: £84.7m) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings at 31 December 2011 was 9.14% (2010: 9.20%) and the free capital ratio was 6.89% (2010: 7.01%).

Mortgage arrears

Group mortgage balances at 31 December 2011 included 561 mortgage cases (2010: 564), either in possession or where payments were 12 months or more in arrears. The capital balances of these loans were £95.4m (2010: £96.7m). The total amount of arrears on those loans was £8.6m (2010: £8.1m).

Charitable donations

During the year the Group made charitable donations of £0.1m (2010: £0.1m). No contributions were made for political purposes (2010: £nil).

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 trade creditor days as at 31 December 2011 for the Group was 19 days (2010: 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, market 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 Risk Management Report on pages 28 to 33 and in note 33.

The risk management objectives and policies of the Group are also shown in the Risk Management Report.

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 age, 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 employees 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 employees 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 employee trade union ('SURGE'), with which management meets regularly to consult and negotiate on a wide variety of matters and to which employees 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

Directors' Report - continued

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 45, 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; and
- 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 22 and the Risk Management Report on pages 28 to 33. 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 M H Ellis	(Chairman) (appointed 24 May 2011)
Mr C N Hutton	(Vice Chairman)
Mr D J Cutter*	(Group Chief Executive)
Mr R D East	(appointed 29 November 2011)
Mr M R Fleet*	(appointed 6 December 2011)
Mr A I Findlay	(resigned 24 May 2011)
Mr P R Hales	
Ms A B E Kinney	
Mr P J S Thompson	
Mr R J Twigg*	
Mr W R Worsley	(retired 3 May 2011)

* Executive Directors

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

No Director at 31 December 2011 had any interest in the shares of any group undertaking at 31 December 2011.

On 17 January 2012, Mr G E Picken was appointed to the Board as a Non-Executive Director.

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

M H Ellis

Chairman

28 February 2012

Risk Management Report

Risk management framework

Through the Group's risk management framework and governance structure, the Group has a formal mechanism for identifying and addressing 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, as follows:

- 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, Market and Liquidity) and related independent Compliance, Information Security and Insurance functions. 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'), Retail Credit Committee ('RCC'), Capital Committee ('CC') and Group Operational Risk Committee ('GORC')) responsible for setting and monitoring the Group's adherence to policy. The independent Group risk functions are represented on each of these risk committees. A Board Risk Committee, headed by a Non-Executive Chairman, is responsible for oversight of the risk management framework and monitoring of the business risk profile against Board approved risk appetites.
- 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 predominantly focused in the UK and is to a large extent 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 (Bank Base Rate 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 past two years to improve interest margins have assisted in 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 which were put in place during the height of the financial crisis, together with tougher regulatory requirements on liquidity, will result in savings rates remaining high in relation to Bank Base Rate and create ongoing margin pressure.

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 rising unemployment creating higher levels of arrears and possessions, particularly in the Group's non-prime mortgage portfolios within Amber and NYM.

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 puts pressure on Connells' income levels. However, the Estate Agency division is partially protected against the performance of its core business through its own diversification into complementary businesses such as surveys and valuation and asset management.

The general subdued nature of the mortgage and housing market within the UK continues to impact the business performance of the Mortgage Services division as established lenders continue to run off their mortgage portfolios due to liquidity and capital constraints whilst new entrants to the lending market encounter difficulty securing adequate funding and FSA approval.

The Financial Advice division is also exposed to the wider UK economy. The significant fluctuations this year in the level of the FTSE will undoubtedly affect the confidence and the willingness of some customers to invest in longer term equity based products. The current uncertainty surrounding the Eurozone has also affected people's confidence in the overall economy.

However, the ability of the Group to maintain profitability and generate capital, in what continues to be a tough external environment, provides confidence that the Group will withstand the ongoing economic pressures that we expect to continue for the next few years.

Credit risk

Credit risk is the risk of suffering financial loss should borrowers or counterparties default on their contractual obligations to the Group.

The Group faces this risk from its lending to:

- individual customers (retail mortgages);
- businesses (through past commercial lending). The

Society ceased new commercial lending in November 2008; 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.

Market background

The key driver of credit risk remains a further slowdown in the UK economy which could lead to higher unemployment, deterioration in household finances and falls in house prices, all of which would increase arrears and defaults. Whilst the economic outlook remains fragile, the Group plans to maintain a cautious approach to new lending.

Wholesale markets remain volatile, particularly within the Eurozone where the uncertainties surrounding the future of countries within the single currency continues and, whilst the Group has some exposure to European entities, we continue to be vigilant and reduce our lending to counterparties accordingly.

Risk mitigation

The controlled management of credit risk is critical to the Group's overall strategy. The Group has therefore 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 risk appetite. The RCC provides oversight to the effectiveness of all credit management across the Group and the controls in place ensure lending is within the Board approved credit risk appetite.

Retail mortgage lending to customers

The Group currently lends in the prime residential UK mortgage market, including buy-to-let, through the Society and via Skipton International in the Channel Islands.

We have established comprehensive risk management processes in accordance with the Board's credit risk appetite which defines a number of limits regarding customer and collateral credit quality to which all lending activity must adhere. The Group maintains a low risk appetite for new lending and will continue to be especially cautious whilst current economic conditions remain.

The credit decision process is achieved by automated credit scoring and policy rules within 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 the Board's risk appetite. The Group also has credit exposures through Amber and NYM which comprise residential UK mortgages, including buy-to-let, across prime and sub-prime lending markets. In light of the deteriorating economic conditions in early 2008, we ceased new lending in these portfolios in March 2008.

The Group's collections and recoveries functions aim to provide a responsive and effective operation for the arrears management process. We seek to engage in early communication with borrowers experiencing difficulty in meeting their repayments, to obtain their commitment to maintaining or re-establishing a regular payment plan. We consider forbearance options on a case by case basis in line with industry guidance and best practice. Such options include capitalisation of arrears, interest only concessions, payment holidays and term extensions where these are in the interests of the borrower and the Group. The impact of any such forbearance is recognised within our provisioning policy.

Commercial lending to customers and businesses

The Society retains a commercial loan portfolio which is UK based and, following a reduction in the Group's risk appetite, was closed to new lending in November 2008. We have retained an appropriately skilled team of staff to ensure these loans are managed appropriately and their credit performance is actively monitored. We consider forbearance options on a case by case basis in line with industry guidance and best practice. Such options include capitalisation of arrears and interest only concessions. The impact of any such forbearance is recognised within our provisioning policy.

Other loans

These loans include a number of business and personal loans, and loans made by our factored debt and invoice discounting business, Skipton Business Finance, which continue to be managed by appropriately skilled teams.

Wholesale lending to other financial institutions

Wholesale credit risk arises from the wholesale investments made by the Society's Treasury function, which is responsible for managing this aspect of credit risk in line with Board approved risk appetite and wholesale credit policies. Wholesale counterparty limits are reviewed monthly by the Group Wholesale Credit Committee (a sub-committee of ALCO) based on analyses of counterparties' financial performance, ratings and other market information to ensure that limits remain within our risk appetite. During 2011, in light of the continuing uncertain global economic outlook, we have further reduced the number of counterparties to whom we will lend, and for those that remain, we have reviewed both the amount and duration of any limits.

A further deterioration in wholesale credit markets could lead to volatility in the Group's portfolio of available-for-sale assets together with the risk of further impairment within our treasury investments portfolio.

The Group has no direct sovereign exposure to Portugal, Ireland, Italy, Greece or Spain. At the year end, the Group

Risk Management Report - continued

had a £38m exposure to Irish financial institutions and a net derivative exposure amounting to £3.8m to a Spanish bank. Since the year end the Irish exposures have reduced to £15m and the remaining exposures are expected to mature by 30 June 2012.

The Group also has exposures to banks in other Eurozone countries and to a number of European Supranational Banks which it expects to maintain in the ordinary course of its business.

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

Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost. The Group has, therefore, developed comprehensive funding and liquidity policies to ensure that it maintains sufficient liquid assets to be able to meet all financial obligations and maintain public confidence.

Market background

Wholesale funding markets are not operating effectively which has reduced the supply and increased the cost of wholesale funds. The maturity and withdrawal of Government support schemes and the introduction of the new regulatory liquidity regime is also expected to increase the demand for longer term wholesale funding and stable retail funds, while requiring banks to maintain better quality, albeit lower yielding, liquid assets.

Risk mitigation

The Society's Treasury function is responsible for the day to day management of the Group's liquidity and wholesale funding. 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 and Risk personnel (i.e. independent of Treasury) and additionally, a series of liquidity stress tests are performed weekly by Risk and formally reported to ALCO and the Board to ensure that the Group maintains adequate liquidity for business purposes even under stressed conditions.

The Group's liquidity and funding policies have been fundamentally reviewed and enhanced in line with the FSA's liquidity regime FSA Policy Statement 09/16 "Strengthening Liquidity Standards" and, since June 2010, the Group has reported its liquidity position against Individual Liquidity Guidance ('ILG') provided by the FSA for regulatory purposes. The Group continues to exceed both the ILG requirement and satisfy its own internal liquidity risk appetite.

The Group continued to actively manage its funding profile during the year and has raised over £1bn of secured long term funding during the year, through RMBS bonds issued by its securitisation vehicle Darrowby No 1 plc and similar private transactions. The longer term unsecured wholesale markets remain largely unavailable for the Society. The Group's main source of funding is retail deposits which accounted for 80% (2010: 82%) of our total funding.

We have also increased the quality of the Group's liquidity portfolio by focussing on high quality UK Government issued debt and, at 31 December 2011, the proportion of our liquidity rated A3 or above was 98%. We continue to maintain a close watching brief on the money markets and hold prudent levels of liquidity.

Market risk

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk, including the use of derivatives, foreign currency risk and equity risk.

The Society's treasury function is responsible for managing the Group's exposure to all aspects of market risk within the operational limits set out in the Group's treasury policies. ALCO approves the Group's treasury policies and receives regular reports on all aspects of market risk exposure, including interest rate risk, foreign currency risk and equity risk.

Market risk also exists within the Group's defined benefit pension schemes and is managed by the Trustee of the schemes.

Interest rate risk

Interest rate risk is the risk of loss arising from adverse movements 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 where appropriate, through the use of derivatives, with established risk limits and other control procedures.

Derivatives are only used to limit the extent to which the Group will be affected by changes in interest rates, foreign exchange rates or other indices which affect fair values or cash flows. Derivatives are therefore used exclusively to hedge risk exposures. The principal derivatives used by the Group are interest rate exchange contracts, commonly known as interest rate swaps, interest rate options and foreign exchange contracts.

The Group's forecasts and plans take account of the risk of interest rate changes and are prepared and stressed accordingly, in line with FSA guidance.

Currency risk

Currency risk is the risk of loss because of changes in foreign exchange rates.

Throughout the year, the Group had no material direct exposure to foreign currency exchange fluctuations. The Group's currency risk appetite is low and any issuance denominated in foreign currency is immediately swapped into Sterling.

Equity risk

This is the risk of loss due to movements in equity markets. The Group offers savings products where the return to the customer is linked to the performance of equity markets and hedges this risk through the use of derivative contracts.

Operational risk

Operational risk is the risk of financial loss or reputational damage arising from inadequate or failed internal processes or systems, human error or external events. The Group maintains a system of internal controls commensurate with the characteristics of the business, the markets in which it operates and regulatory considerations.

Market background

With its diverse business model and an ever more competitive operating environment, the Board acknowledges that the Group is exposed to increased levels of operational risk, for example in terms of systems capability and staff competencies. The financial services sector also faces growing levels of fraud and financial crime, particularly in relation to e-distribution channels, which require increasingly sophisticated controls.

Risk mitigation

The role of the Group's operational risk management function is to ensure appropriate strategies are in place to manage, control and mitigate the risks that could impact the ability of the Group to meet its business objectives whilst protecting its reputation, operating within the Board approved operational risk appetite.

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 and Management Information
- Fraud
- Information Security
- Information Technology
- Legal and Regulatory
- People
- Premises
- Process
- Third Party Relationships

The Group's operational risk management framework sets out the strategy for identifying, assessing and managing operational risk. Senior management are responsible for understanding the nature and extent of the impact on each business area and for embedding appropriate controls to mitigate those risks. The framework is updated periodically to take account of changes in business profile, new product development, and the external operating environment. The GORC provides oversight and assesses the Group's exposure to operational risks based on both quantitative and qualitative considerations. The crystallisation of operational risks is captured through the recording and analysis of operational losses (and near misses) which is used to identify any potential systemic weaknesses in operational processes.

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 Group 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.

Business risk

Business risk is the risk of changes in the environment in which the Group operates or the occurrence of events which damage the franchise or operating economics of the Group's businesses. The Group addresses these risks within its corporate plan which is approved by the Board and the Board is regularly provided with updates on the Group's key strategies and plans to ensure progress is consistent with the Group's risk appetite.

If the Group does not deliver its plans as anticipated, its earnings could grow more slowly or decline. In addition, potential sources of business risk include revenue volatility due to factors such as macroeconomic conditions, inflexible cost structures, uncompetitive products or pricing and structural inefficiencies.

Risk Management Report - continued

Reputational risk

Reputational risk is the risk to earnings, liquidity or capital arising from negative market or public opinion. Management has considered how this might arise and what the impact could be. The consequences would adversely impact the future prospects of the Group and could expose the Group to litigation and financial loss. Reputational risk is inherent across the Group. Senior Management manage this risk in the following ways:

- Management of the Society's reputation through marketing and external communications.
- By ensuring compliance with all regulatory requirements.
- Through the risk management framework which has reputational risk as a key consideration.

Pension obligation risk

The Group has funding obligations for five defined benefit schemes which are all now closed to new entrants and to future accrual of benefit. Pension risk is the risk that the value of the schemes' assets, together with ongoing contributions, will be insufficient to cover their obligations over time. The return on assets, which includes equities and bonds, will vary with movements in equity prices and interest rates. The projection of the schemes' obligations includes estimates of mortality, inflation and future salary increases, the actual outturn of which may differ from the estimates. The schemes are also exposed to possible changes in pensions legislation.

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 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 Individual Capital Adequacy Assessment Process ('ICAAP'). Note 35 of this Report and Accounts details the steps management have undertaken to manage the Group's pension risk exposure and further information is also set out in the Group's Pillar 3 disclosures available on our website.

Regulatory risk

Regulatory risk is the risk that the Group does not adhere to the fast changing regulatory environment in which it operates. Key changes on the horizon include the Independent Commission on Banking reforms, Resolution and Recovery Planning, the FSA moving to a 'twin peaks' regulatory approach, the replacement of Basel II by CRD IV (Basel III) and the impact upon our capital, the Retail Distribution Review and the Mortgage Market Review. The Group has allocated resource to ensure continued compliance in these areas and we believe we are well placed to meet all requirements.

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. It could also lead to reputational damage or financial penalties. The Group has effective, well-documented and controlled processes in place to ensure compliance with tax disclosure and filing obligations and employs its own tax professionals who take appropriate advice from reputable professional firms when necessary.

The Group takes a responsible approach to the management, governance and oversight of its tax affairs which is documented in a Tax Policy approved by the Board which requires tax risks to be reviewed and assessed as part of the Group's formal governance processes. The Group has adopted the Code of Practice on Taxation for Banks, which requires banks to have proper governance around tax, integrated into business decision making, to establish an appropriate working relationship with HMRC and to undertake tax planning only to support business operations and not to achieve unintended tax advantages. The Group will continue to be co-operative and transparent in its dealings with the tax authorities and has embedded the terms of the Code into its Tax Policy.

Capital management

The Group conducts an ICAAP at least annually, which is approved by the Board. This is used to assess the Group's capital adequacy and determine the levels of capital required to support the current and future risks in the business derived from the corporate plan. The ICAAP addresses all the Group's material risks and includes Board approved stress scenarios which are intended, as a minimum, to meet regulatory requirements. The ICAAP is used by the FSA to set the Group's Individual Capital Guidance ('ICG') requirements.

The amount and composition of the Group's capital requirement is determined by assessing the Basel II Pillar 1 minimum capital requirement, the impact of stress and scenario tests under Pillar 2, and the Group's ICG. The Board Risk Committee and the Capital Committee monitor the Group's capital and compliance with the regulatory limit.

The Group currently adopts the following approaches to calculate the Basel II Pillar 1 minimum capital requirements: Standardised approach for mortgages and other lending exposures; Comprehensive approach for Treasury portfolios and Standardised approach for operational risk. The Group intends to continue to develop its credit management processes further and apply to the FSA for permission to use an Internal Ratings Based ('IRB') approach for retail credit risk exposures in due course.

The Basel Committee on Banking Supervision issued its final Basel III text in December 2010 but this has yet to be incorporated into European and UK law and, therefore, remains subject to change. The text outlines proposals to strengthen the regulation and supervision of liquidity and capital management of banks, raising both the quality and quantity of the regulatory capital base. We will continue to manage our capital to ensure our position remains above the current and emerging regulatory requirements.

To meet Basel II Pillar 3 requirements, the Group publishes further information about its exposures and risk management processes and policies on the Society's website skipton.co.uk. The 2011 Pillar 3 disclosures will be available from April 2012.

P R Hales
Chairman of Board Risk Committee
28 February 2012

Directors' Report on Corporate Governance

The Board is committed to maintaining the highest levels of corporate governance within the Skipton Group. In support of this the Society seeks to comply with the Principles of the UK Corporate Governance Code ('the UK Code') issued by the Financial Reporting Council which became effective for accounting periods ending on or after 29 June 2010. Whilst the Society is not required to comply with the UK Code, as it is not a listed company, the Board believes that general compliance with its provisions supports good governance and Board effectiveness.

Governance framework

The Group comprises Skipton Building Society ('the Society') and its direct and indirect holdings in numerous legal entities, 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
- Estate Agency
- Mortgage Services
- 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 control of the Group.

Directors

The Board

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', developed to ensure that:

1. **Governing Body** - The Society is headed by an effective Board which is collectively responsible for the long term success of the Group.

   The Board formulates strategy and establishes the Society's risk appetite and balance sheet strategy. It has a proper understanding of, and competence to deal with, the current and emerging issues facing the business of the Group, effectively reviewing and challenging the performance of management and exercising independent judgement.

2. **Management and Oversight** - The Society's management and oversight framework enables the Board to provide strategic guidance for and effective oversight of management throughout the Group.

   The framework clarifies the respective roles and responsibilities of Directors and Senior Executives in order to facilitate Board and management accountability to both the Society and its members and ensures a balance of authority such that no single individual has unfettered powers. It has clear, risk-based, lines of sight into activities to support challenge and direction which enable the Board to ensure that assurance is obtained over the integrity of reporting and the adequacy of the control framework and control activities.

3. **Recognise and Manage Risk** - The Board has a sound system of risk oversight, risk management and internal control.

   This framework identifies, assesses, manages and monitors risk. It informs Senior Executives and the Board of material changes to the risk profile of the Society or any of its divisions, and monitors and provides assurance over the effectiveness of the control framework and control activities and the 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.

The Board has agreed a formal schedule of matters which are reserved to it, and 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 regular strategy review meetings. 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 might affect his judgement.

The Group Chief Executive leads the executive team and 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 reviewed its composition during the year and 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 UK Code.

The Board has appointed Mr Hutton (Vice Chairman) as the Senior Independent Director. Whilst the Senior Independent Director role is more pertinent within a quoted company, the role does provide a point of contact for members and other stakeholders with concerns which have failed to be resolved or would not be appropriate to pursue through the normal channels of the Chairman, Group Chief Executive or Group Finance Director. The Senior Independent Director also provides a sounding board for the Chairman and serves as a trusted intermediary for other members of the Board, if necessary, and meets with the other Non-Executive Directors, without the Chairman present, at least annually in order to appraise the performance of the Chairman.

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. The Nominations Committee adopts a thorough and rigorous process in appointing Directors, and 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.

The roles and responsibilities of Non-Executive Directors are set out in their letters of appointments which identify their key responsibilities in relation to:

i) Strategy - constructively challenge and contribute to the development of strategy.

ii) Performance - scrutinise the performance of management in meeting agreed business goals and objectives.

iii) Risk - obtain assurance that financial controls and systems of risk management are robust and allow for production of accurate financial reporting.

iv) People - determine appropriate levels of remuneration for Executive Directors and oversee succession planning.

A copy of the Society's current Non-Executive Director appointment letter can be obtained from the Secretary, on request.

Information and professional development

On appointment, new Directors receive a comprehensive and tailored induction programme on the Group's business and regulatory environment. Ongoing training and development needs are identified and addressed through regular review and usually take the form of attendance at external seminars and Board training sessions led by relevant internal and external specialists.

Through the 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 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. In early 2011 the Board received an independent evaluation of the Board's effectiveness including the Board's interactions with its sub-committees and management, and has subsequently implemented the recommendations contained therein.

A further, internal assessment of Board effectiveness, facilitated by the Secretary, was carried out in early 2012 and its findings were considered by the Board. Such reviews are an important means of assessing Board performance and will be conducted annually, with an externally facilitated exercise taking place periodically.

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 while the Vice Chairman leads the Board evaluation of the Chairman's performance.

Directors' Report on Corporate Governance - continued

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 nine years in total.

The UK Code recommends that all Directors of FTSE 350 Companies should stand for annual re-election. The Board has determined that it is not currently appropriate to introduce this Code requirement and will consider the appropriateness of this recommendation annually. The Board appointed a new Chairman and two other new Directors during the year, and a further Non-Executive Director after the year end, all of whom will stand for election at the forthcoming AGM.

Remuneration

Details relating to Directors' remuneration and contracts are contained in the Directors' Remuneration Report set out on pages 40 to 44.

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 Statement of Directors' Responsibilities Statement set out on pages 26 to 27.

Risk management and 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 Risk Management Report on pages 28 to 33, together with an explanation of the framework adopted by the Group for managing financial risk.

The Group's risk appetite is formally approved by the Board.

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

- Regular reports to the Board by the Chairmen of the various Board Committees (see below);
- Presentations to the Board by Divisional leaders about the performance of companies within each of the divisions, summarising both historic and future performance together with key business risks, issues and strategies;
- Regular reports to the Board, through the Audit Committee, from the internal audit function 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 functions on the principal operational, credit, market, business and regulatory risks facing the Group and the strength of the controls in place to mitigate such risks; and
- Reports on at least a quarterly basis presented by the Chief Conduct Risk Officer and Secretary and the Chief Financial Risk Officer.

From December 2011, in anticipation of the new regulatory regime which will see the Financial Services Authority replaced by the Prudential Regulatory Authority and the Financial Conduct Authority, the Society has delegated Executive responsibility for financial and prudential risks to the Chief Financial Risk Officer and for conduct of business risk to the Chief Conduct 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, 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 2011 the Society maintained an adequate system of internal control that met the requirements of the UK Code.

Board committees

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

The **Board Risk Committee** is responsible for considering and recommending the Group's risk appetite, capital adequacy and liquidity management policy to the Board. It is also responsible for ensuring that the Group maintains an effective risk governance structure to ensure that internal and external risks across the Group are identified, reviewed and managed accordingly.

The current members of the Committee are:

Mr Hales, Non-Executive Director (Committee Chairman)
Mr Cutter, Group Chief Executive
Mr East, Non-Executive Director
Mr Picken, Non-Executive Director
Mr Twigg, Group Finance Director

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 current members of the Committee are:

Mr Ellis, Chairman (and also Committee Chairman)
Mr East, Non-Executive Director
Mr Hales, Non-Executive Director
Mr Hutton, Non Executive Director
Ms Kinney, Non-Executive Director
Mr Picken, Non-Executive Director
Mr Thompson, 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 the Annual Accounts. Further detail is set out in the Directors' Remuneration Report. The current members of the Committee are:

Mr Hutton, Non-Executive Director (Committee Chairman)
Mr East, Non-Executive Director
Mr Thompson, Non-Executive Director

The **Non-Executive Remuneration Committee** is responsible for the review of the fees to be paid to Non-Executive Directors other than the Chairman, in accordance with the Society rules. The current members of the Committee are:

Mr Ellis, Chairman (and also Committee Chairman)
Mr Cutter, Group Chief Executive
Mr Twigg, Group Finance Director

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

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 Executive Directors and other senior executives.

The **Group Operational Risk Committee** is primarily responsible for developing and reviewing the Group's operational risk management framework. Mr Gibson (Chief Conduct Risk Officer and Secretary) chairs the Committee which comprises the 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, funding and wholesale credit, recommending changes to these policies to the Board Risk Committee, 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 Financial Risk Officer and senior Executives from Treasury, Finance, Risk and the Group's lending businesses.

The **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 other assets, recommending changes to these policies to the Board Risk Committee 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 Conduct Risk Officer and Secretary, Chief Financial Risk Officer, together with executives from the Credit Risk team and the Group's lending businesses.

Divisional Boards exist for the Estate Agency and the Mortgage Services divisions which comprise two Shareholder Directors (appointed by the Society) 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 a Society Executive and the Board also contains at least one other Shareholder Director (appointed by the Society) and the business executive management. The 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 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, Non-Executive Director (Committee Chairman)
Mr Picken, Non-Executive Director
Mr Thompson, Non-Executive Director

Directors' Report on Corporate Governance - continued

In addition, the Group Chief Executive, Group Finance Director, Chief Conduct Risk Officer and Secretary, Chief Financial Risk Officer, 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.

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 judgements 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, payable to the auditors; and
- 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 2011, the Committee met six times in the execution of its responsibilities and, in particular, considered reports on the:

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

The Committee also held private discussions with the external auditors, the Chief Conduct 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.

A copy of the Audit Committee terms of reference can be obtained from the Secretary, on request.

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 2011. 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 the 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:

	Board	Audit Committee	Nominations Committee	Remuneration Committee	Risk Committee
Mr M H Ellis (appointed 24 May 2011)	8/8	-	2/2	-	-
Mr A I Findlay (resigned 24 May 2011)	5/5	-	1/4	-	-
Mr R D East (appointed 29 November 2011)	2/2	-	-	-	-
Mr M R Fleet (appointed 6 December 2011)	1/1	-	-	-	-
Mr C N Hutton	12/13	4/6	6/6	6/6	-
Mr D J Cutter	13/13	-	5/6	-	7/8
Mr P R Hales	13/13	-	5/6	6/6	8/8
Ms A B E Kinney	11/13	6/6	6/6	6/6	-
Mr P J S Thompson	13/13	6/6	5/6	-	8/8
Mr R J Twigg	13/13	-	-	-	7/8
Mr W R Worsley (retired 3 May 2011)	4/5	-	-	-	1/2

Relations with members

As a mutual, the Society's membership comprises 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 AGM

Each year the Society gives all eligible members at least 21 days' notice of the Annual General Meeting ('AGM'). At the AGM, the Chairman and Group Chief Executive address members on the previous year's 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 2011 are also available on request in branches or by post.

M H Ellis

Chairman

28 February 2012

Directors' Remuneration Report

This report explains the Group's policies for the remuneration of Directors and discloses the remuneration of Directors, explaining the key changes which have taken place in 2011. The Board is committed to best practice in its approach to remuneration policy 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 at which members will, once again, 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, reviewing its adequacy, effectiveness and compliance with the FSA's Remuneration Code ('the Code'). The Committee sets remuneration for the Chairman and the Executive Directors. In 2011, the remit of the Committee extended to include the approval of remuneration policy for senior managers who have a material impact on the Society's risk profile ('Code Staff'). The Committee also receives recommendations from the Group Chief Executive for approval of the remuneration for certain senior executives in the Group.

The Committee has established clear remuneration principles which reflect both the requirements of the Society and the Code. These principles, which are reviewed annually and apply Group-wide, set appropriate standards with regard to remuneration governance, risk management, variable pay structures and Code Staff remuneration. The Committee receives an annual report from the Chief Conduct Risk Officer and Secretary on the implications of the remuneration policies within the Group on risk management and compliance with the principles. The 2011 report concluded that there were no incentive arrangements which might give rise to inappropriate risk-taking behaviour among Group Executives.

The terms of reference of the Remuneration Committee are available, on request, from the Secretary.

The Remuneration Committee met six times during 2011. 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 currently comprises three Non-Executive Directors, Messrs Hutton (Chairman), Thompson and East. The Chairman, Group Chief Executive, Chief Conduct Risk Officer and Secretary, Chief Human Resources Officer and external advisers may be invited to attend meetings as and when appropriate.

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

Remuneration policy

In establishing, implementing and maintaining the remuneration policy, the Committee applies the Group's remuneration principles. The general principles set out the Committee's standards with regard to remuneration, governance, risk management, and the link to performance.

In addition to the general principles listed below, the Committee sets out requirements for the operation of variable pay, setting appropriate rules and limits around bonus and incentive payments. Further requirements on deferral and performance adjustment apply specifically to Code Staff.

General principles

1. A total rewards approach to remuneration is taken which encompasses the key elements deployed to attract, engage and retain employees, namely: compensation (base and variable), benefits and the 'work experience'. The 'work experience' includes but is not restricted to culture / environment, work / life balance, career development and recognition.
2. Remuneration throughout the Skipton Group encourages a high level of stewardship and corporate governance.
3. Remuneration policies, procedures and practices reflect sound, effective risk management and do not encourage risk taking which falls outside the Board's risk appetite or the scope of Board policies.
4. Remuneration policies are reviewed at least annually by the Risk function to ensure they do not encourage inappropriate risk taking behaviour or present conflicts of interest which may result in unfair outcomes for our members and customers.
5. Remuneration is to be competitive and sufficient to secure and retain the services of talented individuals from other companies or mutual organisations with the key skills, knowledge and expertise necessary to run group businesses effectively, recognising the diverse nature of the Group and the nature of its stakeholders.
6. Remuneration recognises the appropriate level of business and individual performance which will create a strong and sustainable Group for the benefit of our members and customers, now and in the future.
7. Where remuneration is performance related, it will be based on the assessment of the individual / team, the business unit and overall Group performance (if appropriate). In assessing individual performance, a balance of financial and non-financial criteria will be taken into account.
8. Remuneration arrangements are transparent, consistent and fair, reflecting individual responsibilities and performance. Base compensation will reflect the core role and responsibilities of the individual whereas

variable compensation will reflect the achievement of agreed targets, or objectives which are over and above business as usual activities.

9. All employees will be rewarded fairly, regardless of race, colour, creed, ethnic or national origin, marital status, disability, age, gender, gender reassignment, sexual orientation, political opinion, religion, trade union or non trade union membership.
10. Remuneration arrangements are cost effective and straightforward to understand, communicate and administer.

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.

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

Basic salary - basic salary reflects the size of the role and responsibilities, individual performance (assessed annually) and salary levels of similar positions in comparable organisations. The Society uses a recognised job evaluation mechanism to determine the relative size of roles.

Annual Performance Pay - the Executive Directors participate in the Senior Leadership Incentive Scheme ('the Incentive Scheme') which is a non-pensionable performance incentive scheme which is designed to encourage performance across a range of financial and non-financial measures.

Pensions - the Executive Directors receive contributions payable into defined contribution pension arrangements.

Benefits - include the provision of a car or car allowance and private medical insurance.

2011 Executive Directors' Remuneration review

Basic Salary

During 2011, the Remuneration Committee commissioned an external benchmarking survey of executive remuneration. The report benchmarked the Group Chief Executive's and Group Finance Director's remuneration against a peer group of UK building societies and similar financial services organisations, together with information from the 2010 Mercer Executive Remuneration Guide: Pan European Financial Services Survey. The Committee concluded that the Group Chief Executive's and Group Finance Director's basic salaries, which had not been increased since 1 January and 1 April 2009 respectively, had fallen behind the market for roles of similar size and complexity in comparable financial services organisations. The Remuneration Committee therefore decided to increase the basic salaries of the Chief Executive and the Group Finance Director to £352,000 and £275,000 respectively from 1 April 2011. Mr Fleet's basic salary, following his appointment to the Board as Distribution Director on 6 December 2011, was set at £230,000 with reference to comparable market data.

Variable pay

During the year, the Incentive Scheme, in which Executive Directors and senior managers in the Society participate, was reviewed to ensure that it continued to reward sustained business and individual success, while incorporating the requirements of the Code.

The Incentive Scheme is based on the achievement of a balance of financial (profit based) measures and a mixture of commercial, employee, customer and capital targets as follows:

Financial - Group profit, Society profit, and subsidiary profit

Commercial - Mortgages and retail savings performance

Employee - Employee engagement

Customer - Customer complaints

Capital - Core Tier One capital ratio

The Incentive Scheme is also in part based on the achievement of individual performance objectives.

The Incentive Scheme is capped in line with acceptable market practice and provides an appropriate balance between base and variable pay. The Incentive Scheme includes the requirement to defer over three years a portion of the amount earned if the amount earned under the Incentive Scheme is more than 33% of total remuneration.

The Remuneration Committee may reduce or withdraw the payment of a deferred amount in certain circumstances and has the power to reduce or cancel payments due under the Incentive Scheme if it believes in extreme circumstances that the payments are not appropriate given the underlying health of the business.

Under the terms of the Incentive Scheme and based on the results of the business and their individual performance, the Executive Directors are entitled to the following annual performance payments for 2011, expressed as a percentage of their basic salary: Mr Cutter 15.0% (2010: 21.2%); Mr Twigg 10.1% (2010: 21.2%); and Mr Fleet 17.5%.

Non-Executive Directors' remuneration

Non-Executive Directors' fees (excluding those of 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.

Directors' Remuneration Report - continued

Additional fees are paid to those Non-Executive Directors who undertake additional duties and responsibilities, including chairmanship of Board committees.

Non-Executive Directors only receive fees and do not participate in any performance pay scheme, nor do they receive pension or other benefits. The Non-Executive Directors' basic fee for 2011 has remained unchanged since 2007. In 2011, the committee fee paid to the Chairman of the Risk Committee was increased to £8,000 per annum to reflect the responsibility and time commitment of the role.

The Chairman's fees are reviewed and approved by the Remuneration Committee. During the year the Remuneration Committee increased the Chairman`s annual fee to £155,000 to reflect the increased time commitment now required to fulfil the role.

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. 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

	2011 Fees £000	2011 Committee Fees £000	2011 Total £000	2010 Fees £000	2010 Committee Fees £000	2010 Total £000
Mr M H Ellis (Chairman) (note 1)	**94**	**-**	**94**	-	-	-
Mr A I Findlay (resigned 24 May 2011)	**28**	**-**	**28**	63	-	63
Mr C N Hutton (Vice Chairman) (note 2)	**48**	**4**	**52**	45	4	49
Mr R D East (note 3)	**4**	**-**	**4**	-	-	-
Mr P R Hales (note 4)	**40**	**5**	**45**	40	1	41
Ms P M Hay-Plumb (resigned 21 December 2010)	**-**	**-**	**-**	40	8	48
Ms A B E Kinney (note 5)	**40**	**8**	**48**	40	-	40
Mr J B Rawlings (retired 27 April 2010)	**-**	**-**	**-**	23	-	23
Mr J Spence (resigned 30 September 2010)	**-**	**-**	**-**	30	-	30
Mr P J S Thompson	**40**	**-**	**40**	40	-	40
Mr W R Worsley (retired 3 May 2011)	**13**	**-**	**13**	40	-	40
	307	**17**	**324**	361	13	374

Notes

1. Mr Ellis was appointed Chairman on 24 May 2011, replacing Mr Findlay who resigned from the Board on the same date.
2. Mr Hutton became Vice Chairman on 28 April 2010, and is Chairman of the Remuneration Committee.
3. Mr East was appointed a Director on 29 November 2011.
4. Mr Hales is the Chairman of the Board Risk Committee which was established in September 2010.
5. Ms Kinney was reappointed Chairman of the Audit Committee on 21 December 2010.

Executive Directors 2011

	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	**344**	**53**	**15**	**412**	**1**	**69**	**482**
Mr M R Fleet (note 2)	**16**	**2**	**2**	**20**	**-**	**1**	**21**
Mr R J Twigg	**269**	**28**	**12**	**309**	**1**	**54**	**364**
	629	**83**	**29**	**741**	**2**	**124**	**867**

Notes

1. Benefits comprise the provision of a car, or car allowance and private medical insurance contributions.
2. Mr Fleet was appointed as Executive Director on 6 December 2011 and the above table includes his remuneration, annual performance pay and benefits as a Director of the Society pro-rata from that date.

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 (note 3)	182	-	9	191	-	38	229
	752	121	32	905	-	152	1,057

Notes

3. Mr Wood's 2010 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 was also paid compensation for loss of office amounting to £262,068.

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 Scheme was closed to future accrual on 31 December 2009 and no further employee contributions have been made since that date.

	Increase in accrued pension in the year to 31 December 2011 £000	**Accrued pension entitlement as at 31 December 2011 £000**	**Transfer value of accrued rights at 31 December 2010 £000**	**Members' contribution for the year ended 31 December 2011 £000**	**Transfer values equivalent of increase in accrued pension for the year ended 31 December 2011 £000**	**Transfer values of accrued rights at 31 December 2011 £000**
Mr D J Cutter	**1**	**80**	**759**	**-**	**144**	**903**
Mr M R Fleet	**-**	**-**	**-**	**-**	**-**	**-**
Mr R J Twigg	**1**	**65**	**541**	**-**	**105**	**646**

	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

Directors' Remuneration Report - continued

Code Staff

The Code includes the principle of proportionality which means that firms are expected to comply with the remuneration requirements of the Code in relation to their size, internal organisation and the nature, scope and complexity of its activities. Accordingly, the Society is grouped with banks and building societies with capital resources between £50m and £1bn in 'Tier 2'. Those group subsidiaries which fall within the scope of the Code are in 'Tier 4' and are excluded from the disclosure below. During the year the Society had 38 senior managers who were considered under the rules of the Code to have a material impact on the risk profile of the business and details relating to their total remuneration are set out in the table below.

The Remuneration Committee is responsible for approving remuneration policies and maintaining oversight of the remuneration of Code Staff and for ensuring that remuneration is paid to them in accordance with the relevant provisions of the Code.

Code Staff Remuneration

The basic salary of Code Staff is set according to the size of the role and responsibilities, individual performance, (assessed annually), salary levels of similar positions in comparable organisations and internal benchmarks. The Society uses a recognised job evaluation mechanism to determine the relative size of roles.

Salaries are reviewed annually and individual increases are awarded based on the individual's performance against personal objectives measured in accordance with the Society's performance management framework.

Code Staff participate in the Incentive Scheme alongside non-Code Staff colleagues. Targets set for Code Staff are similar to those outlined above for Executive Directors but for Code Staff in control functions, while profit remains a key element, an increased weighting is given to the achievement of non-financial objectives, in accordance with the requirements of the Code.

The requirement to defer a portion of the bonus if it exceeds 33% of total remuneration, applies to all members of the Senior Leadership Team bonus scheme irrespective of whether they are Code Staff.

The table below sets out the aggregate remuneration for Code Staff for the year ended 31 December 2011.

Code Staff 2011

	Number of beneficiaries	Fixed remuneration £000	Variable remuneration[1] £000	Total remuneration £000	Deferred variable remuneration £000
Senior management (including Executive Directors)	**8**	**2,037**	**464**	**2,501**	**149**
Other Code Staff	**30**	**2,337**	**154**	**2,491**	**-**

Note
1. Variable remuneration includes amounts which are deferred for payment in future periods.

C N Hutton

C N Hutton

Chairman of the Remuneration Committee

28 February 2012

Independent auditor's report to the members of Skipton Building Society

We have audited the Group and Society Annual Accounts of Skipton Building Society for the year ended 31 December 2011 set out on pages 46 to 119. 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 auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 26, 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 2011 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

28 February 2012

Income Statements

For the year ended 31 December 2011	Notes	**Group 2011 £m**	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
Interest receivable and similar income	2	**373.6**	363.6	**393.7**	373.2
Interest payable and similar charges	3	**(302.4)**	(308.7)	**(342.5)**	(341.1)
Net interest receivable		**71.2**	54.9	**51.2**	32.1
Fees and commissions receivable	4	**369.4**	381.7	**21.6**	13.8
Fees and commissions payable	5	**(7.9)**	(20.8)	**(2.6)**	(2.7)
Fair value gains / (losses) on financial instruments		**3.0**	2.0	**(0.1)**	1.7
Income from shares in subsidiary undertakings		**-**	-	**20.4**	70.3
Profit on disposal of subsidiary undertakings	17b)	**0.9**	1.2	**-**	1.9
Share of profits from joint ventures and associates	17c)	**0.7**	0.3	**-**	-
Other income	6	**13.2**	24.1	**6.2**	13.4
Total income		**450.5**	443.4	**96.7**	130.5
Administrative expenses	7	**(384.8)**	(395.5)	**(61.5)**	(66.9)
Operating profit before impairment losses and provisions		**65.7**	47.9	**35.2**	63.6
Negative goodwill arising on merger		**-**	3.1	**-**	3.1
Impairment losses on loans and advances	16	**(30.0)**	(14.8)	**(15.2)**	(12.6)
Impairment losses on debt securities	13	**-**	(0.1)	**-**	-
Provisions for liabilities	27	**(13.5)**	(1.1)	**(6.0)**	(0.2)
Provisions against investments in subsidiary undertakings	17a)	**-**	-	**(11.9)**	(36.9)
Provisions against loans to subsidiary undertakings	17a)	**-**	-	**0.8**	(0.8)
Profit before tax		**22.2**	35.0	**2.9**	16.2
Tax (expense) / income	11	**(6.7)**	(9.8)	**(0.9)**	9.6
Profit for the financial year		**15.5**	25.2	**2.0**	25.8
Profit for the financial year attributable to:					
Members of Skipton Building Society		**15.4**	25.5	**2.0**	25.8
Non-controlling interests		**0.1**	(0.3)	**-**	-
		15.5	25.2	**2.0**	25.8

Segmental performance of the Group is shown in note 34.

The notes on pages 53 to 119 form part of these Accounts.

Statements of Comprehensive Income

For the year ended 31 December 2011	Notes	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Profit for the financial year		**15.5**	25.2	**2.0**	25.8
Other comprehensive income:					
Available-for-sale investments: valuation gains / (losses) taken to equity	31	**17.0**	(0.5)	**14.8**	1.3
Cash flow hedges: (losses) / gains taken to equity	31	**(25.8)**	22.6	**(25.7)**	23.1
Exchange differences on translation of foreign operations	31	**0.9**	1.4	**-**	-
Movement in reserves attributable to non-controlling interests	31	**(0.4)**	(0.1)	**-**	-
Actuarial (loss) / gain on retirement benefit obligations	35	**(18.4)**	9.7	**(12.5)**	4.6
Income tax relating to components of other comprehensive income	31	**6.6**	(9.7)	**5.4**	(8.4)
Other comprehensive (expense) / income for the year, net of tax		**(20.1)**	23.4	**(18.0)**	20.6
Total comprehensive (expense) / income for the year		**(4.6)**	48.6	**(16.0)**	46.4
Total comprehensive (expense) / income attributable to:					
Members of Skipton Building Society		**(4.7)**	48.9	**(16.0)**	46.4
Non-controlling interests		**0.1**	(0.3)	**-**	-
		(4.6)	48.6	**(16.0)**	46.4

The notes on pages 53 to 119 form part of these Accounts.

Statements of Financial Position

As at 31 December 2011	Notes	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Assets					
Cash in hand and balances with the Bank of England		**782.3**	664.6	**782.2**	664.5
Loans and advances to credit institutions	12	**361.0**	293.9	**262.2**	191.0
Debt securities	13	**1,877.3**	2,421.2	**2,507.3**	2,391.7
Derivative financial instruments	14	**216.3**	140.6	**216.5**	169.6
Loans and advances to customers	15	**10,252.8**	9,814.7	**7,819.7**	7,330.6
Current tax asset		**-**	1.9	**-**	3.2
Deferred tax asset	28	**30.7**	26.2	**20.0**	16.4
Investments in group undertakings	17a)	**-**	-	**2,166.5**	3,211.3
Investments in joint ventures and associates	17c)	**2.5**	1.5	**-**	-
Intangible assets	18	**196.7**	190.9	**2.2**	3.4
Property, plant and equipment	19	**86.2**	89.4	**38.5**	42.8
Investment property	20	**6.8**	6.8	**28.1**	28.5
Other assets	21	**97.7**	87.8	**5.4**	6.4
Total assets		**13,910.3**	13,739.5	**13,848.6**	14,059.4
Liabilities					
Shares	22	**9,280.4**	9,388.5	**9,280.4**	9,388.5
Amounts owed to credit institutions	23	**877.4**	853.6	**709.7**	1,132.8
Amounts owed to other customers	24	**921.3**	1,088.8	**1,678.4**	1,377.9
Debt securities in issue	25	**1,129.9**	846.2	**809.9**	846.2
Derivative financial instruments	14	**374.4**	260.8	**309.5**	251.2
Current tax liability		**3.1**	-	**1.3**	-
Other liabilities	26	**78.0**	69.6	**8.5**	7.4
Accruals and deferred income		**41.4**	39.0	**5.8**	6.0
Provisions for liabilities	27	**34.2**	31.3	**10.5**	8.2
Deferred tax liability	28	**10.1**	9.9	**5.7**	6.7
Retirement benefit obligations	35	**43.6**	31.8	**18.9**	9.7
Subordinated liabilities	29	**214.2**	214.2	**225.7**	225.6
Subscribed capital	30	**85.8**	84.7	**85.8**	84.7
Total liabilities		**13,093.8**	12,918.4	**13,150.1**	13,344.9
Members' interests					
General reserve		**820.8**	819.6	**712.6**	720.2
Available-for-sale reserve		**6.0**	(6.9)	**4.9**	(6.0)
Cash flow hedging reserve		**(19.0)**	0.3	**(19.0)**	0.3
Translation reserve		**5.9**	5.0	**-**	-
Attributable to members of Skipton Building Society		**813.7**	818.0	**698.5**	714.5
Non-controlling interests		**2.8**	3.1	**-**	-
Total members' interests		**816.5**	821.1	**698.5**	714.5
Total members' interests and liabilities		**13,910.3**	13,739.5	**13,848.6**	14,059.4

These Accounts were approved by the Board of Directors on 28 February 2012 and were signed on its behalf by:

M H Ellis	Chairman
D J Cutter	Group Chief Executive
R J Twigg	Group Finance Director

The notes on pages 53 to 119 form part of these Accounts.

Statements of Changes in Members' Interests

For the year ended 31 December 2011

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 2011	**819.6**	**(6.9)**	**0.3**	**5.0**	**818.0**	**3.1**	**821.1**
Profit for the financial year	15.4	-	-	-	**15.4**	0.1	**15.5**
Other comprehensive income							
Actuarial loss on retirement benefit obligations	(14.2)	-	-	-	**(14.2)**	-	**(14.2)**
Net gains / (losses) from changes in fair value	-	12.9	(19.3)	-	**(6.4)**	-	**(6.4)**
Exchange differences on translation of foreign operations	-	-	-	0.9	**0.9**	-	**0.9**
Movement in reserves attributable to non-controlling interests	-	-	-	-	**-**	(0.4)	**(0.4)**
Total other comprehensive income (note 31)	**(14.2)**	**12.9**	**(19.3)**	**0.9**	**(19.7)**	**(0.4)**	**(20.1)**
Total comprehensive income for the year	**1.2**	**12.9**	**(19.3)**	**0.9**	**(4.3)**	**(0.3)**	**(4.6)**
Balance at 31 December 2011	**820.8**	**6.0**	**(19.0)**	**5.9**	**813.7**	**2.8**	**816.5**
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

The notes on pages 53 to 119 form part of these Accounts.

Statements of Changes in Members' Interests - continued

For the year ended 31 December 2011
Society

	General reserve £m	Available-for-sale financial assets £m	Cash flow hedges £m	Total £m
Balance at 1 January 2011	**720.2**	**(6.0)**	**0.3**	**714.5**
Profit for the financial year	2.0	-	-	**2.0**
Other comprehensive income				
Actuarial loss on retirement benefit obligations	(9.6)	-	-	**(9.6)**
Net gains / (losses) from changes in fair value	-	10.9	(19.3)	**(8.4)**
Total other comprehensive income (note 31)	**(9.6)**	**10.9**	**(19.3)**	**(18.0)**
Total comprehensive income for the year	**(7.6)**	**10.9**	**(19.3)**	**(16.0)**
Balance at 31 December 2011	**712.6**	**4.9**	**(19.0)**	**698.5**
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

The notes on pages 53 to 119 form part of these Accounts.

Statements of Cash Flows

For the year ended 31 December 2011	Notes	**Group 2011 £m**	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
Cash flows from operating activities					
Profit before taxation		**22.2**	35.0	**2.9**	16.2
Adjustments for:					
Impairment losses on loans and advances	16	**30.0**	14.8	**15.2**	12.6
Impairment losses on debt securities	13	**-**	0.1	**-**	-
Loans and advances written off, net of recoveries		**(21.3)**	(21.1)	**(4.2)**	(3.5)
Provisions against investments in subsidiary undertakings	17a)	**-**	-	**11.9**	36.9
Provisions against loans to subsidiary undertakings	17a)	**-**	-	**(0.8)**	0.8
Goodwill impairment	18	**1.0**	7.5	**-**	-
Depreciation and amortisation	18,19,20	**20.6**	19.9	**5.6**	4.8
Impairment of investment property	20	**0.1**	1.4	**0.1**	1.4
Dividends received		**-**	-	**(20.4)**	(70.3)
Interest on capital and subordinated liabilities		**24.2**	25.1	**24.2**	25.1
Profit on sale of property, plant and equipment and investment property	6	**(1.4)**	(6.7)	**(1.6)**	(7.1)
Negative goodwill arising on merger		**-**	(3.1)	**-**	(3.1)
Share of profits from joint ventures and associates	17c)	**(0.7)**	(0.3)	**-**	-
Profit on disposal of subsidiary undertakings	17b)	**(0.9)**	(1.2)	**-**	(1.9)
Other non-cash movements		**(11.4)**	71.3	**(24.2)**	77.8
		62.4	142.7	**8.7**	89.7
Changes in operating assets and liabilities:					
Movement in prepayments and accrued income		**(3.8)**	2.3	**(3.6)**	(1.2)
Movement in accruals and deferred income		**5.0**	(10.6)	**0.5**	(8.6)
Movement in provisions for liabilities		**2.9**	11.8	**2.4**	(3.8)
Movement in loans and advances to customers		**(409.5)**	1,192.8	**(461.0)**	1,124.5
Movement in shares		**(136.9)**	(1,268.4)	**(136.9)**	(1,268.4)
Net movement in amounts owed to credit institutions and other customers		**(141.7)**	(225.3)	**(121.6)**	(213.0)
Net movement in debt securities in issue		**288.3**	(502.5)	**(31.0)**	(502.5)
Net movement in loans and advances to credit institutions		**(70.0)**	157.5	**(70.9)**	155.6
Net movement in other assets		**(12.9)**	17.6	**(4.6)**	5.2
Net movement in other liabilities		**15.7**	(28.2)	**1.1**	0.6
Income taxes (paid) / received		**(0.4)**	(4.9)	**3.7**	10.6
Net cash flows from operating activities		**(400.9)**	(515.2)	**(813.2)**	(611.3)

Statements of Cash Flows - continued

For the year ended 31 December 2011	Notes	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Net cash flows from operating activities		**(400.9)**	(515.2)	**(813.2)**	(611.3)
Cash flows from investing activities					
Purchase of debt securities	13	**(4,075.2)**	(3,623.8)	**(4,719.3)**	(3,623.8)
Proceeds from disposal of debt securities	13	**4,637.1**	3,555.4	**4,618.6**	3,520.0
Purchase of intangible assets	18	**(7.9)**	(8.9)	**(0.3)**	(1.0)
Purchase of property, plant and equipment and investment property	19,20	**(10.5)**	(11.2)	**(1.5)**	(21.2)
Proceeds from disposal of property, plant and equipment and investment property		**4.9**	9.8	**3.7**	9.6
Dividends received		**-**	-	**20.4**	70.3
Dividends received from joint venture		**0.4**	0.5	**-**	-
Dividends paid to non-controlling interests	26	**(1.8)**	(3.3)	**-**	-
Cash acquired on transfer of engagements		**-**	0.1	**-**	0.1
Purchase of subsidiary undertakings	17a)	**(7.0)**	-	**-**	-
Net cash acquired with subsidiaries		**0.6**	-	**-**	-
Further investment in subsidiary undertakings	17a)	**(0.3)**	(20.9)	**(0.8)**	(31.2)
Investment in joint venture	17c)	**(0.7)**	-	**-**	-
Purchase of other business units		**(0.3)**	-	**-**	-
Cash received from sale of subsidiary undertakings	17b)	**1.1**	1.6	**-**	1.2
Net cash disposed on sale of subsidiary undertakings		**(0.5)**	-	**-**	-
Net cash flows from investing activities		**539.9**	(100.7)	**(79.2)**	(76.0)
Cash flows from financing activities					
Decrease in loans to subsidiary undertakings	17a)	**-**	-	**1,033.7**	105.4
Write back of loans to subsidiary undertakings	17a)	**-**	-	**0.8**	-
Interest paid on subordinated liabilities		**(16.0)**	(16.9)	**(16.0)**	(16.9)
Interest paid on Permanent Interest Bearing Shares		**(8.2)**	(8.2)	**(8.2)**	(8.2)
Net cash flows from financing activities		**(24.2)**	(25.1)	**1,010.3**	80.3
Net increase / (decrease) in cash and cash equivalents		**114.8**	(641.0)	**117.9**	(607.0)
Cash and cash equivalents at 1 January		**755.3**	1,396.3	**653.3**	1,260.3
Cash and cash equivalents at 31 December		**870.1**	755.3	**771.2**	653.3

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

	Notes	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Cash in hand and balances with the Bank of England		**782.3**	664.6	**782.2**	664.5
Mandatory reserve deposit with the Bank of England		**(11.0)**	(11.2)	**(11.0)**	(11.2)
		771.3	653.4	**771.2**	653.3
Loans and advances to credit institutions repayable on demand	12	**98.8**	101.9	**-**	-
Cash and cash equivalents as at 31 December		**870.1**	755.3	**771.2**	653.3

The notes on pages 53 to 119 form part of these Accounts.

Notes to the 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 26 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 2011; 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 24, *Related Parties (revised 2009)* and IFRIC 14 IAS 19 - *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.*

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 2011, 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 and subsequent changes in the Group's 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. 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.

Notes to the Accounts - continued

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.

Securitisation transactions

The Group has securitised certain mortgage loans by the transfer of the loans to special purpose vehicles ('SPVs'). The securitisation enables a subsequent issuance of debt, either by the SPVs or the Society, to investors who gain the security of the underlying assets as collateral. The SPVs are fully consolidated into the Group's accounts in accordance with SIC-12.

The transfers of the mortgage loans to the SPVs are not treated as sales by the Society. The Society continues to recognise the mortgage loans on its own Statement of Financial Position after the transfer because it retains the risks and rewards of the portfolio. In the accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the SPVs.

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 ordinarily based upon approved profit budgets for the next three years (adjusted for non-cash items) and assumed growth thereafter for the next 12 years generally 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.

1. Accounting policies (continued)

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:

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. Interest on derivatives is included within interest receivable where the derivative hedges an asset and within interest expense where the derivative hedges a liability, to align the recognition with its economic purpose. 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 or is de-designated from the hedge relationship, the associated adjustment to the carrying amount of the hedge item or the amount in the cash flow hedge reserve is amortised to the Income Statement over the remaining life of the hedged item.

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

Notes to the Accounts - continued

1. Accounting policies (continued)

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.

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 of future performance 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 Darrowby No 1 plc and Beckindale No 1 Limited, special purpose entities, which are consolidated into the Group Accounts. The loans secure debt securities issued by the Society. The loans are retained within 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.

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 as opposed to equity instruments since their terms do not permit the Directors discretion to avoid the payment of interest. Permanent Interest Bearing Shares 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. The key drivers influencing the objective evidence predominantly relate to affordability issues driven by unemployment and the increased costs of living. Based upon these assessments an individual impairment reduction of these assets is made.

1. Accounting policies (continued)

In addition, a collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that credit losses have been incurred but not yet identified at the reporting date. The impairment value is calculated by applying various economic factors to pools within our mortgage portfolio that have similar characteristics. These factors take into account the Group's experience of default rates; the 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. In addition the collective impairment provision takes into account the level of forbearance applied to loans, such as, payment reductions, term extensions, conversion to interest only and capitalisation of arrears, and reflects the relative performance of each of these pools. The impairment provision also considers macro-economic indicators affecting affordability such as unemployment rates and interest rates.

Impairment provisions are recognised in the Income Statement and reflected as a deduction against the carrying value of the asset in the Statement of Financial Position. 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.

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 securitisation issues 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

Notes to the Accounts - continued

1. Accounting policies (continued)

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.

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

1. Accounting policies (continued)

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.

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 facilities	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

In accordance with IFRS 8, *Operating Segments*, operating segments are identified on the basis of internal reports and components of the Group regularly reviewed by the chief operating decision maker, the Board, to allocate resources to segments and to assess their performance.

Each segment is determined according to distinguishable operating components of the Group that are regularly reviewed

Notes to the Accounts - continued

1. Accounting policies (continued)

by the Board 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.

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 an internal valuation is carried out annually.

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 is charged to the Income Statement.

r) Financial guarantee contracts

Where the Society has entered into financial guarantee contracts with a Group company, the Society asserts that these are 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 £2.5m (2010: £2.7m) increase in the Group's interest income and a £1.7m (2010: £1.7m) increase in the Society's interest income.

During the year a credit of £1.7m (2010: £6.5m) for the Group and a debit of £1.4m (2010: £0.7m credit) for the Society were 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

1. Accounting policies (continued)

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.

A critical estimate in calculating the eventual loss incurred in the event of sale is the future level of house prices which is assumed to be flat over the next two years. 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 £7.8m (2010: £8.1m). Other sensitivities include the emergence period, where an increase of three months would increase the loan impairment provision by £4.2m (2010: £4.1m), and the loss given default rate, where a 10% increase equates to a £5.2m (2010: £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 provision 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 £1.4m (2010: £1.8m). A 10% increase in the aggregate market value of these businesses would increase the put option liability by £1.3m (2010: £1.5m).

Goodwill

The carrying value of goodwill is assessed against 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 2011, to the extent that discount rates were to increase by 10%, the impairment charge would increase by £0.3m (2010: £1.0m). In addition, a reduction in the long term growth rate assumption from 2.5% to 0% would increase the impairment charge by £1.0m (2010: £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.

Notes to the Accounts - continued

1. Accounting policies (continued)

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 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.

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 £8.8m (2010: £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 £3.9m (2010: £4.0m) and vice versa.

Financial Services Compensation Scheme

The Group's ultimate liability for levies payable to the FSCS in respect of failed financial institutions remains uncertain. The provided amount is dependent 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% movement in the estimate of the 12 month LIBOR rate would increase / decrease the provision by £2.0m (2010: £2.0m) and vice versa.

Further details of the FSCS levy and the provision are included in note 27 and note 32(b).

2. Interest receivable and similar income

	Group 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
On loans fully secured on residential property	**401.1**	421.4	**306.5**	321.2
On other loans:				
To subsidiary undertakings	**-**	-	**96.5**	82.6
Other	**17.7**	19.4	**15.7**	17.1
On debt securities	**41.7**	35.8	**41.1**	35.1
On other liquid assets	**7.6**	9.0	**6.6**	8.8
Net expense on derivative financial instruments	**(94.5)**	(122.0)	**(72.7)**	(91.6)
	373.6	363.6	**393.7**	373.2

Included within Group and Society interest receivable and similar income on debt securities is income from fixed income securities of £25.5m (2010: £22.4m).

Included within interest receivable and similar income is interest accrued on impaired financial assets in the Group of £9.9m (2010: £11.8m) and in Society of £2.3m (2010: £5.0m).

3. Interest payable and similar charges

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
On shares held by individuals	**236.1**	257.2	**236.1**	257.2
On subscribed capital	**8.2**	8.2	**8.2**	8.2
On deposits and other borrowings:				
Subordinated liabilities	**16.0**	16.9	**16.0**	16.9
Subsidiary undertakings	**-**	-	**77.8**	52.0
Wholesale and other funding	**56.3**	47.9	**33.6**	31.0
Net income on derivative financial instruments	**(14.5)**	(22.2)	**(29.2)**	(24.2)
Other	**0.3**	0.7	**-**	-
	302.4	308.7	**342.5**	341.1

4. Fees and commissions receivable

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Mortgage origination related fees	**31.1**	26.4	**7.2**	3.6
General insurance fees	**25.2**	24.3	**4.4**	4.2
Commissions earned on property sales	**111.6**	128.8	**-**	-
Mortgage servicing fees	**66.8**	78.2	**-**	-
Financial advice fees	**54.1**	51.6	**-**	-
Other fees and commissions	**80.6**	72.4	**10.0**	6.0
	369.4	381.7	**21.6**	13.8

5. Fees and commissions payable

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Mortgage origination related fees	**0.4**	13.1	**0.4**	0.2
Other fees and commissions	**7.5**	7.7	**2.2**	2.5
	7.9	20.8	**2.6**	2.7

6. Other income

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Investment property income	**0.4**	0.5	**2.2**	2.3
Expected return on pension scheme assets (note 35)	**10.2**	10.7	**5.2**	5.4
Interest on pension scheme liabilities (note 35)	**(10.0)**	(11.1)	**(4.8)**	(5.4)
Government grants	**0.6**	0.6	**-**	-
Net profit on sale of fixed assets	**1.4**	6.7	**1.6**	7.1
Other	**10.6**	16.7	**2.0**	4.0
	13.2	24.1	**6.2**	13.4

Included in the profit on sale of fixed assets for Group and Society is profits of £1.1m (2010: £5.7m) in relation to the sale and leaseback of two (2010: nine) properties during the year.

Notes to the Accounts - continued

7. Administrative expenses

	Group 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
Employee costs:				
Wages and salaries	**220.8**	223.1	**32.6**	32.0
Social security costs	**21.1**	19.9	**3.0**	2.7
Pension costs:				
Defined contribution arrangements (note 35)	**6.5**	7.1	**1.9**	1.7
Defined benefit schemes service costs (note 35)	**1.8**	-	**1.3**	-
Settlement gain (note 35)	**(4.5)**	-	**(2.1)**	-
	245.7	250.1	**36.7**	36.4
Other administrative expenses	**139.1**	145.4	**24.8**	30.5
	384.8	395.5	**61.5**	66.9
Other administrative expenses include:				
Amortisation / write offs of intangible assets (note 18)	**10.1**	9.8	**1.5**	2.2
Depreciation of property, plant and equipment (note 19) and investment properties (note 20)	**10.5**	10.1	**4.1**	2.6
Impairment of investment properties (note 20)	**0.1**	1.4	**0.1**	1.4
Impairment of goodwill (note 18)	**1.0**	7.5	**-**	-
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**	0.5	**-**	-
Other services relating to taxation	**0.1**	0.1	**-**	-
Services relating to information technology	**-**	0.3	**-**	0.3
All other services	**0.2**	0.4	**-**	0.1
Amounts payable under operating leases:				
Plant and machinery	**3.8**	4.7	**3.3**	3.8
Other	**19.2**	19.8	**4.1**	6.8

Settlement gains of, Group £4.5m and Society £2.1m, were realised upon completion of an enhanced pension transfer exercise. The costs of, Group £4.7m and Society £2.6m, for providing these enhancements are included in wages and salaries and social security costs above. Further detail is provided in note 35.

8. Employee numbers

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

	Group 2011	Group 2010	**Society 2011**	Society 2010
Principal office and administration centres	**774**	720	**774**	720
Society branch offices	**645**	554	**645**	554
Subsidiary undertakings	**6,750**	6,959	**-**	-
	8,169	8,233	**1,419**	1,274

9. Directors' emoluments

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

Total Directors' emoluments amounted to £1.2m (2010: £1.7m including compensation for loss of office of £0.3m).

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:

	2011 £m	2010 £m
Short term employee benefits such as wages and bonuses	**1.1**	1.5
Employer pension contributions	**0.1**	0.2
	1.2	1.7

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.

	2011 £m	2010 £m
Mortgage loans outstanding at 31 December	**0.1**	0.3
Savings balances at 31 December	**1.1**	1.1

Interest receivable and payable on the above accounts:	**2011 £000**	2010 £000
Interest receivable	**7**	15
Interest payable	**29**	19

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

Directors' loans and transactions

At 31 December 2011 there were outstanding mortgage loans granted in the ordinary course of business amounting in aggregate to £0.1m (2010: £0.3m) to two (2010: three) 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 £10.2m (2010: £13.4m) and £4.0m (2010: £7.0m) 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:

	2011 £m	2010 £m
Rendering and receiving of services	**7.9**	5.0
Recharges of central costs	**13.1**	10.0
Interest receivable	**96.5**	82.6
Interest payable	**(77.8)**	(52.0)
Other income	**2.6**	1.9
Collateral transferred for covered bond programme	**(780.8)**	600.0
Collateral transferred to securitisation vehicles	**1,578.2**	-
Purchase of debt securities in issue*	**(850.0)**	-
Repayment of debt securities in issue	**121.4**	-

* During the year, the Society purchased £850.0m of debt securities in issue from the Group's special purpose securitisation vehicle, Darrowby No 1 plc.

Notes to the Accounts - continued

10. Related party transactions (continued)

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 2011 the Society owed subsidiary undertakings £1,616.7m (2010: £1,317.6m) and was owed £2,030.7m (2010: £3,064.3m) 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:

	2011 £m	2010 £m
Services provided to the Group	**0.2**	-
Services provided by the Group	**1.6**	1.3

11. Taxation expense / (income)

	Group 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
Current tax	**2.1**	3.4	**(3.0)**	(4.5)
Deferred tax (note 28)	**4.6**	6.4	**3.9**	(5.1)
	6.7	9.8	**0.9**	(9.6)

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 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
Profit before tax from continuing operations	**22.2**	35.0	**2.9**	16.2
Less share of profits of joint venture and associate (net of tax)	**(0.7)**	(0.3)	**-**	-
	21.5	34.7	**2.9**	16.2
Tax calculated at UK standard rate of 26.5% (2010: 28%)	**5.7**	9.7	**0.8**	4.5
Effects of:				
Expenses not deductible for tax purposes	**2.3**	3.9	**3.5**	11.2
Adjustment to tax expense in respect of prior periods	**0.3**	(0.1)	**0.4**	(2.7)
Utilisation of tax losses	**-**	-	**-**	0.1
Non-taxable income	**(1.1)**	(3.7)	**(5.6)**	(23.1)
Corporation tax rate change	**(0.5)**	0.4	**0.3**	0.3
Other	**-**	(0.4)	**1.5**	0.1
Tax expense / (income)	**6.7**	9.8	**0.9**	(9.6)

The effective tax rate for the Group for the year ended 31 December 2011 is 31.2% (2010: 28.2%). The major impacts on the effective rate for the year are the non-taxable profits arising on asset disposals, expenditure which is not deductible for tax purposes and the impact of the Corporation tax rate change on brought forward deferred tax asset balances.

The effective rate for the Society for the year ended 31 December 2011 is 31.0% (2010: (59.3)%). The major impacts on the effective rate are the non-taxable dividend income of £20.4m (2010: £70.3m) received and the non-taxable profit on asset disposals made during the year. Also impacting the effective rate is the non-tax deductible £11.9m (2010: £36.9m) written off investments during the year.

The future reduction in the Corporation tax rate to 25% effective from 1 April 2012 results in a charge of £0.4m in the Income Statement in respect of the Group's net deferred tax asset. No account has been taken of further planned reductions in corporation tax rates as these have not yet been substantively enacted and it is not currently possible to quantify the effects of the proposed reductions.

12. Loans and advances to credit institutions

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Repayable on demand	**98.8**	101.9	**-**	-
In not more than three months	**244.4**	184.9	**244.4**	183.9
In more than three months but not more than one year	**0.6**	-	**0.6**	-
In more than one year	**17.2**	7.1	**17.2**	7.1
	361.0	293.9	**262.2**	191.0

At 31 December 2011 £13.9m (2010: £16.3m) of cash has been pledged by the Group and Society against derivative contracts.

13. Debt securities

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Gilts	**187.3**	200.8	**187.3**	200.8
Treasury bills	**40.4**	749.4	**40.4**	749.4
Certificates of deposit	**414.6**	205.4	**379.5**	205.4
Fixed rate bonds	**396.3**	452.6	**396.3**	452.6
Floating rate notes	**543.8**	532.0	**529.8**	502.5
Residential mortgage backed securities	**256.6**	233.3	**935.7**	233.3
Commercial mortgage backed securities	**38.3**	47.7	**38.3**	47.7
	1,877.3	2,421.2	**2,507.3**	2,391.7
Debt securities have remaining maturities as follows:				
In not more than one year	**945.9**	1,100.6	**896.9**	1,089.3
In more than one year	**931.4**	1,320.6	**1,610.4**	1,302.4
	1,877.3	2,421.2	**2,507.3**	2,391.7
Transferable debt securities comprise:				
Listed on a recognised investment exchange	**1,462.3**	2,215.8	**2,092.3**	2,186.3
Unlisted	**415.0**	205.4	**415.0**	205.4
	1,877.3	2,421.2	**2,507.3**	2,391.7
Market value of listed transferable debt securities	**1,467.1**	2,207.9	**2,097.2**	2,178.4
Carrying value of securities pledged as collateral under sale and repurchase agreements	**161.1**	328.8	**766.2**	328.8

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

Debt securities of the Group, included in the table above, with a carrying value of £161.1m (2010: £328.8m), have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group has retained substantially all the risks and rewards of ownership.

Included in the Society's residential mortgage backed securities is £679.1m (2010: £nil) of notes purchased by the Society from the Group's securitisation vehicle, Darrowby No 1 plc.

The Society also holds £127.2m (2010: £nil) of securities which are pledged as collateral with Group subsidiary, SIL, in a repurchase agreement.

Notes to the Accounts - continued

13. Debt securities (continued)

Movements in debt securities during the year are summarised as follows:

	Group 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
At 1 January	**2,421.2**	2,339.3	**2,391.7**	2,273.6
Acquired on transfer of engagements	**-**	13.0	**-**	13.0
Additions	**4,075.2**	3,623.8	**4,719.3**	3,623.8
Disposals	**(4,637.1)**	(3,555.4)	**(4,618.6)**	(3,520.0)
Impairment losses	**-**	(0.1)	**-**	-
Changes in fair value	**18.0**	0.6	**14.9**	1.3
At 31 December	**1,877.3**	2,421.2	**2,507.3**	2,391.7

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% (2010: 0.90%).

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

	Group and Society	
	2011 £m	2010 £m
Carrying value of reclassified assets	**224.4**	281.8
Fair value of reclassified assets	**200.3**	277.7

If these assets had not been reclassified, the fair value loss arising in the Statement of Comprehensive Income would have been £8.3m (2010: £28.3m gain).

14. Derivative financial instruments

	Group		Society	
	Positive market value 2011 £m	**Negative market value 2011 £m**	**Positive market value 2011 £m**	**Negative market value 2011 £m**
Derivatives designated as fair value hedges:				
Interest rate swaps	139.9	142.9	139.4	135.9
Currency swaps	13.8	-	13.8	-
	153.7	**142.9**	**153.2**	**135.9**
Derivatives designated as cash flow hedges:				
Interest rate swaps	14.0	33.8	14.0	33.7
	14.0	**33.8**	**14.0**	**33.7**
Other derivatives held at fair value:				
Quanto swaps	-	0.2	-	0.2
Mortgage products - embedded derivatives	0.1	-	0.1	-
Equity swaps	13.1	93.3	13.1	93.3
Investment products - embedded derivatives	16.9	12.9	16.9	12.9
Interest rate swaps	18.3	91.3	19.0	33.5
Options	0.2	-	0.2	-
	48.6	**197.7**	**49.3**	**139.9**
	216.3	**374.4**	**216.5**	**309.5**

	Group		Society	
	Positive market value 2010 £m	Negative market value 2010 £m	Positive market value 2010 £m	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

All derivatives are held for economic hedging purposes.

Notes to the Accounts - continued

15. Loans and advances to customers

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Loans fully secured on residential property	**9,472.9**	9,030.4	**7,122.2**	6,624.8
Other loans:				
Loans fully secured on land	**460.4**	497.0	**460.4**	497.0
Other loans	**78.6**	81.3	**3.2**	11.7
Fair value adjustment for hedged risk	**240.9**	206.0	**233.9**	197.1
	10,252.8	9,814.7	**7,819.7**	7,330.6
The remaining maturity of loans and advances to customers from the reporting date is as follows:				
On call and at short notice	**52.6**	52.3	**9.2**	5.9
In not more than three months	**36.1**	8.7	**28.9**	4.4
In more than three months but not more than one year	**58.1**	67.4	**33.6**	49.9
In more than one year but not more than five years	**474.7**	433.3	**331.5**	307.8
In more than five years	**9,719.4**	9,332.4	**7,457.8**	6,992.9
	10,340.9	9,894.1	**7,861.0**	7,360.9
Less: Impairment (note 16)	**(88.1)**	(79.4)	**(41.3)**	(30.3)
	10,252.8	9,814.7	**7,819.7**	7,330.6

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

Certain loans and advances to customers are used to secure external funding as follows:

	Group and Society			
	2011		2010	
	Assets pledged £m	**Secured funding £m**	Assets pledged £m	Secured funding £m
Covered bonds	**-**	**-**	1,031.3	750.0
Securitisations and other secured lending	**1,423.5**	**968.6**	-	-
	1,423.5	**968.6**	1,031.3	750.0

At 31 December 2011, loans and advances to customers include £1,423.5m (2010: £nil) for both the Group and Society which have been used in secured funding arrangements and transferred to Darrowby No 1 plc (£1,043.5m), and Beckindale No 1 Limited (£380.0m) which are special purpose vehicles consolidated into the Group Accounts. The loans secure £968.6m (2010: £nil) of funding.

At 31 December 2010, loans and advances to customers included £1,031.3m for both the Group and Society which had been transferred from the Society to Skipton Covered Bonds LLP, a limited liability partnership which is consolidated into the Group Accounts. The loans secured £750.0m of covered bonds issued by the Society. The Society cancelled the covered bonds in October 2011 and transferred the loans and advances to customers back to the Society.

All the assets pledged are retained in the Society's Statement of Financial Position as the Society substantially retains the risk and rewards relating to the loans.

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 2011				
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**
Amounts written off during the year				
Individual impairment	(20.3)	(0.3)	(0.7)	**(21.3)**
	(20.3)	**(0.3)**	**(0.7)**	**(21.3)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	24.1	3.3	9.4	**36.8**
Collective impairment	(5.9)	(0.5)	-	**(6.4)**
	18.2	**2.8**	**9.4**	**30.4**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.6)	-	0.2	**(0.4)**
Charge for the year	**17.6**	**2.8**	**9.6**	**30.0**
At 31 December 2011				
Individual impairment	**46.3**	**5.2**	**21.8**	**73.3**
Collective impairment	**13.3**	**1.5**	**-**	**14.8**
	59.6	**6.7**	**21.8**	**88.1**
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

Notes to the Accounts - continued

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 2011				
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**
Amounts written off during the year				
Individual impairment	(3.8)	(0.3)	(0.1)	**(4.2)**
	(3.8)	**(0.3)**	**(0.1)**	**(4.2)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	4.5	3.3	9.1	**16.9**
Collective impairment	(0.9)	(0.5)	-	**(1.4)**
	3.6	**2.8**	**9.1**	**15.5**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.3)	-	-	**(0.3)**
Charge for the year	**3.3**	**2.8**	**9.1**	**15.2**
At 31 December 2011				
Individual impairment	**7.4**	**5.2**	**21.2**	**33.8**
Collective impairment	**6.0**	**1.5**	**-**	**7.5**
	13.4	**6.7**	**21.2**	**41.3**
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

16. Impairment losses on loans and advances (continued)

Further analysis of the impairment provision in our residential and commercial books is provided in note 33.

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 £1.3m (2010: £1.1m); for the Society it amounted to £0.7m (2010: £0.6m).

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	
	2011 £m	2010 £m	**2011 £m**	2010 £m	**2011 £m**	2010 £m
Cost						
At 1 January	**186.1**	156.1	**3,065.1**	3,171.8	**3,251.2**	3,327.9
Amounts written off	**-**	-	**(0.8)**	-	**(0.8)**	-
Additions	**0.8**	31.2	**129.5**	75.4	**130.3**	106.6
Repayments	**-**	-	**(1,163.2)**	(180.8)	**(1,163.2)**	(180.8)
Disposals	**-**	(1.2)	**-**	(1.3)	**-**	(2.5)
At 31 December	**186.9**	186.1	**2,030.6**	3,065.1	**2,217.5**	3,251.2
Provisions						
At 1 January	**39.1**	2.8	**0.8**	2.5	**39.9**	5.3
Provided / (released) in the year	**11.9**	36.9	**(0.8)**	0.8	**11.1**	37.7
Utilised in the year	**-**	(0.6)	**-**	(2.5)	**-**	(3.1)
At 31 December	**51.0**	39.1	**-**	0.8	**51.0**	39.9
Net book value at 31 December	**135.9**	147.0	**2,030.6**	3,064.3	**2,166.5**	3,211.3

The Society reviews the carrying value of its investments in subsidiary undertakings at each reporting date. During the year, the Society provided £10.3m (2010: £35.1m) against the carrying value of its investment in the specialist lending companies Amber Homeloans and North Yorkshire Mortgages. A further £1.6m (2010: £1.8m) has been provided against the cost of investment of a number of smaller businesses based upon our assessment of the carrying value and recoverable amounts of these businesses.

Notes to the Accounts - continued

17. Investments in group undertakings (continued)

At 31 December 2011, the Group held a controlling interest in the following principal trading subsidiary undertakings:

Name of subsidiary undertaking	Principal business activity	Percentage of ownership interest 2011	2010
Amber Homeloans Limited	Lending body	**100.0**	100.0
Bailey Computer Services Limited	Provider of IT services	**100.0**	100.0
Beckindale No 1 Limited	Funding vehicle	**(See below)**	-
Connells Limited and subsidiary undertakings	Estate agency and related businesses	**100.0**	100.0
Darrowby No 1 plc	Funding vehicle	**(See below)**	-
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	**56.8**	56.7
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
Pearson Jones Plc*	Independent financial adviser	**99.7**	99.7
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
Skipton International Limited	Offshore deposit taker and lender	**100.0**	100.0
Skipton Trustees Limited	Provider of will writing services	**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
Torquil Clark Holdings Limited*	Financial adviser	**89.1**	89.1

* 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). 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 2011 this financial liability was £11.6m (2010: £9.3m).

The remaining subsidiary undertakings are 100% owned except for Jade Software Corporation Limited where the Group holds a 56.8% interest (2010: 56.7%) and no put options exist.

The Society's interests in Skipton Covered Bonds LLP, Darrowby No 1 plc and Beckindale No 1 Limited are, in substance, no different than if they were 100% held subsidiary undertakings and consequently they are 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 2011 and their audited results have been included in the Group Accounts.

17. Investments in group undertakings (continued)

During the year Connells Limited, through its intermediate holding company, Just Wills Holdings Limited, acquired shareholdings in a number of will writing and storage businesses for a total cost of £3.1m. The fair value of net assets acquired amounted to £3.1m including £3.9m of intangible assets.

On 12 November 2011, Connells Limited acquired a 100% shareholding in Burchell Edwards (Midlands) Limited, an estate agency business, Connells Residential acquired the trade and assets of Burchell Edwards Financial Services and Conveyancing Direct Limited acquired the trade and assets of BE Legal. The combined cost of these acquisitions was £3.9m. The assets acquired had a fair value of £2.2m, including £2.8m of intangible assets, and generated £1.7m of goodwill.

During the period the Group also increased its shareholding in existing subsidiary undertakings at a total cost of £0.3m (2010: £20.9m). Together with the reassessment of the expected future payments under the put option agreements and adjustments to contingent consideration, this resulted in a further £4.2m (2010: £15.7m) of goodwill being recognised.

Subsequent event

On 31 January 2012, Connells Limited acquired a 25% shareholding in Hearthstone Investments plc for £2.0m of which £0.5m has been paid in cash and a further £1.5m is payable contingent on certain conditions being fulfilled.

b) Disposals

On 30 May 2011, the Group sold the trade and assets of Thomson Shepherd Limited to Carbon Financial Holdings Limited for £0.3m, a price equivalent to its carrying value.

On 5 November 2011, Connells Limited disposed of 30% of its holding in Vibrant Energy Matters Limited, reducing its shareholding to 45%. As a result, the individual assets and liabilities of Vibrant Energy Matters Limited were derecognised at the date of disposal and the remaining investment recognised as an investment in joint venture. The transaction resulted in a loss on disposal of £0.1m.

On 30 November 2011, Jade Software Corporation Limited sold its entire holding in Empower HR Limited for £4.1m generating a profit on disposal of £1.0m. As a result of the disposal £1.9m of goodwill was eliminated. During the period of ownership in the year, Empower HR Limited contributed a £0.3m (2010: £0.4m) profit to the Group's profit before taxation.

c) Joint ventures and associates

At 31 December 2011, the Group held interests in the following companies:

Name of investment	Principal business activity	Percentage of ownership interest 2011	2010
TMG Holdings Limited	Property search provider	**33.3**	33.3
Legal Marketing Services Limited	Conveyancing services	**33.3**	-
Vibrant Energy Matters Limited	Energy assessor	**45.0**	75.0

On 15 July 2011, Connells Limited acquired a 33.3% holding in Legal Marketing Services Limited for £0.7m.

	Group 2011 £m	Group 2010 £m
Share of joint ventures and associates		
Gross assets	**5.5**	2.7
Gross liabilities	**(3.0)**	(1.2)
At 31 December	**2.5**	1.5
Share of joint ventures and associates		
Income	**13.5**	10.6
Expense	**(12.6)**	(10.2)
Taxation	**(0.2)**	(0.1)
Share of joint ventures' and associates' profit after tax	**0.7**	0.3

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.

Notes to the Accounts - continued

18. Intangible assets

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Software, databases and customer contracts	**25.7**	22.4	**2.2**	3.4
Goodwill	**171.0**	168.5	**-**	-
	196.7	190.9	**2.2**	3.4

Software, databases and customer contracts	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Cost				
At 1 January	**65.2**	55.9	**12.8**	11.2
Acquisition of subsidiary undertakings	**6.7**	-	**-**	-
Acquisition of business assets	**0.8**	-	**-**	-
Acquired on transfer of engagements	**-**	0.7	**-**	0.7
Additions	**7.9**	8.9	**0.3**	1.0
Disposals	**(1.7)**	(0.2)	**-**	(0.1)
Disposals of subsidiary undertakings	**(5.4)**	(0.1)	**-**	-
At 31 December	**73.5**	65.2	**13.1**	12.8
Amortisation and impairment				
At 1 January	**42.8**	33.5	**9.4**	7.2
Charge for the year	**10.1**	9.2	**1.5**	2.2
Amounts written off	**-**	0.6	**-**	-
Disposals	**(1.2)**	(0.4)	**-**	-
Disposal of subsidiary undertakings	**(3.9)**	(0.1)	**-**	-
At 31 December	**47.8**	42.8	**10.9**	9.4
Net book value at 1 January	**22.4**	22.4	**3.4**	4.0
Net book value at 31 December	**25.7**	22.4	**2.2**	3.4

Goodwill	Group 2011 £m	Group 2010 £m
Cost less amortisation to 1 January 2004		
At 1 January	**190.2**	181.0
Acquisitions of subsidiary undertakings and business units	**1.9**	0.7
Additions and revaluations of put options	**4.2**	15.7
Disposals	**(8.8)**	(7.2)
At 31 December	**187.5**	190.2
Impairment losses		
At 1 January	**21.7**	21.2
Provisions for impairment losses in the year	**1.0**	7.5
Disposals	**(6.2)**	(7.0)
At 31 December	**16.5**	21.7
Net book value at 1 January	**168.5**	159.8
Net book value at 31 December	**171.0**	168.5

18. Intangible assets (continued)

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. The carrying value of goodwill has been allocated as follows:

Operating segment		**Group 2011**	
	Cost of Goodwill £m	**Impairment £m**	**Carrying value £m**
Mortgage Services	**2.9**	**-**	**2.9**
Estate Agency	**125.2**	**3.4**	**121.8**
Financial Advice	**31.0**	**3.1**	**27.9**
Investment Portfolio	**28.4**	**10.0**	**18.4**
Cost of goodwill	**187.5**	**16.5**	**171.0**

Operating segment		Group 2010	
	Cost of Goodwill £m	Impairment £m	Carrying value £m
Mortgage Services	2.9	-	2.9
Estate Agency	120.5	3.4	117.1
Financial Advice	36.9	8.0	28.9
Investment Portfolio	29.9	10.3	19.6
Cost of goodwill	190.2	21.7	168.5

At 31 December 2011, before impairment testing, goodwill of £28.9m was allocated to the Financial Advice segment. Following a revision in future cashflows and based upon our assessment of recoverable amounts, £1.0m impairment has been recognised during the year.

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% (2010: 2.5%) or specific where circumstances dictate.

The Group estimates discount rates based upon the weighted average cost of capital of each operating segment which takes into account the market risks associated with each cash generating unit.

The pre-tax discount rates are as follows:

Operating segment	**Group 2011 %**	Group 2010 %
Mortgage Services	**10**	12
Estate Agency	**15**	15
Financial Advice	**12-13**	12-14
Investment Portfolio	**12-16**	12-19

Notes to the Accounts - continued

19. Property, plant and equipment

Group

	2011 Land and buildings £m	**2011** Equipment, fixtures and fittings £m	**2011** Total £m	2010 Land and buildings £m	2010 Equipment, fixtures and fittings £m	2010 Total £m
Cost						
At 1 January	90.8	99.6	**190.4**	89.8	106.8	196.6
Acquisitions	-	0.3	**0.3**	-	0.1	0.1
Acquired on transfer of engagements	-	-	**-**	1.0	-	1.0
Additions	2.7	7.8	**10.5**	4.1	7.1	11.2
Disposals	(2.7)	(9.8)	**(12.5)**	(5.7)	(12.1)	(17.8)
Disposal of subsidiary undertakings	-	-	**-**	(0.7)	(2.3)	(3.0)
Transfer (to) / from investment property	(0.8)	-	**(0.8)**	2.3	-	2.3
At 31 December	**90.0**	**97.9**	**187.9**	90.8	99.6	190.4
Depreciation						
At 1 January	18.3	82.7	**101.0**	18.9	89.0	107.9
Charge for the year	3.8	6.6	**10.4**	2.9	7.1	10.0
Disposals	(1.0)	(8.5)	**(9.5)**	(4.1)	(11.2)	(15.3)
Disposal of subsidiary undertakings	-	-	**-**	(0.2)	(2.2)	(2.4)
Transfer (to) / from investment property	(0.2)	-	**(0.2)**	0.8	-	0.8
At 31 December	**20.9**	**80.8**	**101.7**	18.3	82.7	101.0
Net book value at 1 January	72.5	16.9	89.4	70.9	17.8	88.7
Net book value at 31 December	**69.1**	**17.1**	**86.2**	72.5	16.9	89.4

19. Property, plant and equipment (continued)

Society

	2011 Land and buildings £m	**2011** Equipment, fixtures and fittings £m	**2011** Total £m	2010 Land and buildings £m	2010 Equipment, fixtures and fittings £m	2010 Total £m
Cost						
At 1 January	50.3	29.0	**79.3**	45.8	28.9	74.7
Acquired on transfer of engagements	-	-	**-**	1.0	-	1.0
Additions	1.1	0.4	**1.5**	18.0	0.2	18.2
Disposals	(2.2)	(0.1)	**(2.3)**	(5.7)	(0.1)	(5.8)
Transfer to investment property	(0.8)	-	**(0.8)**	(8.8)	-	(8.8)
At 31 December	**48.4**	**29.3**	**77.7**	50.3	29.0	79.3
Depreciation						
At 1 January	9.1	27.4	**36.5**	10.5	26.8	37.3
Charge for the year	2.8	0.6	**3.4**	1.8	0.7	2.5
Disposals	(0.3)	(0.2)	**(0.5)**	(4.1)	(0.1)	(4.2)
Transfer (to) / from investment property	(0.2)	-	**(0.2)**	0.9	-	0.9
At 31 December	**11.4**	**27.8**	**39.2**	9.1	27.4	36.5
Net book value at 1 January	41.2	1.6	42.8	35.3	2.1	37.4
Net book value at 31 December	**37.0**	**1.5**	**38.5**	41.2	1.6	42.8

The net book value of land and buildings comprises:

	Group 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
Freehold	**64.2**	67.3	**33.4**	37.1
Long leasehold	**2.6**	2.5	**1.8**	2.0
Short leasehold	**2.3**	2.7	**1.8**	2.1
	69.1	72.5	**37.0**	41.2

Notes to the Accounts - continued

20. Investment property

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Cost				
At 1 January	**9.8**	13.5	**32.1**	21.8
Acquired on transfer of engagements	**-**	0.1	**-**	0.1
Additions	**-**	-	**-**	3.0
Disposals	**(0.5)**	(1.6)	**(0.3)**	(1.6)
Transfer from / (to) property, plant and equipment	**0.8**	(2.2)	**0.8**	8.8
At 31 December	**10.1**	9.8	**32.6**	32.1
Depreciation				
At 1 January	**3.0**	3.2	**3.6**	3.9
Charge for the year	**0.1**	0.1	**0.7**	0.1
Impairment	**0.1**	1.4	**0.1**	1.4
Disposals	**(0.1)**	(0.9)	**(0.1)**	(0.9)
Transfer from / (to) property, plant and equipment	**0.2**	(0.8)	**0.2**	(0.9)
At 31 December	**3.3**	3.0	**4.5**	3.6
Net book value at 1 January	**6.8**	10.3	**28.5**	17.9
Net book value at 31 December	**6.8**	6.8	**28.1**	28.5

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

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Market value of investment property	**11.3**	11.0	**32.0**	32.1

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

21. Other assets

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Trade receivables	**35.5**	31.1	**0.2**	-
Prepayments and accrued income	**22.3**	23.1	**4.3**	5.3
Other	**39.9**	33.6	**0.9**	1.1
	97.7	87.8	**5.4**	6.4

Included within 'other' other assets are £29.5m (2010: £27.2m) of undrawn advances to debt factoring clients.

21. Other assets (continued)

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

	2011 £m	**%**	2010 £m	%
Neither past due nor individually impaired	**19.1**	**47.9**	15.0	41.4
Past due but not individually impaired:				
Up to 30 days	**8.9**	**22.3**	9.8	27.1
30 to 120 days	**5.8**	**14.5**	5.1	14.1
Over 120 days	**1.7**	**4.3**	1.2	3.3
	35.5	**89.0**	31.1	85.9
Individually impaired	**4.4**	**11.0**	5.1	14.1
	39.9	**100.0**	36.2	100.0

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

	Group 2011 £m	Group 2010 £m
At 1 January	**(5.1)**	(5.1)
Provisions made during the year	**(1.0)**	(1.4)
Receivables written off during the year	**1.5**	1.0
Provisions no longer required	**0.2**	0.4
At 31 December	**(4.4)**	(5.1)

22. Shares

	Group and Society	
	2011 £m	2010 £m
Held by individuals	**9,144.5**	9,363.7
Other shares	**86.3**	2.2
Fair value adjustment for hedged risk	**49.6**	22.6
	9,280.4	9,388.5
Shares are repayable from the reporting date in the ordinary course of business as follows:		
On demand	**2,523.3**	2,871.1
In not more than three months	**3,657.8**	2,983.2
In more than three months but not more than one year	**881.9**	202.9
In more than one year but not more than five years	**1,332.8**	2,461.2
In more than five years	**884.6**	870.1
	9,280.4	9,388.5

Notes to the Accounts - continued

23. Amounts owed to credit institutions

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Amounts owed to subsidiary undertakings	-	-	132.5	279.2
Other	877.4	853.6	577.2	853.6
	877.4	853.6	709.7	1,132.8
Amounts owed to credit institutions are repayable from the reporting date in the ordinary course of business as follows:				
Repayable on demand	32.4	18.7	164.9	297.9
In not more than three months	75.8	138.9	75.4	138.9
In more than three months but not more than one year	122.7	598.9	122.7	598.9
In more than one year but not more than five years	646.5	97.1	346.7	97.1
	877.4	853.6	709.7	1,132.8

Amounts owed to credit institutions by the Group includes an amount of £646.1m (2010: £nil) of external funding facilitated through the Group's securitisation vehicles Darrowby No 1 plc and Beckindale No 1 Limited. This is secured on debt securities and loans and advances to customers originated by the Group.

24. Amounts owed to other customers

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Amounts owed to subsidiary undertakings	-	-	1,484.2	1,038.4
Other	921.3	1,088.8	194.2	339.5
	921.3	1,088.8	1,678.4	1,377.9
Amounts owed to other customers are repayable from the reporting date in the ordinary course of business as follows:				
Repayable on demand	224.4	306.6	1,497.6	1,075.6
In not more than three months	410.2	511.7	87.6	186.8
In more than three months but not more than one year	194.8	173.0	80.8	101.9
In more than one year but not more than five years	91.9	97.5	12.4	13.6
	921.3	1,088.8	1,678.4	1,377.9

25. Debt securities in issue

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Certificates of deposit	**19.1**	71.1	**19.1**	71.1
Other debt securities	**1,078.7**	738.0	**758.7**	738.0
Fair value adjustment for hedged risk	**32.1**	37.1	**32.1**	37.1
	1,129.9	846.2	**809.9**	846.2
Debt securities in issue are repayable from the reporting date in the ordinary course of business as follows:				
In not more than one year	**690.2**	96.7	**689.5**	96.7
In more than one year	**439.7**	749.5	**120.4**	749.5
	1,129.9	846.2	**809.9**	846.2

Group debt securities in issue include £322.5m (2010: £nil) of funding secured on certain loans and advances to customers through the Group's securitisation vehicle, Darrowby No 1 plc.

Included in Group and Society other debt securities are 2 (2010: 6) floating rate notes issued to the capital markets totalling £45.7m (2010: £69.2m).

26. Other liabilities

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Trade payables	**7.2**	6.7	**0.6**	0.6
Tax deducted at source from interest paid	**3.7**	3.3	**3.7**	3.0
Fair value of put option obligation	**11.6**	9.3	**-**	-
Debt factoring liabilities	**29.5**	27.2	**-**	-
Other	**26.0**	23.1	**4.2**	3.8
	78.0	69.6	**8.5**	7.4

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

	Group 2011 £m	Group 2010 £m
At 1 January	**9.3**	17.3
Unwind of the discount factor	**1.5**	0.9
Exercise of put options by non-controlling shareholders	**(0.3)**	(6.9)
Revaluation of market value and future exercise dates	**2.9**	1.3
Dividends paid to non-controlling shareholders	**(1.8)**	(3.3)
At 31 December	**11.6**	9.3

27. Provisions for liabilities

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Provision for the costs of surplus properties	**6.8**	7.3	**0.5**	0.4
Financial Services Compensation Scheme	**9.7**	8.1	**9.4**	7.4
Regulatory and other provisions	**17.7**	15.9	**0.6**	0.4
	34.2	31.3	**10.5**	8.2

Notes to the Accounts - continued

27. Provisions for liabilities (continued)

Movements in provisions during the year:

Group	**Provision for the costs of surplus properties 2011 £m**	**Financial Services Compensation Scheme 2011 £m**	**Regulatory and other provisions 2011 £m**	**Total 2011 £m**
At 1 January	**7.3**	**8.1**	**15.9**	**31.3**
Acquisition of subsidiary undertakings	**0.2**	**-**	**-**	**0.2**
Charge for the year	**0.1**	**5.8**	**7.6**	**13.5**
Utilised during the year	**(0.8)**	**(4.2)**	**(5.8)**	**(10.8)**
At 31 December	**6.8**	**9.7**	**17.7**	**34.2**

Group	Provision for the costs of surplus properties 2010 £m	Financial Services Compensation Scheme 2010 £m	Regulatory and other provisions 2010 £m	Total 2010 £m
At 1 January	5.7	11.1	2.5	19.3
Acquired on transfer of engagements	-	0.2	-	0.2
Reclassified from other liabilities and accruals	0.4	-	16.9	17.3
Charge / (release) for the year	1.7	0.9	(1.5)	1.1
Utilised during the year	(0.5)	(4.1)	(2.0)	(6.6)
At 31 December	7.3	8.1	15.9	31.3

Society	**Provision for the costs of surplus properties 2011 £m**	**Financial Services Compensation Scheme 2011 £m**	**Regulatory and other provisions 2011 £m**	**Total 2011 £m**
At 1 January	**0.4**	**7.4**	**0.4**	**8.2**
Charge for the year	**0.3**	**5.4**	**0.3**	**6.0**
Utilised during the year	**(0.2)**	**(3.4)**	**(0.1)**	**(3.7)**
At 31 December	**0.5**	**9.4**	**0.6**	**10.5**

Society	Provision for the costs of surplus properties 2010 £m	Financial Services Compensation Scheme 2010 £m	Regulatory and other provisions 2010 £m	Total 2010 £m
At 1 January	0.2	11.1	0.5	11.8
Acquired on transfer of engagements	-	0.2	-	0.2
Charge / (release) for the year	0.3	-	(0.1)	0.2
Utilised during the year	(0.1)	(3.9)	-	(4.0)
At 31 December	0.4	7.4	0.4	8.2

27. Provisions for liabilities (continued)

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

The Society pays levies to the Financial Service Compensation Scheme ('FSCS') to enable the FSCS to meet claims against it as described in note 32(b). The Society FSCS provision at 31 December 2011 represents management expense levies for the scheme years triggered but not yet invoiced and the £9.4m provision at that date is an estimate of the levy for the scheme years 2011/2012 and 2012/2013.

The management expenses levy for scheme year 2011/2012 was calculated using the agreed funding rate of 12 months LIBOR + 30bps. We are aware that negotiations are continuing between HM Treasury ('HMT') and FSCS on the appropriate funding rate for the HMT loans for the period from 1 April 2012, on which the management expenses levy for scheme year 2012/2013 will be based. Because this negotiation has not been finalised, we have calculated our provision for the scheme year 2012/2013 levy based on a funding rate of 12 months LIBOR + 100bps, which is our best estimate based on the press announcement made by HMT in September 2008 which stated that the loans would revert to 12 months LIBOR + 100bps at the end of the agreed three year period. However, until negotiations are complete and the funding rate is finalised there exists the possibility that the levy for scheme year 2012/2013 will be based on a different rate than 12 months LIBOR + 100bps, and that our liability will be consequently different. In addition, an agreement by the FSCS not to charge a compensation cost levy for three years is also at an end and there exists the possibility that compensation for losses suffered could be levied in the scheme year commencing 1 April 2012.

The Society's provision does not include management expenses levies for any further scheme years beyond 2012/2013. No provision is made for any compensation levies which may arise from the claims relating to the defaults as set out in note 32(b).

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.

Regulatory and other provisions represent amounts relating to customer redress together with estimated compensation payments for claims made by the clients of subsidiaries.

28. Deferred tax

Deferred taxes are calculated on timing differences under the liability method using an effective tax rate of 25% (2010: 27%) 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 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
At 1 January	**16.3**	31.2	**9.7**	12.1
Income Statement (note 11)	**(4.6)**	(6.4)	**(3.9)**	5.1
Items taken directly to reserves	**9.0**	(10.5)	**8.5**	(9.5)
Acquired on transfer of engagements	**-**	2.0	**-**	2.0
Acquisitions / disposals	**(0.1)**	-	**-**	-
At 31 December	**20.6**	16.3	**14.3**	9.7

Notes to the Accounts - continued

28. Deferred tax (continued)

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

Deferred tax assets	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Fixed asset temporary differences	**1.6**	2.4	**-**	-
Pension benefits	**10.9**	6.1	**4.7**	2.6
Provisions for loan impairment	**1.9**	1.2	**0.5**	0.5
Corporation tax losses	**6.0**	9.6	**4.7**	8.2
Derivatives and loans	**10.2**	5.4	**10.1**	5.1
Other	**0.1**	1.5	**-**	-
	30.7	26.2	**20.0**	16.4

Deferred tax liabilities	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Fixed asset temporary differences	**2.2**	2.0	**2.2**	1.9
Derivatives and loans	**5.9**	7.7	**3.5**	4.8
Other	**2.0**	0.2	**-**	-
	10.1	9.9	**5.7**	6.7
Net deferred tax asset	**20.6**	16.3	**14.3**	9.7

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

	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Fixed asset temporary differences	**0.5**	8.8	**(0.1)**	(0.1)
Provisions	**0.1**	-	**-**	-
Unwind of merger fair value adjustments	**0.1**	1.3	**-**	-
Other	**3.9**	(3.7)	**4.0**	(5.0)
	4.6	6.4	**3.9**	(5.1)

There is no unrecognised deferred tax relating to trading losses brought forward at 31 December 2011 (2010: £nil).

The majority of deferred tax assets are anticipated to be recoverable after one year. The Group's plans indicate that the Group and Society will generate sufficient taxable profits over its three year planning period to absorb the Corporation tax losses included within deferred tax at the reporting date, together with those other temporary differences that are expected to reverse during that period.

29. Subordinated liabilities

	Group		Society	
	2011 £m	2010 £m	**2011 £m**	2010 £m
Subordinated floating rate notes	**-**	-	**11.5**	11.4
Subordinated fixed rate notes 2014	**15.2**	15.2	**15.2**	15.2
Subordinated fixed rate notes 2015	**20.1**	20.2	**20.1**	20.2
Subordinated fixed rate notes 2017	**10.3**	10.3	**10.3**	10.3
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
	215.1	215.2	**226.6**	226.6
Unamortised discount on issue	**(0.9)**	(1.0)	**(0.9)**	(1.0)
	214.2	214.2	**225.7**	225.6

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 (2010: £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 FSA. The note holders' rights are subordinate to those of the depositors and other payables.

The £11.5m (2010: £11.4m) Society Floating Rate Notes in the above table relates to a floating rate subordinated debt issue held by Skipton International Limited. The variable rate coupons on this issue are paid on a quarterly basis.

All 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	
	2011 £m	2010 £m
6.875% Permanent Interest Bearing Shares	**44.3**	43.1
8.500% Permanent Interest Bearing Shares	**15.2**	15.2
12.875% Permanent Interest Bearing Shares	**26.3**	26.4
	85.8	84.7

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.

Notes to the Accounts - continued

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

Group

	2011			2010		
	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	**17.0**	**(4.1)**	**12.9**	(0.5)	(0.2)	(0.7)
Cash flow hedges	**(25.8)**	**6.5**	**(19.3)**	22.6	(6.3)	16.3
Actuarial (loss) / gains on retirement benefit obligations	**(18.4)**	**4.2**	**(14.2)**	9.7	(3.2)	6.5
Translation of foreign operations	**0.9**	**-**	**0.9**	1.4	-	1.4
Movement of reserves attributable to non-controlling interests	**(0.4)**	**-**	**(0.4)**	(0.1)	-	(0.1)
Other comprehensive income	**(26.7)**	**6.6**	**(20.1)**	33.1	(9.7)	23.4

Society

	2011			2010		
	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	**14.8**	**(3.9)**	**10.9**	1.3	(0.3)	1.0
Cash flow hedges	**(25.7)**	**6.4**	**(19.3)**	23.1	(6.4)	16.7
Actuarial (loss) / gains on retirement benefit obligations	**(12.5)**	**2.9**	**(9.6)**	4.6	(1.7)	2.9
Other comprehensive income	**(23.4)**	**5.4**	**(18.0)**	29.0	(8.4)	20.6

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 2011.

b) In common with all regulated UK deposit takers, the Society pays levies to the 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 were triggered against the FSCS in relation to Bradford and Bingley plc, Kaupthing Singer and Friedlander, Heritable Bank plc, Landsbanki Islands hf, London Scottish Bank plc and Dunfermline Building Society.

The FSCS meets these current claims by way of loans received from HMT. The terms of these loans were interest only for the first three years, and the FSCS seeks to recover the interest cost, together with ongoing management expenses, by way of annual management levies on members over this period. The three year initial term expired in September 2011 and refinancing negotiations are underway as detailed in note 27. In addition, an agreement by the FSCS not to charge a compensation cost levy for three years is also at an end and there exists the possibility that compensation for losses suffered could be levied in the scheme year commencing 1 April 2012.

32. Other financial commitments and contingent liabilities (continued)

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

	Group 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
Contracted but not provided for	**1.2**	0.6	**-**	-

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

	Land and buildings 2011 £m	**Other 2011 £m**	Land and buildings 2010 £m	Other 2010 £m
Group				
Amounts falling due:				
Within one year	**16.6**	**3.8**	15.3	4.7
Within two to five years inclusive	**49.8**	**4.1**	46.4	6.8
Over five years	**32.3**	**0.6**	33.8	1.7
	98.7	**8.5**	95.5	13.2
Society				
Amounts falling due:				
Within one year	**5.4**	**2.2**	5.2	3.3
Within two to five years inclusive	**20.3**	**0.1**	19.6	2.7
Over five years	**18.1**	**-**	19.4	-
	43.8	**2.3**	44.2	6.0

33. Financial instruments

The Group uses financial instruments to invest liquid asset balances and raise wholesale funding. The Group also uses derivative financial instruments ('derivatives') to manage the risks arising from its operations.

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 derivatives are used by the Group for economic hedging purposes only. The Group does not run a trading book.

Types of derivatives

The principal derivatives used by the Group are interest rate swaps, interest rate options, 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. These risks may also be managed using Statement of Financial Position instruments as part of an integrated approach to risk management.

Type of hedge	**Risk**	**Activity**
Interest rate swaps and options	Sensitivity to changes in interest rates	Fixed rate savings products, funding activities, fixed rate mortgage lending and asset investment
Equity linked interest rate swaps	Sensitivity to changes in equity indices	Equity linked investment products
Cross currency swaps and foreign exchange contracts	Sensitivity to changes in foreign exchange rates	Investment and funding in foreign currencies

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.

Notes to the Accounts - continued

33. Financial instruments (continued)

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').

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. Cash flow hedge accounting 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 2011 was approximately 1.9 years (2010: 2.0 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 Risk Management Report.

Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its financial obligations as they fall due, or is only able to do so at excessive cost. It is an inherent part of the Group's business as long term mortgages are funded by short term retail customer balances. Mortgages typically have a contractual maturity date of around 25 years but in practice are frequently repaid early; conversely retail deposits, nominally repayable on demand or with much shorter notice periods, actually remain with the Society for relatively long periods. It is this mismatch in the maturity profiles of retail assets and liabilities that creates liquidity risk.

The Group's liquidity policy is designed to ensure the maintenance of sufficient liquid assets to cover statutory, regulatory and operational requirements. This is achieved through maintaining a prudent level of liquid assets, in realisable form to ensure the Group is able to meet its liabilities as they arise and to absorb potential cash flow requirements created by the maturity mismatches referred to above or by a liquidity stress scenario. The policy delegates liquidity management, within risk appetite limits established by the Board, as well as to monitor the composition of liquidity in line with risk management objectives.

The management of the Group's liquidity is as follows:

- The Board establishes limits over the quantity, quality and marketability of the Group's portfolio of liquid assets. The portfolio is managed by the Treasury function, monitored by the Market Risk function and overseen by ALCO under a series of delegated authorities;
- The Group's Market Risk function conducts a series of daily, weekly and monthly stress tests that are designed to ensure that its liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include ones caused by both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding; and
- Under the FSA's liquidity regime, introduced in 2010, the Group is required to hold highly liquid collateral ("buffer liquidity" such as government and supranational debt securities and cash) in excess of the FSA's Individual Liquidity Guidance for Backstop Purposes (ILG for BP) and the wholesale refinancing gap.

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

- Buffer liquidity - which analyses daily the amount of high quality liquidity that it is necessary to hold;
- Wholesale refinancing gap - which sets a maximum permitted net wholesale outflow limit over the following two weeks; and
- Liquidity stress tests - where, as noted above, the Group models how far its liquid asset holdings would fall under a number of different stress scenarios.

Further details of liquidity management are contained within the Risk Management Report on pages 28 to 33.

33. Financial instruments (continued)

The following table is an analysis of gross contractual cash flows payable under financial liabilities:

Group			**2011**		
Liabilities	**0-3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Shares	**6,181.1**	**882.2**	**1,394.2**	**884.7**	**9,342.2**
Amounts owed to credit institutions, customers and debt securities in issue	**222.7**	**990.4**	**1,209.2**	**45.0**	**2,467.3**
Derivative financial instruments	**33.9**	**82.0**	**212.9**	**131.5**	**460.3**
Subordinated liabilities	**4.0**	**11.6**	**94.5**	**210.0**	**320.1**
Subscribed capital	**1.6**	**6.3**	**31.7**	**96.7**	**136.3**
	6,443.3	**1,972.5**	**2,942.5**	**1,367.9**	**12,726.2**

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

Society			**2011**		
Liabilities	**0-3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Shares	**6,181.1**	**882.2**	**1,394.2**	**884.7**	**9,342.2**
Amounts owed to credit institutions, customers and debt securities in issue	**222.7**	**990.4**	**1,487.2**	**45.0**	**2,745.3**
Derivative financial instruments	**33.9**	**82.0**	**214.9**	**131.5**	**462.3**
Subordinated liabilities	**4.0**	**11.6**	**95.2**	**214.5**	**325.3**
Subscribed capital	**1.6**	**6.3**	**31.7**	**96.7**	**136.3**
	6,443.3	**1,972.5**	**3,223.2**	**1,372.4**	**13,011.4**

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

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

Notes to the Accounts - continued

33. Financial instruments (continued)

Market risk

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk, including the use of derivatives, foreign currency risk and equity risk.

The Society's Treasury department is responsible for managing the Group's exposure to all aspects of market risk within the operational limits set out in the Group's Treasury policies which is overseen by ALCO. ALCO approves the market risk policy and receives regular reports on all aspects of market risk, including interest rate risk, foreign currency risk and equity risk.

Interest rate risk

The main market risk faced by the Group is interest rate risk.

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

The Group 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. Results are compared to Board and Operational limits weekly and formally reported to ALCO and the Board monthly.

Other interest rate risk metrics employed by the Group incorporate earnings-at-risk and market value methodologies, which calculate interest rate risk exposure positions based on 250 historical data observations going back over approximately the last seven years. 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.

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

	As at 31 December 2011 £m	Average 2011 £m	High 2011 £m	Low 2011 £m	As at 31 December 2010 £m
Static earnings-at-risk	2.9	2.6	3.6	1.9	1.8
Historical value-at-risk	2.8	1.5	2.9	0.2	1.0
2% parallel interest rate shift	-*	8.9	20.1	-*	11.1

* As at 31 December 2011, a 2% parallel interest rate shift up or down would result in a small profit to the Group therefore the net loss exposure is nil.

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

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 Group has a small exposure to foreign currency interest rates at the year end. This arises from a Sterling mortgage product whose rate is linked to US Dollar interest rates and Euro debt issuances. However, due to the effect of cross currency swaps the net exposure is immaterial.

33. Financial instruments (continued)

The Group also has 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.

A number of the Group's businesses undertake transactions denominated in foreign currency as part of their normal business. Any amounts outstanding at the year end are not material.

Other price risk

As at 31 December 2011, 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.

Credit risk

Credit risk is the risk of suffering financial loss should borrowers or counterparties default on their contractual obligations to the Group.

The Group faces this risk from its lending to:

- 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 controlled management of credit risk is critical to the Group's overall strategy. The Group has therefore embedded a detailed risk management framework with clear lines of accountability and oversight as part of its overall governance framework. The Group has processes and policies to monitor, control, mitigate and manage credit risk within the Group's inherently low risk appetite. The RCC 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.

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 £240.9m (2010: £206.0m) is included.

Retail mortgage lending to customers

The Group currently lends in the prime residential UK mortgage market, including buy-to-let, through the Society and via SIL in the Channel Islands.

The Group has established comprehensive risk management processes in accordance with the Board's credit risk appetite which defines a number of limits regarding customer and collateral credit quality to which all lending activity must adhere. The Group maintains a low risk appetite for new lending.

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 comprise residential UK mortgages, including buy-to-let, across prime and specialist lending markets. In light of the prevailing deteriorating economic conditions, new lending in these portfolios ceased in early 2008.

Commercial lending to customers and businesses

The Society retains a commercial mortgage portfolio which is UK based and, following a reduction in the Group's risk appetite, was closed to new lending in November 2008. We have retained an appropriately skilled team of staff to ensure these loans are managed appropriately and their credit performance is actively monitored.

Notes to the Accounts - continued

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 business and personal loans, and loans made by our factored debt and invoice discounting business, Skipton Business Finance.

Wholesale lending to other financial institutions

Wholesale credit risk arises from the wholesale investments held by the Society's Treasury function, which is responsible for managing this aspect of credit risk in line with Board approved risk appetite and wholesale credit policies. Wholesale counterparty limits are reviewed monthly by the Group Wholesale Credit Committee based on analyses of counterparties' financial performance, ratings and other market information to ensure that limits remain within our risk appetite. During 2011, in light of the continuing uncertain global economic outlook, we have further reduced the number of counterparties to whom we will lend, and for those that remain, we have reviewed both the amount and duration of any limits.

A further deterioration in wholesale credit markets could lead to volatility in the Group's portfolio of available-for-sale assets together with the risk of further impairment within our treasury investments portfolio.

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

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			
	2011		2010	
	£m	%	£m	%
Total residential mortgages	**9,532.5**	**94.4**	9,092.7	93.9
Commercial loans	**467.1**	**4.6**	501.2	5.2
Other lending:				
Debt factoring loans	**42.0**	**0.4**	39.5	0.4
Other loans	**58.4**	**0.6**	54.7	0.5
Gross balances	**10,100.0**	**100.0**	9,688.1	100.0
Impairment provisions	**(88.1)**		(79.4)	
Fair value adjustment for hedged risk	**240.9**		206.0	
	10,252.8		9,814.7	

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 Society, SIL, which lends in the Channel Islands, and the specialist mortgage lending in Amber Homeloans and North Yorkshire Mortgages.

The tables below provide further information on types of lending and geographical split.

Lending analysis	Group		Society	
	2011	2010	2011	2010
	£m	£m	£m	£m
Total book:				
Prime	**6,291.0**	5,678.1	**5,506.2**	4,929.9
Buy-to-let	**1,790.3**	1,801.6	**1,399.0**	1,397.1
Fast track	**182.8**	238.4	**182.8**	238.4
Self certified	**775.1**	827.3	**-**	-
Sub-prime	**445.7**	474.0	**-**	-
Self build	**47.6**	73.3	**47.6**	73.3
	9,532.5	9,092.7	**7,135.6**	6,638.7

33. Financial instruments (continued)

Geographical analysis	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Total book:				
North	**343.7**	334.3	**288.7**	275.1
Yorkshire	**1,012.3**	1,029.3	**885.1**	890.2
East Midlands	**596.7**	591.7	**476.5**	463.5
East Anglia	**562.8**	540.5	**437.8**	409.5
London	**1,175.6**	1,106.0	**853.1**	756.0
South East	**1,940.6**	1,815.4	**1,531.1**	1,362.7
South West	**795.2**	771.6	**645.3**	608.4
West Midlands	**554.9**	535.5	**423.8**	397.6
North West	**1,032.6**	1,039.7	**834.5**	832.5
Wales	**188.3**	178.5	**111.3**	97.9
Scotland	**690.8**	604.1	**613.6**	519.6
Northern Ireland	**68.7**	63.2	**34.8**	25.7
Channel Islands	**570.3**	482.9	**-**	-
	9,532.5	9,092.7	**7,135.6**	6,638.7

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

Indexed loan-to-value analysis	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Total book:				
<70%	**3,980.9**	4,014.7	**3,497.6**	3,502.3
70% - 80%	**1,437.1**	1,253.5	**1,196.8**	1,016.6
80% - 90 %	**1,579.3**	1,355.8	**1,248.9**	1,006.7
>90%	**2,535.2**	2,468.7	**1,192.3**	1,113.1
	9,532.5	9,092.7	**7,135.6**	6,638.7

Indexed loan-to-value analysis	Group 2011 %	Group 2010 %	Society 2011 %	Society 2010 %
Total book:				
<70%	**41.7**	44.1	**49.0**	52.7
70% - 80%	**15.1**	13.8	**16.8**	15.3
80% - 90 %	**16.6**	14.9	**17.5**	15.2
>90%	**26.6**	27.2	**16.7**	16.8
Average indexed loan-to-value	**55.5**	55.5	**50.9**	50.6

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

Notes to the Accounts - continued

33. Financial instruments (continued)

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

	Group				Society			
	2011		2010		**2011**		2010	
	£m	**%**	£m	%	**£m**	**%**	£m	%
Neither past due nor individually impaired	**8,981.6**	**94.2**	8,542.2	93.9	**6,967.5**	**97.7**	6,454.3	97.3
Past due but not individually impaired:								
Up to 3 months	**74.2**	**0.8**	91.1	1.0	**57.6**	**0.8**	74.9	1.1
3 to 6 months	**12.2**	**0.1**	15.1	0.2	**7.1**	**0.1**	9.4	0.2
6 to 9 months	**5.0**	**0.1**	4.8	0.1	**3.5**	**-**	3.1	-
9 to 12 months	**2.3**	**-**	3.3	-	**0.8**	**-**	2.2	-
Over 12 months	**3.3**	**-**	4.3	-	**0.9**	**-**	1.8	-
Total	**9,078.6**	**95.2**	8,660.8	95.2	**7,037.4**	**98.6**	6,545.7	98.6
Individually impaired	**420.8**	**4.4**	406.6	4.5	**89.6**	**1.3**	87.7	1.3
Possessions	**33.1**	**0.4**	25.3	0.3	**8.6**	**0.1**	5.3	0.1
	9,532.5	**100.0**	9,092.7	100.0	**7,135.6**	**100.0**	6,638.7	100.0

Where appropriate for customers' needs, the Company applies a policy of forbearance and may grant a concession to borrowers. This may be applied where actual or apparent financial stress of the customer is deemed short term with a potential to be recovered. A concession may involve arrears capitalisation, a reduction in the monthly payment, a conversion to interest only or a mortgage term extension. These strategies are undertaken in order to achieve reduced long term arrears and allow the best outcome for both the customer and the business by dealing with arrears at an early stage. The customer accounts are monitored to ensure that these strategies remain appropriate.

Capitalisation is only offered where all other forbearance options (transfer to interest only, reduced payment, mortgage extension) have been exhausted and is the right option for the customer. The Group policy, after obtaining the customers consent, is to capitalise arrears once the customer has made at least six consecutive contractual monthly mortgage repayments following the instance of non-payment.

33. Financial instruments (continued)

The table below provides further information on the residential loans existing at the 2011 reporting date by types of account renegotiations applied to our customers over two years since January 2010. This includes renegotiations regardless of whether or not our customer has experienced financial difficulty in repaying their loan with the Group. For clarity, this table illustrates all balances which have had their terms renegotiated in the last two years, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms.

Group 2011	**Balance £m**	**Capitalisation £m**	**Reduced payment £m**	**Transfer to interest only £m**	**Term extension £m**	**Total renegotiations £m**	**%**
Neither past due nor individually impaired	**8,981.6**	138.4	94.1	183.6	99.8	**515.9**	**5.7**
Past due but not individually impaired:							
Up to 3 months	**74.2**	5.6	9.8	8.3	4.2	**27.9**	**37.6**
3 to 6 months	**12.2**	1.1	1.0	1.8	0.9	**4.8**	**39.3**
6 to 9 months	**5.0**	0.5	1.1	0.6	0.3	**2.5**	**50.0**
9 to 12 months	**2.3**	-	0.1	0.5	-	**0.6**	**26.1**
Over 12 months	**3.3**	-	0.3	1.1	-	**1.4**	**42.4**
	9,078.6	**145.6**	**106.4**	**195.9**	**105.2**	**553.1**	**6.1**
Individually impaired	**420.8**	68.2	47.8	38.2	4.6	**158.8**	**37.7**
Possessions	**33.1**	3.4	2.7	2.3	0.4	**8.8**	**26.6**
	9,532.5	**217.2**	**156.9**	**236.4**	**110.2**	**720.7**	**7.6**
Collective impairment	**(13.3)**	(2.9)	(1.0)	(0.5)	-	**(4.4)**	**33.1**
Individual impairment	**(46.3)**	(3.9)	(4.4)	(3.6)	(0.2)	**(12.1)**	**26.1**
	9,472.9	**210.4**	**151.5**	**232.3**	**110.0**	**704.2**	**7.4**

Notes to the Accounts - continued

33. Financial instruments (continued)

Society 2011	Balance £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Neither past due nor individually impaired	**6,967.5**	48.3	76.8	163.3	97.7	**386.1**	**5.5**
Past due but not individually impaired:							
Up to 3 months	**57.6**	3.8	9.7	7.4	4.2	**25.1**	**43.6**
3 to 6 months	**7.1**	0.5	0.8	1.7	0.9	**3.9**	**54.9**
6 to 9 months	**3.5**	-	1.1	0.4	0.3	**1.8**	**51.4**
9 to 12 months	**0.8**	-	-	0.3	-	**0.3**	**37.5**
Over 12 months	**0.9**	-	-	0.2	-	**0.2**	**22.2**
	7,037.4	**52.6**	**88.4**	**173.3**	**103.1**	**417.4**	**5.9**
Individually impaired	**89.6**	4.1	22.5	19.0	4.5	**50.1**	**55.9**
Possessions	**8.6**	0.2	1.8	1.3	0.4	**3.7**	**43.0**
	7,135.6	**56.9**	**112.7**	**193.6**	**108.0**	**471.2**	**6.6**
Collective impairment	**(6.0)**	(0.8)	(0.1)	(0.2)	-	**(1.1)**	**18.3**
Individual impairment	**(7.4)**	(0.2)	(1.0)	(0.9)	(0.2)	**(2.3)**	**31.1**
	7,122.2	**55.9**	**111.6**	**192.5**	**107.8**	**467.8**	**6.6**

A collective impairment allowance is made against performing loans where objective evidence indicates that it is likely that credit losses have been incurred but not yet identified at the reporting date. This impairment allowance is calculated by applying various economic factors to our mortgage portfolio exposures and incorporates the relative credit risk assessment of the account renegotiation categories shown above.

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.

Fair value of collateral held:	Group 2011 £m	Group 2010 £m	Society 2011 £m	Society 2010 £m
Not individually impaired	**16,711.6**	15,946.5	**13,914.7**	13,025.1
Impaired	**424.2**	413.4	**96.1**	92.6
Possessions	**29.5**	22.1	**7.4**	4.6
	17,165.3	16,382.0	**14,018.2**	13,122.3

The collateral held consists predominantly of residential properties. 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

An analysis of loans secured on commercial property by industry type and geography is provided below:

	Group and Society			
	2011		2010	
	£m	%	£m	%
Leisure and hotel	**44.5**	**9.5**	47.7	9.5
Retail	**16.5**	**3.5**	17.6	3.5
Nursing / residential homes	**25.4**	**5.4**	32.7	6.5
Offices	**15.6**	**3.4**	17.5	3.5
Commercial investment and industrial units	**341.5**	**73.1**	358.9	71.6
Miscellaneous	**23.6**	**5.1**	26.8	5.4
	467.1	**100.0**	501.2	100.0

Geographical analysis	Group and Society			
	2011		2010	
	£m	%	£m	%
Total book:				
North	**21.1**	**4.5**	28.7	5.7
Yorkshire	**41.7**	**8.9**	44.7	8.9
East Midlands	**32.0**	**6.9**	32.9	6.6
East Anglia	**17.8**	**3.8**	19.6	3.9
London	**105.1**	**22.5**	111.1	22.2
South East	**96.7**	**20.7**	102.2	20.4
South West	**52.5**	**11.2**	57.6	11.5
West Midlands	**33.9**	**7.3**	34.0	6.8
North West	**50.5**	**10.8**	53.2	10.6
Wales	**8.8**	**1.9**	9.0	1.8
Scotland	**7.0**	**1.5**	8.2	1.6
	467.1	**100.0**	501.2	100.0

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

Loan-to-value analysis	Group and Society			
	2011		2010	
	£m	%	£m	%
Total book:				
<70%	**407.1**	**87.1**	427.3	85.2
70% - 80%	**24.3**	**5.2**	44.6	8.9
80% - 90 %	**10.6**	**2.3**	3.3	0.7
>90%	**25.1**	**5.4**	26.0	5.2
	467.1	**100.0**	501.2	100.0
Average loan-to-value		**73.8**		75.4

Notes to the Accounts - continued

33. Financial instruments (continued)

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

	Group and Society			
	2011		2010	
	£m	**%**	£m	%
Neither past due nor individually impaired	**441.0**	**94.5**	475.1	94.9
Past due but not individually impaired:				
Up to 3 months	**12.4**	**2.7**	5.4	1.1
3 to 6 months	**0.1**	**-**	1.7	0.3
6 to 9 months	**0.5**	**0.1**	1.6	0.3
9 to 12 months	**0.1**	**-**	-	-
Over 12 months	**1.1**	**0.2**	-	-
Total	**455.2**	**97.5**	483.8	96.6
Individually impaired	**11.9**	**2.5**	17.2	3.4
Possessions	**-**	**-**	0.2	-
	467.1	**100.0**	501.2	100.0

Where appropriate for customers' needs, the Company applies a policy of forbearance and may grant a concession to borrowers. This may be applied where actual or apparent financial stress of the customer is deemed short term with a potential to be recovered. A concession may involve arrears capitalisation or a conversion to interest only. These strategies are undertaken in order to achieve reduced long term arrears and allow the best outcome for both the customer and the business by dealing with arrears at an early stage. The customer accounts are monitored to ensure that these strategies remain appropriate.

Capitalisation is only offered where all other forbearance options (transfer to interest only and arrears capitalisation) have been exhausted and is the right option for the customer. The Group policy, after obtaining the customers consent, is to capitalise arrears once the customer has made at least six consecutive contractual monthly mortgage repayments following the instance of non-payment.

The table below provides further information on the commercial loans existing at the 2011 reporting date by types of account renegotiations applied to our customers over two years since January 2010. This includes renegotiations regardless of whether or not our customer has experienced financial difficulty in repaying their loan with the Society. For clarity, this table illustrates all balances which have had their terms renegotiated in the last two years, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms.

Group and Society 2011	**Balance**	**Capitalisation**	**Transfer to interest only**	**Total renegotiations**	
	£m	**£m**	**£m**	**£m**	**%**
Neither past due nor individually impaired	**441.0**	17.8	11.9	**29.7**	**6.7**
Past due but not individually impaired:					
Up to 3 months	**12.4**	-	0.4	**0.4**	**3.2**
3 to 6 months	**0.1**	-	-	**-**	**-**
6 to 9 months	**0.5**	-	-	**-**	**-**
9 to 12 months	**0.1**	-	-	**-**	**-**
Over 12 months	**1.1**	-	-	**-**	**-**
	455.2	**17.8**	**12.3**	**30.1**	**6.6**
Individually impaired	**11.9**	-	11.8	**11.8**	**99.2**
	467.1	**17.8**	**24.1**	**41.9**	**9.0**
Collective impairment	**(1.5)**	(0.1)	(0.1)	**(0.2)**	**13.3**
Individual impairment	**(5.2)**	(0.2)	(1.2)	**(1.4)**	**26.9**
	460.4	**17.5**	**22.8**	**40.3**	**8.8**

33. Financial instruments (continued)

A collective impairment allowance is made against performing loans where objective evidence indicates that it is likely that credit losses have been incurred but not yet identified at the reporting date. This impairment allowance is calculated using third party valuation indices which are discounted further to assume a forced sale value in addition to default propensity modelling.

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

Fair value of collateral held:	**Group and Society**	
	2011 £m	2010 £m
Not individually impaired	**625.2**	650.4
Individually impaired	**8.0**	14.6
Possessions	**-**	0.1
	633.2	665.1

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.

c) Other lending

	Group				**Society**			
	2011		2010		**2011**		2010	
	Gross £m	**Impairment £m**	Gross £m	Impairment £m	**Gross £m**	**Impairment £m**	Gross £m	Impairment £m
Factored debt and invoice discounting	**42.0**	**(0.6)**	39.5	(0.7)	**-**	**-**	-	-
Other loans	**58.4**	**(21.2)**	54.7	(12.2)	**24.4**	**(21.2)**	23.9	(12.2)
	100.4	**(21.8)**	94.2	(12.9)	**24.4**	**(21.2)**	23.9	(12.2)

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 individually impaired amount to £1.5m (2010: £2.2m). 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 individually impaired amount to £23.5m (2010: £22.6m) 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.

Credit risk - debt securities and loans and advances to credit institutions

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

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.

As at 31 December 2011 £7.4m (2010: £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 2011, 98% (2010: 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.

Notes to the Accounts - continued

33. Financial instruments (continued)

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

Rating	2011		2010	
	£m	%	£m	%
Aaa	**2,082.9**	**68.9**	2,572.6	76.2
Aa1	**74.1**	**2.5**	82.6	2.4
Aa2	**279.0**	**9.2**	171.5	5.1
Aa3	**144.4**	**4.8**	307.3	9.1
A1	**126.4**	**4.1**	153.5	4.5
A2	**226.0**	**7.5**	9.3	0.3
A3	**33.6**	**1.1**	25.1	0.7
Baa1	**1.9**	**0.1**	6.3	0.2
Baa2	**4.5**	**0.1**	6.7	0.2
Baa3	**2.5**	**0.1**	34.7	1.0
Ba1	**1.7**	**0.1**	-	-
Ba2	**22.7**	**0.8**	-	-
Caa1	**6.6**	**0.2**	6.6	0.2
Caa2	**14.3**	**0.5**	-	-
Unrated:				
Building societies	**-**	**-**	3.0	0.1
Local authorities	**-**	**-**	0.5	-
	3,020.6	**100.0**	3,379.7	100.0

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

Industry sector / asset class	2011		2010	
	£m	%	£m	%
Cash in hand and balances with the Bank of England	**782.3**	**25.9**	664.6	19.7
Cash with banks and building societies	**361.0**	**12.0**	293.4	8.7
Gilts	**187.3**	**6.2**	200.8	5.9
Treasury bills	**40.4**	**1.3**	749.4	22.2
Certificates of deposit	**414.6**	**13.7**	205.4	6.1
Local authority investments	**-**	**-**	0.5	-
Fixed rate bonds	**396.3**	**13.1**	452.6	13.4
Floating rate notes	**543.8**	**18.0**	532.0	15.7
Residential mortgage backed securities	**256.6**	**8.5**	233.3	6.9
Commercial mortgage backed securities	**38.3**	**1.3**	47.7	1.4
	3,020.6	**100.0**	3,379.7	100.0

Geographical exposure	2011		2010	
	£m	%	£m	%
UK	**2,190.6**	**72.5**	2,631.0	77.9
Rest of Europe	**725.1**	**24.0**	622.4	18.4
North America	**84.1**	**2.8**	81.2	2.4
Australasia	**17.0**	**0.6**	42.2	1.2
Far East	**3.8**	**0.1**	2.9	0.1
	3,020.6	**100.0**	3,379.7	100.0

33. Financial instruments (continued)

Within the treasury investments portfolio, the Group has no direct sovereign exposure to Greece, Ireland, Italy, Portugal or Spain as at 31 December 2011. As at 31 December 2011, the Group had £38m of senior debt exposure to financial institutions based in Ireland, £23m of which was repaid after the year end, and the remainder is due to mature in June 2012. Whilst the political and economic environment in Europe remains very challenging, we do not currently expect any impairment to be required for these investments.

Credit risk - derivative financial instruments

A credit exposure could arise in respect of derivative contracts entered into by the Group if the counterparty was unable to fulfil its contractual obligations. The Group address the risks associated with these activities by monitoring counterparty credit exposure and requiring additional collateral to be posted or returned as necessary. The only form of collateral accepted by the Group is cash or gilts. Derivatives are transacted under International Swaps and Derivatives Association ('ISDA') Master Agreements. In addition a Credit Support Annex ('CSA') has been executed with certain counterparties in conjunction with the ISDA Master Agreement and as such may require collateral to be posted from time to time, as required by specific terms and conditions of the arrangements.

Netting arrangements do not necessarily 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.

Collateral received and pledged

The fair value of the collateral which the Group and Society hold is as follows:

	Group 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
Assets under reverse repurchase agreements	**6.1**	-	**6.1**	-
Cash collateral received in respect of derivative contracts	**230.3**	144.2	**230.3**	144.2
	236.4	144.2	**236.4**	144.2

The liability to repay the cash collateral received is included within 'amounts owed to credit institutions'.

Notes to the Accounts - continued

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	**2011**				
	Positive book value £m	**Positive fair value £m**	**Negative book value £m**	**Negative fair value £m**	**Notional value / principal £m**
Cash and cash equivalents	782.3	782.3	-	-	782.3
Debt securities	1,877.3	1,853.2	-	-	1,847.6
Loans and advances to customers	10,252.8	10,192.5	-	-	10,076.2
Loans and advances to credit institutions	361.0	361.0	-	-	243.5
Trade receivables	35.5	35.5	-	-	35.5
Shares	-	-	(9,280.4)	(9,280.4)	9,172.9
Amounts owed to credit institutions	-	-	(877.4)	(877.4)	876.1
Amounts owed to other customers	-	-	(921.3)	(770.2)	911.5
Debt securities in issue	-	-	(1,129.9)	(1,044.9)	1,044.2
Subordinated liabilities and subscribed capital	-	-	(300.0)	(260.6)	300.0
Trade payables	-	-	(7.2)	(7.2)	7.2
Derivatives designated as fair value hedges	153.7	153.7	(142.9)	(142.9)	5,686.9
Derivatives designated as cash flow hedges	14.0	14.0	(33.8)	(33.8)	2,474.9
Other derivatives and embedded derivatives	48.6	48.6	(197.7)	(197.7)	2,650.5
	13,525.2	**13,440.8**	**(12,890.6)**	**(12,615.1)**	

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	9,752.1	-	-	9,661.7
Loans and advances to credit institutions	293.9	293.9	-	-	195.5
Trade receivables	31.1	31.1	-	-	31.1
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
	13,366.1	13,299.4	(12,743.5)	(12,559.9)	

33. Financial instruments (continued)

Society	2011				
	Positive book value £m	**Positive fair value £m**	**Negative book value £m**	**Negative fair value £m**	**Notional value / principal £m**
Cash and cash equivalents	782.2	782.2	-	-	782.2
Debt securities	2,507.3	2,483.2	-	-	2,511.7
Loans and advances to customers	7,819.7	7,803.0	-	-	7,612.1
Loans and advances to credit institutions	262.2	262.2	-	-	261.8
Trade receivables	0.2	0.2	-	-	0.2
Shares	-	-	(9,280.4)	(9,280.4)	9,172.9
Amounts owed to credit institutions	-	-	(709.7)	(709.7)	708.4
Amounts owed to other customers	-	-	(1,678.4)	(1,535.7)	1,676.4
Debt securities in issue	-	-	(809.9)	(725.2)	721.8
Subordinated liabilities and subscribed capital	-	-	(311.5)	(272.1)	312.5
Trade payables	-	-	(0.6)	(0.6)	0.6
Derivatives designated as fair value hedges	153.2	153.2	(135.9)	(135.9)	5,938.2
Derivatives designated as cash flow hedges	14.0	14.0	(33.7)	(33.7)	2,487.4
Other derivatives and embedded derivatives	49.3	49.3	(139.9)	(139.9)	2,637.4
	11,588.1	**11,547.3**	**(13,100.0)**	**(12,833.2)**	

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	7,307.4	-	-	7,152.1
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	10,720.1	(13,307.5)	(13,137.2)	

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.

Notes to the Accounts - continued

33. Financial instruments (continued)

The table below summarises the Group's main financial instruments by financial asset type:

2011	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	782.3	-	-	782.3
Trade receivables	35.5	-	-	35.5
Loans and advances to credit institutions	361.0	-	-	361.0
Loans and advances to customers	10,252.8	-	-	10,252.8
Debt securities	224.4	1,652.9	-	1,877.3
Derivative financial instruments	-	-	216.3	216.3
Shares	(9,280.4)	-	-	(9,280.4)
Amounts owed to credit institutions and other customers	(1,798.7)	-	-	(1,798.7)
Trade payables	(7.2)	-	-	(7.2)
Debt securities in issue	(1,129.9)	-	-	(1,129.9)
Subordinated liabilities	(214.2)	-	-	(214.2)
Derivative financial instruments	-	-	(374.4)	(374.4)
	(774.4)	**1,652.9**	**(158.1)**	

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	31.1	-	-	31.1
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)
	(1,311.9)	2,139.4	(120.2)	

33. Financial instruments (continued)

The table below summarises the Society's main financial instruments by financial asset type:

	2011			
	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	782.2	-	-	782.2
Trade receivables	0.2	-	-	0.2
Loans and advances to credit institutions	262.2	-	-	262.2
Loans and advances to customers	7,819.7	-	-	7,819.7
Debt securities	224.4	2,282.9	-	2,507.3
Derivative financial instruments	-	-	216.5	216.5
Shares	(9,280.4)	-	-	(9,280.4)
Amounts owed to credit institutions and other customers	(2,388.1)	-	-	(2,388.1)
Trade payables	(0.6)	-	-	(0.6)
Debt securities in issue	(809.9)	-	-	(809.9)
Subordinated liabilities	(225.7)	-	-	(225.7)
Derivative financial instruments	-	-	(309.5)	(309.5)
	(3,616.0)	**2,282.9**	**(93.0)**	

	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)	

Notes to the Accounts - continued

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. Examples of these are gilts and sovereign debt.

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. Where discounting techniques are used, management have chosen to use LIBOR rather than Overnight Index Swaps ('OIS'). This will be reviewed when derivative clearing is introduced. No Credit ('CVA') or Debit ('DVA') value adjustments have been made in respect of credit risk in the fair value of the Group's derivative financial instruments. Examples of level 2 instruments are certificates of deposit and interest rate swaps.

In considering which similar instruments to use, Market and Liquidity 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 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.

The tables below summarise the fair value measurement basis used for assets and liabilities held at fair value:

Group	2011			
	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	1,329.1	323.8	-	1,652.9
Financial assets at fair value through profit and loss:				
Derivative financial instruments	-	216.3	-	216.3
	1,329.1	540.1	-	1,869.2
Financial liabilities				
Financial liabilities at fair value through profit and loss:				
Derivative financial instruments	-	374.4	-	374.4
	-	374.4	-	374.4

33. Financial instruments (continued)

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

Society	**2011**			
	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	**1,959.1**	**323.8**	**-**	**2,282.9**
Financial assets at fair value through profit and loss:				
Derivative financial instruments	**-**	**216.5**	**-**	**216.5**
	1,959.1	**540.3**	**-**	**2,499.4**
Financial liabilities				
Financial liabilities at fair value through profit and loss:				
Derivative financial instruments	**-**	**309.5**	**-**	**309.5**
	-	**309.5**	**-**	**309.5**

Notes to the Accounts - continued

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

34. Group segmental reporting

The Group's operating results are regularly reviewed by the chief operating decision maker (the Board) 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 a number of small trading companies that do not fall within the core operating segments.

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, £31.3m (2010: £21.2m) was generated outside 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)

	2011						
	Mortgages and Savings £m	Estate Agency £m	Mortgage Services £m	Financial Advice £m	Investment Portfolio £m	Inter-divisional adjustments £m	Total £m
Interest receivable and similar income	386.1	0.8	-	0.2	2.0	(15.5)	373.6
Interest payable and similar charges	(316.4)	(0.4)	-	(0.2)	(0.9)	15.5	(302.4)
Fair value gains on financial instruments	3.0	-	-	-	-	-	3.0
Fees and commissions receivable	22.5	213.6	66.8	54.1	32.7	(20.3)	369.4
Fees and commissions payable	(7.6)	(3.4)	(1.5)	(10.4)	(0.8)	15.8	(7.9)
Profit on disposal of subsidiary undertakings	0.1	(0.1)	-	-	1.0	(0.1)	0.9
Share of profits from joint ventures	-	0.7	-	-	-	-	0.7
Other income	7.0	1.5	0.2	-	7.0	(2.5)	13.2
Total income	94.7	212.7	65.5	43.7	41.0	(7.1)	450.5
Employee and pension costs	43.5	114.2	34.9	27.3	25.8	-	245.7
Depreciation and amortisation	5.8	5.0	4.9	1.2	3.8	-	20.7
Other admin expenses	23.6	51.8	29.1	10.2	9.6	(5.9)	118.4
Operating profit / (loss) before impairment losses and provisions	21.8	41.7	(3.4)	5.0	1.8	(1.2)	65.7
Impairment losses / provisions for liabilities	35.3	5.9	(0.3)	2.1	0.5	-	43.5
(Loss) / profit before tax	(13.5)	35.8	(3.1)	2.9	1.3	(1.2)	22.2
Taxation	3.8	(10.7)	0.9	(0.8)	0.1	-	(6.7)
(Loss) / profit after tax	(9.7)	25.1	(2.2)	2.1	1.4	(1.2)	15.5
Total assets	13,726.5	159.3	26.4	24.8	118.6	(145.3)	13,910.3
Total liabilities	12,871.5	67.5	5.4	2.4	89.8	57.2	13,093.8
Capital expenditure	1.8	7.5	4.2	1.2	3.7	-	18.4

Total income can be analysed as follows:

	2011						
	Mortgages and Savings £m	Estate Agency £m	Mortgage Services £m	Financial Advice £m	Investment Portfolio £m	Inter-divisional adjustments £m	Total £m
Income from other segments	5.5	4.2	4.1	(7.6)	1.5	(7.7)	-
External income	89.2	208.5	61.4	51.3	39.5	0.6	450.5
Total income	94.7	212.7	65.5	43.7	41.0	(7.1)	450.5

Notes to the Accounts - continued

34. Group segmental reporting (continued)

	2010 (Restated*)						
	Mortgages and Savings* £m	Estate Agency £m	Mortgage Services £m	Financial Advice £m	Investment Portfolio* £m	Inter-divisional adjustments £m	Total £m
Interest receivable and similar income	379.6	0.7	-	0.1	2.7	(19.5)	363.6
Interest payable and similar charges	(327.1)	0.3	-	(0.2)	(0.7)	19.0	(308.7)
Fair value gains on financial instruments	2.0	-	-	-	-	-	2.0
Fees and commissions receivable	14.1	208.1	78.2	51.6	44.9	(15.2)	381.7
Fees and commissions payable	(8.4)	(3.1)	(1.9)	(8.9)	(12.3)	13.8	(20.8)
Profit on disposal of subsidiary undertakings	1.4	-	-	-	1.6	(1.8)	1.2
Share of profits from joint ventures	-	0.3	-	-	-	-	0.3
Other income	15.4	1.7	0.6	0.1	9.5	(3.2)	24.1
Total income	77.0	208.0	76.9	42.7	45.7	(6.9)	443.4
Employee and pension costs	42.6	105.5	47.7	27.6	26.7	-	250.1
Depreciation and amortisation	6.4	4.2	4.6	1.8	4.3	-	21.3
Other admin expenses	27.1	53.9	24.4	8.9	10.9	(1.1)	124.1
Operating profit / (loss) before impairment losses and provisions	0.9	44.4	0.2	4.4	3.8	(5.8)	47.9
Negative goodwill arising on merger	(3.1)	-	-	-	-	-	(3.1)
Impairment losses / provisions for liabilities	15.7	(3.7)	0.1	3.4	0.4	0.1	16.0
(Loss) / profit before tax	(11.7)	48.1	0.1	1.0	3.4	(5.9)	35.0
Taxation	6.2	(13.8)	(0.1)	(0.8)	1.0	(2.3)	(9.8)
(Loss) / profit after tax	(5.5)	34.3	-	0.2	4.4	(8.2)	25.2
Total assets	13,592.9	137.5	27.5	23.8	113.9	(156.1)	13,739.5
Total liabilities	12,719.6	50.2	4.2	2.1	83.9	58.4	12,918.4
Capital expenditure	22.3	5.4	5.4	1.0	5.7	(19.7)	20.1

Total income can be analysed as follows:

	2010 (Restated*)						
	Mortgages and Savings* £m	Estate Agency £m	Mortgage Services £m	Financial Advice £m	Investment Portfolio* £m	Inter-divisional adjustments £m	Total £m
Income from other segments	1.8	1.9	4.5	(4.8)	3.9	(7.3)	-
External income	75.2	206.1	72.4	47.5	41.8	0.4	443.4
Total income	77.0	208.0	76.9	42.7	45.7	(6.9)	443.4

* There has been a change in the reporting of business segments compared to the results reported in 2010, aligned with the way that management have assessed performance and allocated resources during the period. There is no impact on the Group Income Statement or Statement of Financial Position; comparative figures have been restated accordingly. The holding company, Skipton Group Holdings Limited, has been transferred from the Investment Portfolio to the Mortgages and Savings division. The impact on the 2011 reporting if this change had not been made would have been a £7.4m additional profit before tax in the Mortgages and Savings division and a corresponding loss in the Investment Portfolio.

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: £6.5m (2010: £7.1m) and Society: £1.9m (2010: £1.7m).

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.

Notes to the Accounts - continued

35. Pensions (continued)

The main financial assumptions used in the actuarial valuation are as follows:

	Group and Society	
	2011	2010
	%	%
Retail price inflation	**2.90**	3.50
Consumer price inflation	**2.00**	3.00
Discount rate	**4.80**	5.50
Expected return on assets	**5.18-6.17**	6.25-7.58
Increases to pension payment:		
RPI max 5%	**2.80**	3.30
RPI min 3% max 5%	**3.55**	3.80
RPI max 2.5%	**2.40**	2.40
CPI max 5%	**2.00**	2.80
CPI min 3% max 5%	**3.30**	3.30
CPI max 2.5%	**1.90**	2.40
Rate of increase deferred pensions (RPI link)	**N/A**	3.50
Rate of increase deferred pensions (CPI link)	**2.00**	3.00

All the schemes' deferred pensions now accrue inflationary increases based on CPI rather than RPI.

The most significant non-financial assumption is the assumed rate of longevity. For the year ended 31 December 2011, this has been based on mortality rates that are 100% of the S1PMA__L tables for males (or S1PFA__L tables for females) with an allowance for projected improvements in mortality in line with CMI 2009 improvements with a 1% per annum long term rate of convergence. This has been amended from the assumption used for the year ended 31 December 2010 to reflect more up to date tables and improvements. The tables adopted assume that, when a member who is fifteen years from retirement reaches age 65, the life expectancy from age 65 is as follows:

Non-retired members	**2011**	2010
Males	**24.5**	24.1
Females	**25.7**	26.3

The table below shows the net pension liability which is recognised in the Statement of Financial Position:

	Group 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
Fair value of plan assets	**148.5**	166.2	**78.1**	86.7
Present value of defined benefit obligations	**(192.1)**	(198.0)	**(97.0)**	(96.4)
Net pension liability	**(43.6)**	(31.8)	**(18.9)**	(9.7)

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 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
At 1 January	**166.2**	148.8	**86.7**	76.4
Expected return on assets	**10.2**	10.7	**5.2**	5.4
Actuarial (losses) / gains	**(11.1)**	6.0	**(4.2)**	3.2
Contributions by employer	**3.7**	6.3	**2.1**	5.3
Contributions by employees	**-**	-	**-**	-
Benefits paid	**(4.2)**	(5.6)	**(2.7)**	(3.6)
Assets distributed on settlements	**(16.3)**	-	**(9.0)**	-
At 31 December	**148.5**	166.2	**78.1**	86.7

35. Pensions (continued)

Towards the end of 2010 an enhanced pension transfer programme was offered to certain deferred members of the defined benefit pension schemes. The offer to members closed in 2011 with payment and transfers for those who accepted the offer being made in the first half of 2011. Transfer values totalling £16.3m for Group and £9.0m for Society were paid out of the schemes and the liability extinguished was £20.8m for Group and £11.1m for Society. This resulted in a settlement gain of £4.5m for Group and £2.1m for Society.

The table below sets out a reconciliation of the present value of the defined benefit obligation for the year:

	Group 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
At 1 January	**198.0**	196.2	**96.4**	95.9
Current service cost	**-**	-	**-**	-
Past service costs	**1.8**	-	**1.3**	-
Interest cost	**10.0**	11.1	**4.8**	5.4
Contributions by employees	**-**	-	**-**	-
Actuarial losses / (gains)	**7.3**	(3.7)	**8.3**	(1.3)
Actual benefit payments	**(4.2)**	(5.6)	**(2.7)**	(3.6)
Liabilities extinguished on settlements	**(20.8)**	-	**(11.1)**	-
At 31 December	**192.1**	198.0	**97.0**	96.4

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 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
Actual return on assets	**(0.9)**	16.7	**1.0**	8.6
Expected return on assets	**(10.2)**	(10.7)	**(5.2)**	(5.4)
Actuarial (loss) / gain on assets	**(11.1)**	6.0	**(4.2)**	3.2

Notes to the Accounts - continued

35. Pensions (continued)

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	**2011**		2010	
	£m	**% pa**	£m	% pa
Equities	**30.3**	**6.55**	100.0	7.95
Property	**1.8**	**4.85**	5.2	6.25
Corporate bonds	**23.4**	**4.80**	21.9	5.50
Government bonds	**29.4**	**2.80**	25.6	4.20
Diversified growth vehicle*	**62.3**	**6.55**	-	-
Cash	**1.3**	**3.00**	13.5	3.00
	148.5	**5.48**	166.2	6.60

* Diversified growth vehicles target equity-like returns with lower volatility which is achieved through dynamic diversification. Funds are invested in a diversified range of assets, including equities, bonds, property and cash and the allocation between these asset classes is actively managed by a fund manager reflecting the changing correlations and risk characteristics.

The actual return on the scheme assets over the year ended 31 December 2011 was estimated as (0.5)% (2010: 12%).

Society	**2011**		2010	
	£m	**% pa**	£m	% pa
Equities	**12.9**	**6.55**	47.3	7.95
Property	**0.9**	**4.85**	2.6	6.25
Corporate bonds	**14.8**	**4.80**	13.3	5.50
Government bonds	**18.3**	**2.80**	16.1	4.20
Diversified growth vehicle	**30.7**	**6.55**	-	-
Cash	**0.5**	**3.00**	7.4	3.00
	78.1	**5.30**	86.7	6.42

The actual return on the scheme assets over the year ended 31 December 2011 was estimated as 1.9% (2010: 10%).

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 2011 £m	Group 2010 £m	**Society 2011 £m**	Society 2010 £m
Current service cost	**-**	-	**-**	-
Past service cost	**1.8**	-	**1.3**	-
Gains on settlements	**(4.5)**	-	**(2.1)**	-
Interest on liabilities	**10.0**	11.1	**4.8**	5.4
Expected return on assets	**(10.2)**	(10.7)	**(5.2)**	(5.4)
Total pension (income) / expense	**(2.9)**	0.4	**(1.2)**	-

The tables below set out the actuarial gains and losses which have been recognised within the Statement of Comprehensive Income:

Group	**2011 £m**	2010 £m	2009 £m	2008 £m	2007 £m
Experience (losses) / gains on scheme assets	**(11.1)**	6.0	13.6	(37.5)	(1.3)
Experience gains / (losses) on defined benefit obligation	**1.7**	0.9	(0.7)	(1.6)	(4.4)
Gains / (losses) from change in assumptions	**(9.0)**	2.8	(30.8)	13.5	15.9
Total amount of surplus not recoverable	**-**	-	-	1.5	(1.5)
Total (losses) / gains recognised in Statement of Comprehensive Income during the year	**(18.4)**	9.7	(17.9)	(24.1)	8.7
Cumulative actuarial (losses) / gains recognised at end of year	**(47.1)**	(28.7)	(38.4)	(20.5)	3.6

Society	**2011 £m**	2010 £m	2009 £m	2008 £m	2007 £m
Experience (losses) / gains on scheme assets	**(4.2)**	3.2	6.8	(16.0)	(0.6)
Experience (losses) / gains on defined benefit obligation	**(2.2)**	0.4	(0.1)	(1.5)	(3.6)
Gains / (losses) from change in assumptions	**(6.1)**	1.0	(16.0)	5.8	5.4
Total (losses) / gains recognised in Statement of Comprehensive Income during the year	**(12.5)**	4.6	(9.3)	(11.7)	1.2
Cumulative actuarial (losses) / gains recognised at end of year	**(27.3)**	(14.8)	(19.4)	(10.1)	1.6

The present value of the defined benefit obligation and the fair value of the scheme assets are as follows:

Group	**2011 £m**	2010 £m	2009 £m	2008 £m	2007 £m
Fair value of plan assets	**148.5**	166.2	148.8	115.7	140.2
Present value of defined benefit obligations	**(192.1)**	(198.0)	(196.2)	(153.6)	(161.0)
Total amount of surplus not recoverable	**-**	-	-	-	(1.5)
Net pension liability	**(43.6)**	(31.8)	(47.4)	(37.9)	(22.3)

Society	**2011 £m**	2010 £m	2009 £m	2008 £m	2007 £m
Fair value of plan assets	**78.1**	86.7	76.4	54.2	63.7
Present value of defined benefit obligations	**(97.0)**	(96.4)	(95.9)	(72.3)	(71.5)
Net pension liability	**(18.9)**	(9.7)	(19.5)	(18.1)	(7.8)

Notes to the Accounts - continued

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 2012:

	Group 2012 £m	Society 2012 £m
Estimated employer contributions	2.1	1.0
Estimated employee contributions	-	-
Estimated total contributions	2.1	1.0

36. Adoption of new and revised International Financial Reporting Standards

Disclosed below are new standards and interpretations which have been adopted during the year.

- IAS 24, *Related Parties (Revised 2009)*. The revised standard must be applied for annual periods beginning on or after 1 January 2011 and amends the definition of a related party and modifies certain related party disclosure requirements for government-related entities. The revised standard has had no impact on these financial statements.
- Amendments to IFRIC 14 IAS 19 - *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*. These amendments remove unintended consequences arising from the treatment of prepayments where there is a minimum funding requirement. These amendments result in prepayments of contributions in certain circumstances being recognised as an asset rather than an expense. These amendments have had no impact on these financial statements.

The Group notes that there are a number of new accounting standards on the horizon, including IFRS 9, 10, 11, 12 and 13. These standards are subject to EU endorsement, the timing of which is uncertain, but are currently expected to be effective for annual periods beginning on or after 1 January 2015. As such the Group is monitoring developments and considering the associated impact on the Report and Accounts.

37. Subsequent events

There have been no material subsequent events between 31 December 2011 and the approval of this Annual Report and Accounts by the Board.

38. Capital Structure

The 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 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.

The following table shows the composition of the Group's capital at 31 December 2011:

	2011 £m	2010 £m
Tier 1		
Reserves	**806.5**	809.6
Permanent Interest Bearing Shares (note 1)	**90.0**	90.0
Pension fund deficit add back (note 2)	**13.5**	3.7
Deductions from Tier 1 capital (note 3)	**(196.7)**	(190.9)
Unrealised (gains) / losses on available-for-sale debt securities	**(6.0)**	6.9
Unrealised losses / (gains) on cash flow hedges	**19.0**	(0.3)
Total Tier 1 capital	**726.3**	719.0
Tier 2		
Subordinated debt (note 1)	**197.4**	204.4
Collective impairment allowance	**14.9**	21.2
Total Tier 2 capital	**212.3**	225.6
Total capital	**938.6**	944.6

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.

Annual Business Statement

1. Statutory percentages

	As at 31 December 2011 %	Statutory limit %
Lending limit	**10.81**	25.00
Funding limit	**19.79**	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

	2011 %	2010 %
As a percentage of shares and borrowings:		
(i) Gross capital	**9.14**	9.20
(ii) Free capital	**6.89**	7.01
(iii) Liquid assets	**24.74**	27.75
As a percentage of mean total assets:		
(i) Group profit after taxation	**0.11**	0.17
(ii) Group management expenses	**2.78**	2.70
(iii) Society management expenses	**0.44**	0.45

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 2011 and 2010 total assets.

Management expenses represent administrative expenses.

3. Information relating to Directors and other officers at 31 December 2011

The Board of Directors at 31 December 2011, 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
R D East	18 March 1960	29 November 2011
M H Ellis	4 August 1951	24 May 2011
M R Fleet*	5 January 1964	6 December 2011
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

* 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 2011 and their business occupations were:

S P Barker	Head of Group Tax
M Beech	Group Financial Control Manager
E A Blythe	General Manager, Audit Services
A P Braddick	Divisional Manager - North
K Brewster	Head of Products
P R Darwin	Head of Intermediary Sales
C J Davey	Head of Skipton Direct
R Fawcett	Chief Human Resources Officer
V French	Group Financial Reporting Manager
J J Gibson	Chief Conduct Risk Officer and Secretary
L Holden	Divisional Manager - South
L J Horwell	General Manager, Asset & Liability Management
I D Le Roux	Head of Insurance
B Ndawula	Chief Financial Risk Officer
A Nelson	General Manager, Finance
R Ramsden	Head of Brand Management
A C Robinson	Commercial Director
H Varney	Chief Operating Officer
D C Wormall	Head of Customer Insight

The Directors' business occupations and other Directorships at 31 December 2011 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 Solutions Limited
		Cashflow4Businesss.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
		Medical Care Direct Limited
		Mortgage Systems Limited
		North East Trustees Limited
		North West Investments NZ Limited

Annual Business Statement - continued

D J Cutter (continued)		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 P.S. Employee Benefits Limited RED ARC Assured Limited Savings Management Limited Sequence (UK) Limited 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
R D East	Non-Executive Director	Cash Flow Services Limited Cattles Holdings Limited Cattles Limited Cattles Properties (Ruddington) Limited C L Finance Limited Compass Credit Limited Dial4aloan Limited Ewbanks Mail Order Limited Lewis Debt Services Limited Lewis Group (Holdings) Limited Lewis Investigation Services Limited Moneytopia Bank Limited Moneytopia Limited Progressive Financial Services Limited Progressive Holdings Limited Progressive Insurance Co Limited Recordpoint Limited Scottish Bureau of Investigation Limited Shopacheck Financial Services Limited Shopacheck Limited Skipton Group Holdings Limited

R D East (continued)		Statusclaim Limited Supremeaccess Limited The Lewis Group Limited UK Debt Defaulters Register Limited Welcome Financial Services Limited Welcome Insurance Services Limited Welcome Mortgages Limited Welcome Retail Services Limited Westernissue Limited
M H Ellis	Non-Executive Director, Chairman	Skipton Group Holdings Limited M H Ellis Consulting Limited W H Smith PLC
M R Fleet	Building Society Distribution Director	Incresco Limited Life Policies Direct Limited P.S. Employee Benefits Limited PACE Financial Solutions Limited PACE Mortgage Solutions Limited Pearson Jones Plc Skipton Financial Services Limited Skipton Group Holdings Limited The Independent Mortgage Shop Limited Torquil Clark Holdings Limited Torquil Clark Limited Torquil Clark Pensions Trustees Limited Torquil Clark Professional Connections Limited TQ Management Services 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 Moorfield School Limited Skipton Group Holdings Limited
A B E Kinney	Retired Partner of a Leading Firm of Chartered Accountants	Gradient Finance Limited Irish Life & Permanent Plc Irish Life & Permanent Group Holdings Plc Skipton Group Holdings Limited
P J S Thompson	Non-Practising Solicitor	Bailey Electrical Limited 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 Group Limited NG Bailey and Company (Overseas) Limited Rushbond Plc Skipton Group Holdings Limited TEP Electrical Distributors Limited

Annual Business Statement - continued

R J Twigg	Building Society Group Finance Director	Amber Homeloans Limited Bailey Computer Services Limited Baseline Capital Limited Beckindale No 1 Limited Cashflow4Business.com Limited Chesham Mortgages Services Number 1 Limited Connells Limited Connell Financial Services Limited Darrowby No 1 PLC Darrowby No 2 PLC Homeloan Management Limited Jade Software Corporation Limited KB Analytics Limited Leeds Share Shop Limited MBO 1994 Limited Mortgage Systems Limited North West Investments NZ Limited North Yorkshire Mortgages Limited Parnell Fisher Child & Co Limited Parnell Fisher Child Holdings 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 Thomson Shepherd Holdings Limited Thomson Shepherd Limited Yorkshire Factors Limited

Messrs Cutter, Fleet and Twigg have service contracts entered into on 1 January 2000, 1 December 2011 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 2011 were as follows:

R Fawcett	Display Techniques Limited
J J Gibson	Connell Financial Services Limited Skipton International Limited Skipton Pension Trustees Limited
A Nelson	AWN Interim Limited
R Ramsden	Skipton Building Society Charitable Foundation
A C Robinson	Admiral Mortgage Company Limited Alegra Fine Products Limited Bailey Computer Services Limited BDS Mortgage Solutions Limited Cashflow4Business.com 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 Limited Sterling International Brokers Limited The Mortgage Helper Limited The Private Health Partnership Limited Torquil Clark Holdings Limited
I D Le Roux	Skipton Pension Trustees Limited
H Varney	Bailey Computer Services Limited Mutual One Limited The Old Saw Mill Management 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 (ABS)	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.
Basel III	In December 2010, the Basel Committee on Banking supervision issued the Basel III rules text, which presents the details of strengthened global regulatory standards on bank capital adequacy and liquidity. The standards will be phased in gradually from 2013.
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 the entire 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.
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.
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.
Forbearance strategies	Strategies to assist borrowers in financial difficulty, such as arrears capitalisation, a reduction in the monthly payment, a conversion to interest only or a mortgage term extension. Forbearance strategies aim, if possible, to avoid foreclosure or repossession.

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.
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.
Invidual 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.

Glossary - continued

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 may be renegotiated whether our customer is experiencing financial difficulty in repaying their loan with the Group or not.
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.
Securitisation	A process by which a group of assets, usually loans, are aggregated into a pool which is used to back the issuance of new securities. A company transfers these assets to a special purpose entity which then issues securities backed by the assets. The Group has established securitisation structures as part of its funding activities. These securitisation structures use retail mortgages as the asset pool.
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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