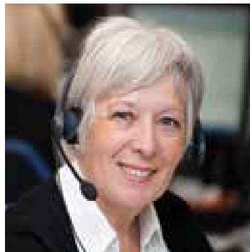

Skipton Building Society

Annual Report & Accounts 2012

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SKIPTON
MY BUILDING SOCIETY

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Key Financial Highlights

- Group profit before tax **£36.4m (2011: £22.2m)**
- Group net interest margin **up 17% to 0.61% (2011: 0.52%)**
- Total capital ratio **15.9% (2011: 15.5%)**
- Core Tier One capital ratio **11.1% (2011: 10.5%)**
- Gross mortgage advances **£1,483.7m (2011: £1,699.7m)**
- Group retail funding as a percentage of total funding **83.07% (2011: 80.21%)**
- Strong liquidity ratio maintained at **21.10%** of shares, deposits and liabilities **(2011: 24.79%)**
- Only **1.30%** of our mortgages have arrears of more than 2.5% of the total outstanding balance **(2011: 1.45%)**

Five Year Summary

Group Income Statements

	2008 £m	2009 £m	2010 £m	2011 £m	**2012 £m**
Net interest receivable	87.5	53.3	54.9	71.2	**84.2**
Other income	351.7	386.5	387.0	377.7	**405.7**
Share of profits from joint ventures and associates	3.9	0.2	0.3	0.7	**1.6**
Profit on disposals of subsidiary undertakings and associates	31.4	-	1.2	0.9	**-**
Total income	474.5	440.0	443.4	450.5	**491.5**
Administrative expenses	(389.7)	(383.7)	(395.5)	(384.8)	**(410.1)**
Operating profit before impairment losses and provisions	84.8	56.3	47.9	65.7	**81.4**
Negative goodwill arising on merger	-	-	3.1	-	**-**
Impairment losses on loans and advances	(34.6)	(43.6)	(14.8)	(30.0)	**(12.3)**
Impairment (losses) / recoveries on debt securities	(11.5)	1.3	(0.1)	-	**(4.0)**
Provisions for liabilities	(20.8)	4.0	(1.1)	(13.5)	**(28.7)**
Profit before tax from continuing operations	17.9	18.0	35.0	22.2	**36.4**
Tax income / (expense)	2.8	(4.3)	(9.8)	(6.7)	**(8.8)**
Profit from continuing operations	20.7	13.7	25.2	15.5	**27.6**
Operating profit from discontinued operation (net of tax)	3.1	4.2	-	-	**-**
Profit on disposal of discontinued operation	-	39.7	-	-	**-**
Profit for the financial year	23.8	57.6	25.2	15.5	**27.6**
Attributable to:					
Members of Skipton Building Society	22.8	57.4	25.5	15.4	**28.6**
Non-controlling interests	1.0	0.2	(0.3)	0.1	**(1.0)**
	23.8	57.6	25.2	15.5	**27.6**
As at 31 December					
Total assets	13,647	15,569	13,740	13,910	**13,760**

The Group's capital resources profile

	2008	2009	2010	2011	**2012**
Core Tier 1 ratio (%)	8.61	9.37	11.06	10.53	**11.08**
Total capital ratio (%)	12.28	14.48	16.60	15.53	**15.94**
Tier 1 ratio (%)	9.03	10.77	12.64	12.02	**12.59**
Tier 1 capital (before deductions[1]) (£m)	780	873	910	923	**948**
Tier 1 capital (after deductions[1]) (£m)	537	691	719	726	**752**
Gross capital (£m)[2]	918	1,063	1,120	1,140	**1,156**
Free capital (£m)[2]	606	811	854	865	**877**

Notes
1. Intangible assets.
2. 2011 comparitives have been revised as detailed in note 1b).

Chairman's Statement

It is now a year since, as Chairman, I first addressed you, in the 2011 Annual Report and Accounts, and I am pleased to say that the Society has continued to prosper during that intervening period.

We are reporting a strong set of results, a robust balance sheet and a year of continuing service to our customers and members.

Further details of our financial performance follow on the ensuing pages. However, supported by our diversified Group, we have once again delivered on our key financial measures of profitability, capital adequacy, liquidity and funding.

Last year I explained the continuing pressures faced by the Society as a result of ongoing turbulence within our operating environment. This centred upon concerns over the lingering spectre of recession, the threat of Eurozone instability, unemployment, inflation and historically low interest rates.

The potential consequences for our savers and borrowers were, and remain, uppermost in our minds. Our saving members receive less interest than historically was the case which impacts their standard of living and our borrowing members could find themselves with lower income from which to service their debts. As a mutual building society we do our best to mitigate the impacts on our members but we are not immune to problems in the UK economy. As I write there remain concerns regarding the prospects for a triple dip recession with potential consequences for employment which has so far

> ...a strong set of results, a robust balance sheet and a year of continuing service to our customers and members.

held up better than many expected. Global uncertainties also continue and while Eurozone problems may have subsided – they have not gone away.

We remain vigilant – but confident that we have the financial strength and management capability to continue serving our members in these challenging times.

2013 will also see significant change for our regulators and the regulatory landscape in the UK. The Financial Services Authority (FSA) will cease to exist and its functions split between the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). We look forward to working closely with both our regulators and within the spirit and not just the letter of regulation. The regulatory landscape will also change significantly as a result of the FSA's Retail Distribution Review (RDR) into financial advice delivery to consumers, and the Mortgage Market Review into lending practices. The potential impact on

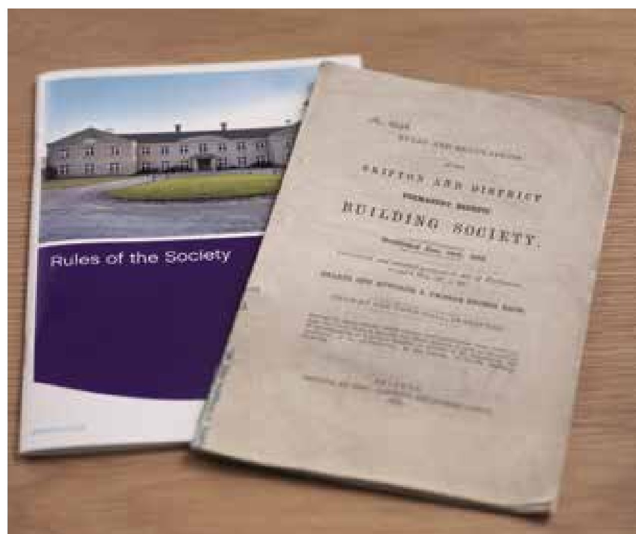
financial advice and mortgage markets is as yet unclear but we will embrace new regulation and continue to serve our members and others who want to do business with us.

We welcome the Government's Funding for Lending Scheme, which is already benefiting the mortgage market, assisting both borrowers and lenders with commensurate benefits to the overall UK economy. And we will not forget our savers who represent the vast majority of members of the Society. We will remain competitive and serve our customers through a variety of channels that suit their needs, be it through the internet, telephone or our ever popular branches that remain the cornerstone of our distribution network. However you choose to do business with Skipton, you can expect a friendly, helpful and personal service.

As a mutual, we also believe in playing an active role in the communities where we and our members are based. With this in mind, we continued to support initiatives close to our Head Office and branch network throughout this year. 77 local community projects benefited through our *Community Contribution Award* scheme and £120,300 was awarded by the Skipton Building Society Charitable Foundation to 77 charities across the UK. A range of key partners, mainly based in our heartland, also benefited from £138,600 to support community, cultural and sporting events and initiatives.

We celebrate our 160th anniversary year in a positive mood, confident that our blend of prudent and cautious financial management, and ongoing focus on delivering the best possible service and value for our membership, see us well placed to maintain our progress and standing as one of the UK's largest building societies.

I also have a number of Society Board changes to report. Firstly, I would like to express my appreciation to Sandy Kinney, who stepped down from her role as a Non-Executive Director and Chairman of the Audit Committee in the Autumn, having served the Society for some nine-years. I would also like to introduce Marisa Cassoni who has joined the Board as a Non-Executive Director in July and became Chairman of the Audit Committee on Sandy's retirement from the Board. Marisa has extensive commercial experience, having most recently been Finance Director for the John Lewis Partnership and, prior to that, held senior positions with the Royal Mail, Britannic Assurance and the Prudential.



We also appointed a new Commercial Director, Ian Cornelius, to oversee our Marketing, Products and Customer Insight activities. Previously, Ian was Commercial Director at our subsidiary, Homeloan Management Limited, and prior to that held senior roles with Virgin Money, Bradford & Bingley, Capital One and Boots.

Since the year end, we have also appointed two further Non-Executive Directors: Cheryl Black and Helen Stevenson who join the Board on 1 March 2013. Cheryl has spent her career in customer service and operations, has held leadership roles at Orange and NTL and was Customer Service Director at Telefonica O2. Helen started her professional life with Mars Inc where she spent nineteen years, culminating in her role as European Marketing Director. She has since held the role of Group Marketing Director at Lloyds TSB and was most recently Chief Marketing Officer at Yell Group.

Collectively, these appointments will ensure that the Board maintains the strength and breadth of experience needed to continue to provide service to you as members.

At this point, I should also thank the devoted team of Skipton people who have gone that extra mile for our members over the past year. Our culture, at all levels of the business, is one of friendly team work, in an environment where people strive tirelessly to do their best. The same is true whether they work in a customer service function or one of our 'unseen' technical functions which make outstanding customer service possible. These people enable those who do business with us to have total confidence in our ongoing financial strength and ability to deliver on their behalf.

I look forward to updating you on another positive performance in 12 months' time.

M H Ellis

Chairman

27 February 2013

Group Chief Executive's Report

Introduction

I am pleased to report that we have achieved a robust and balanced performance over the past year, combining ongoing financial success with a member-centric approach to doing business.

Celebrating our impressive heritage in our 160th anniversary year, we continue to focus on meeting our members' needs through long term good value, relevant products, and a commitment to outstanding personal service.

Continued, prudent growth

In 2012, the Society achieved steady growth in mortgage balances, retail balances and capital, as well as significantly improving profitability. Our strategy of growing steadily, while remaining focussed on meeting our members' needs, has helped the Society to improve its performance in a difficult operating environment.

The key driver of the Group's improved performance has been an £18.4m turnaround in our Mortgages and Savings division, returning to profitability and reporting a profit of £4.9m compared to a loss of £13.5m in 2011. This is despite a £6.1m (2011: £5.4m) contribution to the Financial Services Compensation Scheme (FSCS) within the division, as a result of continuing to pay for the banking crisis of 2008. The improvement in our net interest margin, an important driver of sustainable profitability for the business, is also encouraging, and increased to 0.61% for the full year compared to 0.52% in 2011.

Our strategy of growing steadily, while remaining focussed on meeting our members' needs, has helped the Society to improve its performance in a difficult operating environment.

Capital and liquidity are two important indicators of our financial strength, and both remain robust, as outlined below. The quality of our liquidity remains excellent, with no exposure to Greece, Ireland, Italy, Portugal or Spain.

We have maintained a strong funding base with a high proportion of retail funding and a degree of cost effective wholesale funding to achieve a desirable blend. By the end of the year, 83.1% of our total funding was derived from retail savings balances (2011: 80.2%), covering 90.1% of our mortgage lending (2011: 91.4%). Complementing this solid retail base, we raised £475m of funding from our second securitisation in 18 months – a sign of the market's confidence in the Society.

Arrears continue to fall, as summarised below, and are now lower than the industry average.

At the same time, impairment losses, predominantly within our Mortgages and Savings division, also fell significantly, to £12.3m, compared to £30.0m in 2011. However, Group provisions for liabilities increased to £28.7m compared to £13.5m in 2011, primarily due to total Group FSCS levies of £7.5m (2011: £5.8m), claims against surveys and valuations within our Estate Agency division of £8.4m (2011: £6.1m), provisions for commission clawbacks / rebates of £6.2m (2011: £(0.2)m), customer compensation provisions for MPPI claims and compensation payable to customers as a result of issues identified from our review of past business within the Financial Advice division of £3.7m (2011: £2.1m). Further commentary can be found in the Business Review.

Our key financial highlights were as follows:

Profitability

- Pre-tax profits of £36.4m (2011: £22.2m), up 64%;
- £13.0m improvement in our net interest margin (2012: 0.61%, 2011: 0.52%);
- Continued strong earnings from the Estate Agency division, with profits of £36.2m (2011: £35.8m).

Financial strength

- Core Tier 1 capital of 11.1% compared to 10.5% at the end of December 2011;
- Total capital also improved to 15.9% (2011: 15.5%);
- Strong liquidity ratio maintained at 21.1% of shares, deposits and liabilities (31 December 2011: 24.8%);
- Only 1.30% of mortgages have arrears of more than 2.5% of the total outstanding balance (31 December 2011: 1.45%). This compares to the industry average of 1.40%[1] (31 December 2011: 1.42%).

Help for homeowners

Remaining true to this powerful founding principle, we again continued our support of borrowers during what continues to be a difficult housing market. Gross mortgage lending totalled £1.5bn for the year (2011: £1.7bn), a continued strong performance after the threefold uplift in 2011.

Net lending amounted to £356m, compared to £412m in 2011, as mortgage balances increased by 3.5% during the year to £10.5bn (2011: £10.1bn). Our 4.1% share of the growth in the UK mortgage market compares favourably to our natural market share of 0.8%.

We achieved this by providing solutions for a wide variety of homeowners, including those unable to provide a large deposit. 91% of the Group's gross lending is undertaken by the Society, and of this amount, 4.7% (2011: 4.5%) was to borrowers with a loan-to-value ratio of between 90% and 95%. 16.1% (2011: 19.5%) of the Society's gross lending went towards helping 1,833 (2011: 2,648) first time buyers and Buy-to-Let mortgages for property investors also featured strongly, at 12.9% (2011: 7.5%) of the Society's overall lending, reflecting the increasingly important part they play in the overall health of the mortgage market.

Our mortgage offering was independently endorsed when *What Mortgage* magazine gave us their 'Best National Building Society Award' for the second year running in 2012. We were also highly commended and commended, respectively, in the 'Best First Time Buyer Mortgage Provider' and 'Best Building Society Mortgage Provider' categories at the prestigious *Moneyfacts Awards 2012*. Our outstanding service was also recognised with a 'Five Star Service Award' from *Financial Adviser* magazine.

Promoting savings

We are acutely aware that savers remain the 'forgotten victims of the credit crunch'. Their nominal returns are severely affected by keeping the Bank of England Base Rate at 0.5%, and their real returns are impacted by inflation.

UK monetary policy remains focussed on trying to stimulate growth and avoiding deflation, and the beneficiaries have been borrowers. Savers, on the other hand, continue to suffer.

In recent months their plight has been compounded by the introduction of the Funding for Lending Scheme, again aimed at stimulating the housing and mortgage markets by making more affordable credit available to borrowers. Access to this new and cheaper source of funding has lessened the demand for retail savings and hence the rates payable to savers have declined. New mortgage rates have also fallen as funding is more available for lenders to deploy.

With the very best of intentions, we must operate within our market environment, in order to manage the business responsibly in the best interests of all our members. Hence, we have also reduced our own new mortgage rates and savings rates in recent months.

We recognise that this is cold comfort for those savers that are affected, but we have endeavoured to maintain our rates at levels which continue to compare favourably with other High Street providers.

In spite of Bank Base Rate remaining at 0.5% for four years, the average savings rate paid across all of our accounts at 31 December 2012 (i.e. instant access or term accounts) was 2.56%, exactly the same figure as at 31 December 2011. Within the confines of such a low interest rate environment and difficult market conditions we continue to try to preserve long term saver value.

Our continued efforts to help people manage their finances responsibly, by saving, resulted in a 2% increase in our savings balances during 2012, to £9,462.4m compared to £9,280.4m at 31 December 2011.

We achieved this by listening to our members in order to provide products relevant to their needs, launching a range of new accounts including base rate tracker bonds, fixed rate bonds and regular savers, as well as a Christmas Regular Saver, enabling people to put away cash for future festive seasons instead of getting into debt to fund their celebrations.

[1] Source: Council of Mortgage Lenders, published 14 February 2013

Group Chief Executive's Report - continued

Believing that everyone should have a tax-efficient account in their savings portfolio, another successful ISA season saw us encourage twice as many people to embark on tax free savings as we did in the same period of 2011.

Focussed on our members

The consistent good value we offered across our savings and mortgage ranges during the year was endorsed by 528 media 'best buy table' mentions during the period.

Recognising that our members need help and advice, now more than ever, in navigating a path through the financial maze, we have underlined our commitment to supporting them. Firstly, we will continue to arrange expert financial advice through the Diploma-qualified financial planning managers within our Skipton Financial Services (SFS) subsidiary in each branch. We are doing so at a time when many providers have withdrawn their financial advice services in the wake of the Financial Services Authority's Retail Distribution Review; have restricted their availability to only high net worth clients; or are limiting the advice they give to a small selection of their own products and services. By contrast, Skipton customers continue to have access to a wide range of investment options, as well as expertise in areas such as pensions and inheritance tax planning.

And this is not the only help we offer our members in getting the most from their finances. Last May, we introduced our new *My Review* service, which is available to every member at no cost and has helped more than 20,000 customers since launch. During 2012, we also ran an extensive Free Wills promotion, providing almost 9,000 single and mirror wills during the year, benefiting more than 13,000 customers.

Our commitment to offering our members outstanding personal service has also come to the fore over the past 12 months, as we have introduced a number of enhancements. Quick, online Decisions in Principles, and text updates on mortgage applications and ISA transfer progress, are two examples of innovations we have made to help our borrowers and savers.

We have also continued to invest in our frontline customer service. The great work of our Skipton-based customer service team has been augmented by the installation of a new telephone system which provides a call-back option to save customers queuing and requires that they select a maximum of two options before getting through to a customer adviser who can help them. Dedicated numbers for specific queries mean that, in most cases, they get straight through to the right person.

Understanding, from member feedback, that they value face-to-face service from a strong branch network, we have refurbished 15 branches over the past year, as part of our ongoing modernisation programme.

As a mutual, owned by our members, we believe it is important to involve them in shaping the future direction of the Society. Since we introduced it in the Autumn of 2011, more than 2,800 customers have signed up to our Customer Panel, to have their say on everything from our role in our communities to products and communications. This is complemented by an extended range of customer communications, including our new *My Society* newsletter, launched in June.

Subsidiary performance

Our group of subsidiary companies continues to make a welcome contribution to the Society's success. Our Estate Agency division, the Connells group, provided pre-tax profits of £36.2m, compared to £35.8m in 2011. This was an impressive result given the ongoing uncertainty facing the UK housing market.

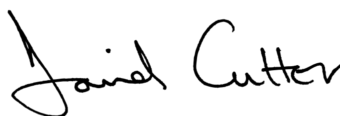
Our mortgage servicing business, Homeloan Management Limited (HML), also moved back into profit. It achieved a pre-tax profit of £0.8m, following a loss of £3.1m in 2011, having gained a number of new clients and extended several existing key relationships. However, our Financial Advice division incurred a pre-tax loss of £0.9m compared to a profit of £2.9m in 2011. While the revenue generated by these businesses increased during 2012, we have made provisions for compensation payable to customers as a result of issues identified from our review of past business.

Outlook

Uncertainty regarding economic growth, and the state of the Government's finances, will continue to hang over the UK economy and dominate fiscal and monetary policy. While we are pleased with the further upturn in our performance over the past year, we are not complacent and maintain a prudent eye on further potential external shocks which could impact the Society.

However, despite such developments, we are confident we will achieve further improvement during 2013 and beyond, as the strength of our Mortgages and Savings division, in particular, continues to gain momentum.

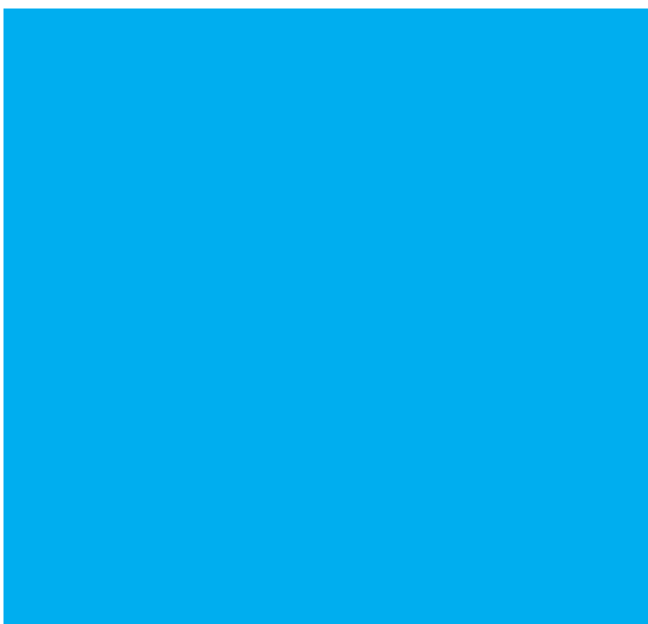
Since the year end, we have utilised funding available from the Funding for Lending Scheme, as we continue to increase our lending to borrowers. Meanwhile, we will remain focussed on satisfying the saving and investment needs of our customers, and I look forward to updating you on the success of this, and many more such initiatives, in a year's time.



D J Cutter

Group Chief Executive

27 February 2013



The Board of Directors

1. 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. He is Chairman of the Society's Executive and Retail Credit Committees, and a member of the Asset & Liability and Board Risk Committees. Externally, he is Deputy Chairman of the Building Societies Association.

2. Mike Ellis
Chairman
Mike joined the Board as Non-Executive Chairman in 2011 and also chairs the Nominations Committee. Mike was Group Finance Director at HBOS plc after serving as a Director of Halifax plc, where he held a number of senior executive positions having joined its predecessor, Halifax Building Society, in 1987. From 2005 until January 2013, he was 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.

3. Noel Hutton
Vice Chairman
Noel joined the Board as a Non-Executive Director in 2004. He is a member of the Nominations Committee and Chairman of the Remuneration Committee, and was appointed Vice Chairman in 2010. Prior to retiring in 2004, he was a partner in international law firm Hammonds, now Squire Sanders, where he specialised in corporate finance.

4. Marisa Cassoni
Non-Executive Director
A Chartered Accountant, Marisa joined the Board in 2012. She chairs the Audit Committee and is a member of the Nominations Committee. Marisa retired as Group Finance Director of the John Lewis Partnership in 2012. Prior to that, she held senior positions at Royal Mail, Britannic Assurance and the Prudential. Marisa is also a Non-Executive Director of the GFI Group Inc.

5. Ian Cornelius
Commercial Director
Ian joined the Skipton Group in 2011. He became Commercial Director with responsibility for products and marketing in 2012, having previously been Commercial Director at our subsidiary Homeloan Management Limited (HML). He is a member of the Executive Committee and Chairman of our subsidiaries Amber Homeloans Limited and North Yorkshire Mortgages Limited. Ian formerly held senior roles at Virgin Money, Bradford & Bingley, Capital One and Boots.

6. Robert East
Non-Executive Director
Robert joined the Board in 2011 and is a member of the Board Risk, Nominations and Remuneration Committees. Robert spent most of his career with Barclays PLC, undertaking senior roles in retail and commercial banking. He is now Chief Executive of Cattles Limited.

7. Mark Fleet

Distribution Director

Mark became Managing Director of Skipton subsidiary Skipton Financial Services Limited in 2008, and then the Society's Chief Distribution Officer and a Board Director in 2011. He oversees the Society's distribution via the Branch network and Skipton Direct and is a member of the Executive and Conduct & Operational Risk Committees. Mark also chairs our Mortgage Services division and our three financial advice businesses. His career has spanned distribution, customer services and credit management. Prior to joining Skipton he worked in subsidiaries of Standard Chartered Bank, Lloyds TSB and Bank of Ireland.

8. Peter Hales

Non-Executive Director

Peter joined the Board in 2007 and is Chairman of the Board Risk Committee and a member of the Nominations Committee. Prior to that, he was Sales and Marketing Director of Norwich Union, having previously been a Director of General Accident and CGU. Peter is also a Director of Unum Limited, Chairman of Sandringham Financial Partners Limited, a Trustee of the Chartered Insurance Pensions Scheme and a member of the Advisory Board of Simply Biz plc.

9. Graham Picken

Non-Executive Director

Graham joined the Board in 2012 and is a member of the Audit, Board Risk and Nominations Committees.

Graham previously worked for HSBC, where he held positions as Executive Chairman of First Direct and Chief Executive of the Forward Trust Group. Between 2005 and 2009, he was Non-Executive Director and then Chief Executive of the Derbyshire Building Society. Graham is Chairman of the FTSE listed HICL Infrastructure Company Limited.

10. Peter (Nimble) Thompson

Non-Executive Director

A solicitor by profession, Nimble joined Skipton's Board in 2009, following our merger with Scarborough Building Society where he had been a Non-Executive Director for three years. He sits on our Remuneration, Audit and Nominations Committees. Nimble was a Senior Partner and then Deputy Chairman of Eversheds before retiring in 1999. He is Chairman of N G Bailey Limited and holds a number of other Non-Executive positions nationally.

11. Richard Twigg

Group Finance Director

Richard is a Chartered Accountant and joined the Skipton Group in 1993. He was appointed to the Board in 2002 as Group Finance Director, having been Finance Director of our subsidiaries HML and then Connells Limited. He is Chairman of the Society's Asset & Liability Committee and a member of the Executive, Risk and Conduct & Operational Risk Committees, with additional responsibility for Skipton International Limited and the Society's investment portfolio. Richard is also a trustee of the Society's Charitable Foundation.

Business Review

Group structure

Skipton Building Society is the UK's fourth largest building society, with over 744,000 members, £13.8bn of assets and a national presence of over 100 branches and agencies. It heads up the Skipton Group, which has significant interests in estate agency and related businesses (through the Connells group), provision of outsourcing services (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 Limited (Amber) and North Yorkshire Mortgages Limited (NYM) and deposit taking and mortgage lending in the Channel Islands through Skipton International Limited (SIL). The division also includes the Group's special purpose vehicles (SPVs) formed to acquire funds from wholesale markets, Darrowby No 1 plc, Darrowby No 2 plc and Beckindale No 1 Limited, and the intermediate holding company Skipton Group Holdings Limited (SGHL).
- Estate Agency – including surveys and valuations, conveyancing, lettings, asset management and mortgage broking carried out through the Connells group.
- Mortgage Services – mortgage administration services, principally Homeloan Management Limited (HML).
- Financial Advice – provision of financial advice and broking services through three separate financial advice businesses, Skipton Financial Services Limited (SFS), Pearson Jones Plc and Torquil Clark Limited.
- Investment Portfolio – includes a number of trading companies that do not fall within the core operating segments.

Overview

The Group profit before tax in 2012 was £36.4m (2011: £22.2m), up 64%. Our continued 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 0.61% (2011: 0.52%). This, together with a fall in the charge for mortgage losses from £30.0m to £12.3m, resulted in the Mortgages and Savings division achieving a pre-tax profit of £4.9m (2011: loss of £13.5m). Our estate agency business, Connells, once again delivered strong results reporting pre-tax profits of £36.2m (2011: £35.8m) despite a continuing subdued UK housing market. Following significant restructuring provisions in 2011, our Mortgage Services division produced a pre-tax profit of £0.8m in 2012 (2011: loss of £3.1m); however the Financial Advice division incurred a pre-tax loss of £0.9m (2011: profit of £2.9m) as a result of provisions for compensation being required against past business cases written.

Our capital and liquidity position allowed us to continue to lend in a controlled and prudent manner and gross mortgage advances in 2012 totalled £1,483.7m (2011: £1,699.7m). We allowed excess liquidity to fall during the year, which resulted in total assets reducing by 1% to £13,760.2m (2011: £13,910.3m). The profits for the year resulted in our Core Tier 1 capital ratio increasing to 11.1% (2011: 10.5%).

Financial performance

Total Group pre-tax profits for 2012 were £36.4m (2011: £22.2m) as set out in the table below:

	2012 £m	2011 £m
Net interest income	84.2	71.2
Other income	402.1	374.7
Fair value gains on financial instruments	3.6	3.0
Profit on sale of subsidiary undertakings	-	0.9
Share of profits from joint ventures and associates	1.6	0.7
Total income	491.5	450.5
Administrative expenses	(410.1)	(384.8)
Operating profit before impairment losses and provisions	81.4	65.7
Impairment losses on loans and advances	(12.3)	(30.0)
Impairment losses on debt securities	(4.0)	-
Provisions for liabilities	(28.7)	(13.5)
Profit before tax	36.4	22.2
Taxation	(8.8)	(6.7)
Profit after tax	27.6	15.5

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, wholesale funding and capital).

The Group's net interest margin for the year increased to 0.61% from 0.52% in 2011. The margin has benefited from our ongoing prudent management of the retail savings portfolio by offering competitive levels of return for savers at rates which are sustainable for the Society. We have also achieved an increase in the margin on new mortgage lending business, while 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.

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 up 7% to £402.1m (2011: £374.7m). Estate Agency income increased

by £39.4m year-on-year due to a 6% increase in the number of properties sold by Connells, as it increased market share in a flat housing market, and also improved returns on its investments in lettings capability and mortgage services headcount. Within the Mortgage Services division, the run-off of the portfolios under management and lower arrears management income resulted in a fall in revenue of £4.9m. The Financial Advice division increased its income marginally, as investment markets saw a more positive year in 2012.

Other income by division is set out below:

	2012 £m	2011 £m
Mortgages and Savings	**18.1**	21.9
Estate Agency	**251.1**	211.7
Mortgage Services	**60.6**	65.5
Financial Advice	**44.5**	43.7
Investment Portfolio	**35.2**	38.9
Inter-divisional adjustments*	**(7.4)**	(7.0)
	402.1	374.7

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

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 £3.6m (2011: £3.0m) 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 increased by 7%, during 2012 to £410.1m (2011: £384.8m). The Group continues to focus on managing its cost base however, it is not immune from inflationary pressures, and part of the year-on-year increase in costs is attributable to investments made by the Estate Agency division in its lettings capability and mortgage services headcount.

The Society continues to manage costs and improve efficiencies and has maintained its ratio of administrative expenses to mean assets at 0.44% (2011: 0.44%), despite additional resource being required to address legislative and compliance requirements. At a Group level, this management expense ratio is less comparable, given our many trading businesses. However, careful cost management across the Group saw the Group cost income ratio improve in the year from 85.55% to 83.71%.

	2012 %	2011 %
Society management expense ratio	**0.44**	0.44
Group management expense ratio	**2.96**	2.78
Group cost / income ratio*	**83.71**	85.55

* 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 reduced year-on-year to £12.3m (2011: £30.0m) and is broken down as follows:

	2012 £m	2011 £m
Residential	**9.4**	17.6
Commercial and other loans	**2.9**	12.4
	12.3	30.0

The impairment loss charge on residential loans has fallen significantly during the year, driven by a decline in the number and value of balances in arrears across both the Society and the specialist residential mortgage portfolios in Amber and NYM. The 2011 charge for Commercial and other loans included £8.5m against legacy business written prior to 2009.

Impairment losses on debt securities

The Society continues to run-off legacy treasury investments. We continue to review the carrying value of this portfolio and during the year have provided £4.0m (2011: £nil) against our holding of one Commercial Mortgage Backed Security, where recovery in full of the principal amount appears doubtful. No purchases of such securities have been made since 2007.

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 and provisions for the cost of surplus properties.

The charge for the year for the FSCS levy is primarily based on our latest estimate of what HM Treasury will charge the FSCS for loans to finance depositor protection. The Financial Advice division is also subject to levies for particular market events such as the failure of Keydata. Previously it was anticipated that the majority

Business Review - continued

of the FSCS' borrowings would be repaid wholly from recoveries from the failed institutions, however, during the year the FSCS advised of an expected shortfall which it intends to levy on the industry over the next three years. The 2012 charge therefore comprises both the annual management expense levy and our estimate of our share of the capital levy which in total amounted to £7.5m (2011: £5.8m).

Other provisions made in the year amounted to £21.2m (2011: £7.7m). The table below provides a further breakdown of the total charge:

	2012 £m	2011 £m
FSCS levy	7.5	5.8
Provision for the costs of surplus properties	2.3	0.1
Commission clawbacks / rebates	6.2	(0.2)
Survey and valuation claims	8.4	6.1
Customer compensation	3.7	2.1
Other provisions	0.6	(0.4)
	28.7	13.5

The provision for the costs of surplus properties includes a £1.9m onerous lease provision following the decision to sell the trade and assets of Sterling International Brokers Limited and cease trading in February 2013.

The provision for commission clawbacks / rebates includes an estimate of the repayment of commission to suppliers as a result of cancelled policies sold by the Financial Advice and Estate Agency divisions of £2.9m (2011: £nil), and a further £3.3m charge (2011: £0.2m credit) in accordance with the customer proposition for Skipton Financial Services of rebating commissions to customers pursuant to investment underperformance.

The customer compensation provision includes £1.1m (2011: £0.3m) for MPPI claims within the Mortgages and Savings and Estate Agency divisions, following a further increase in claims during the year. The Financial Advice division has recognised a further £2.3m (2011: £1.8m) for the cost of customer compensation following reviews currently ongoing into the suitability of advice previously provided to clients. At 31 December 2012, the division has recognised a gross liability of £11.6m (2011: £1.8m) for this compensation and a corresponding professional indemnity insurance asset of £8.5m (2011: £nil). Given the early nature of the advice suitability reviews and associated compensation provision, there is uncertainty regarding its quantum and timing and the provision represents management's best estimate of the expenditure arising from the review, including the costs of remediation and the associated professional indemnity insurance recovery.

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

Taxation

The Group's effective tax rate is 25.3% (2011: 31.2%) compared with the standard rate of Corporation tax of 24.5% (2011: 26.5%). The major impacts on the effective rate for the year are expenditure which is not deductible for tax purposes, offset by non-taxable income, prior period adjustments, the impact of the Corporation tax rate change on the deferred tax asset and lower overseas tax rates.

The reduction of the UK Corporation tax rate from 24% to 23% from 1 April 2013 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 area are as follows:

Business Area	2012 £m	2011 £m
Mortgages and Savings	4.9	(13.5)
Estate Agency	36.2	35.8
Mortgage Services	0.8	(3.1)
Financial Advice	(0.9)	2.9
Investment Portfolio	(3.9)	1.3
Inter-divisional adjustments*	(0.7)	(1.2)
Profit before tax	36.4	22.2

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

Mortgages and Savings

The Group's Mortgages and Savings division made a profit before tax of £4.9m, compared to a loss of £13.5m in 2011, an improvement in performance of £18.4m.

A key driver of this improved result has been an improvement in net interest margin, which has improved 9bps in 2012 to 0.60%, compared to 0.51% in 2011.

Mortgage balances have grown by £356m in the year, which has contributed towards the growth in net interest income, whilst liquidity has been prudently managed downwards from 25% to 21% of shares, deposits and liabilities.

New lending volumes in the year were £1,483.7m, compared to £1,699.7m in 2011, but at much better margins, driven by a strong presence in the intermediary mortgage market, and an enhanced range of mortgage products.

Retail savings rates have remained fairly flat through the year, despite a change in the mix of business following the success of our competitive and attractive range of variable branch and online savings products.

Partly offsetting the improvement in net interest income, we have seen other income reduce in the year to £18.1m

(2011: £21.9m), primarily due to a fall in income derived from investment product sales.

Costs were held flat in 2012, as the benefits from our ongoing program of process improvement across the organisation and tight control of headcount and discretionary spend were offset by inflationary cost pressures and necessary investment in some of our compliance and regulatory functions.

Impairment losses on residential loans have fallen significantly in the year from £17.6m to £9.4m, reflecting in part a significant decline in the value of balances in arrears across the Society, Amber and NYM. A one-off provision of £4.0m was charged in respect of a Treasury held debt instrument, whilst provisions for other liabilities have increased by £1.7m, in part driven by an increase in MPPI claims that are being referred to the Financial Ombudsman Service.

The large impairment charge for commercial and other loans which was incurred in 2011 in relation to legacy business written prior to 2008 has not recurred, resulting in the impairment charge for the year reducing to £2.7m (2011: £11.9m).

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 total value of arrears balances has fallen by £1.0m during 2012, whilst the aggregate size of these two portfolios has reduced to £1.73bn from £1.86bn at the end of 2011.

Our Channel Islands operation, SIL, made a profit before tax of £5.8m (2011: £6.2m). SIL has continued to grow its mortgage book with mortgage assets in Guernsey and Jersey increasing by £51.7m in the year to £621.6m (2011: £569.9m) and the quality of this book remains good.

Estate Agency

The Estate Agency division achieved a profit before tax of £36.2m in the year (2011: £35.8m). Connells entered 2012 with a strong pipeline compared to the start of 2011, and the first half of the year saw a 4.4% increase in average weekly sales over the same period in 2011. However, activity in the second half of the year slowed and average weekly sales were 1.7% lower than the same period in 2011, although in the run up to the year end and into early 2013 there were signs of the market picking up again.

Despite the slow down in the second half of the year, income in our Estate Agency division was up 19% to £251.1m (2011: £211.7m). The Connells group has a good spread of revenue generating services and maintains a tight control of costs in what remains an uncertain market constrained by a general lack of mortgage availability.

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 66% (2011: 68%) and total assets under management of £39.3bn (2011: £41.8bn).

The Mortgage Services division recorded an operating profit before restructuring costs of £1.2m in 2012 (2011: £0.2m). After the costs associated with rationalising the business, the division recorded a profit before tax of £0.8m compared to a loss of £3.1m in 2011. The difficult trading conditions that have been a feature of the market since the latter part of 2007 continued through 2012 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 benefiting the client, does impact adversely on HML's income.

HML is committed to value enhancement by working with existing clients and by attracting new clients and aims to develop more performance based relationships and complementary new products. HML has already seen some success in retaining and expanding existing relationships and new client opportunities continue to be explored.

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 reported a loss before tax of £0.9m (2011: profit of £2.9m). Whilst income was 2% higher in 2012 as a certain amount of confidence returned to investment markets, the division has made provisions in 2012 for the cost of customer compensation following reviews currently ongoing into the suitability of advice previously provided to clients.

Despite these costs, we believe that 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 had a good year. Sterling International Brokers' (money markets broker) performance was again poor in 2012 as a result of ongoing subdued trading conditions in the wholesale cash markets and little movements in interest rates. Accordingly, with no improvements likely for some time, the Group disposed of this business in early 2013 at book value, having provided a total of £3.4m in 2012 to arrive at that amount.

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Financial position

Loans and advances to customers

The Group continues to lend in a controlled and sustainable manner. Group gross mortgage advances in the year were £1,483.7m (2011: £1,699.7m).

An analysis of gross mortgage advances is shown below:

	2012 £m	2011 £m
Society	1,357.1	1,548.2
Amber Homeloans*	0.7	0.9
North Yorkshire Mortgages*	0.1	0.2
Skipton International	125.8	150.4
	1,483.7	1,699.7

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

Society lending continues to be well diversified by product type and geographical distribution. As at 31 December 2012 the Society's average indexed loan-to-value (LTV) for the residential mortgage book was 53.0% (2011: 50.9%). 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 83.2% (2011: 82.1%) and 82.8% (2011: 81.7%) respectively.

SIL grew its mortgage book in the year with gross residential mortgage advances totalling £125.8m (2011: £150.4m), however, the average indexed LTV has reduced marginally to 60.4% (2011: 61.1%) demonstrating our focus on managing our credit risk exposures.

Overall, the Group's average indexed LTV for the residential mortgage book was 57.0% (2011: 55.5%).

The Group's total new advances on buy-to-let products was modest at £185.8m or 12.5% of the Group's gross mortgage lending (2011: £128.5m or 7.6%). 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 £10,456.1m from £10,100.0m at the end of 2011 as set out in the table below:

	2012 £m	2011 £m
Residential mortgages	9,908.3	9,532.5
Commercial loans	438.2	467.1
Other lending:		
Debt factoring loans	48.2	42.0
Other loans	61.4	58.4
Gross balances	10,456.1	10,100.0
Impairment provisions	(72.8)	(88.1)
Fair value adjustments for hedged risk	210.2	240.9
	10,593.5	10,252.8

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 1,262 cases (2011: 1,377), representing 1.30% (2011: 1.45%) 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	2012	2011
Society		
Number of cases	406	474
% of Society book	0.50%	0.60%
Impairment provision on residential mortgages	£14.9m	£13.4m
Amber Homeloans		
Number of cases	588	625
% of Amber book	7.24%	7.14%
Impairment provision on residential mortgages	£24.6m	£32.2m
North Yorkshire Mortgages		
Number of cases	267	276
% of NYM book	5.53%	5.30%
Impairment provision on residential mortgages	£8.1m	£14.0m
Skipton International		
Number of cases	1	2
% of SIL book	0.03%	0.07%
Impairment provision on residential mortgages	-	-
Total		
Number of cases	1,262	1,377
% of total book	1.30%	1.45%
Impairment provision on residential mortgages (note 16)	£47.6m	£59.6m

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.

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 just 9 (2011: 19) cases where the arrears balance was greater than 2.5% of the total outstanding balance, with the capital value associated with these loans representing only 0.42% (2011: 1.18%) of the commercial portfolio. Close monitoring of the credit performance of the commercial book continues and impairment provisions are made where appropriate.

SIL continued to grow its Channel Islands mortgage book during the year, and mortgage balances stood at £621.6m at the year end (2011: £569.9m); the quality of this book remains good 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. At 31 December 2012 the percentage of residential mortgage balances subject to forbearance is 4.3% (2011: 7.6%). For commercial balances the percentage is 7.0% (2011: 9.0%).

Liquidity

Whilst we have managed levels of liquidity down during the year, the Group continues to hold healthy levels of liquid assets to protect cash flow, counter economic uncertainty and allow the Society to continue mortgage lending. An analysis of the Group's liquidity position is shown below:

	2012	2011
Liquidity balance (£m)	**2,531.8**	3,020.6
As % of shares, deposits and liabilities (%)	**21.10**	24.79
Core liquidity buffer*- eligible assets (£m)	**1,240.2**	1,236.8
Core liquidity buffer* as % of liquidity balance (%)	**48.99**	40.95

* 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 99.6% (2011: 98.1%) of the Group's treasury investments are rated A3 or better (as shown below):

Rating	2012 £m	2011 £m
Aaa	**1,933.2**	2,082.9
Aa1	**26.0**	74.1
Aa2	**106.7**	279.0
Aa3	**104.1**	144.4
A1	**-**	126.4
A2	**188.5**	226.0
A3	**164.5**	33.6
Baa1	**2.0**	1.9
Baa2	**1.1**	4.5
Baa3	**1.8**	2.5
Ba1	**1.7**	1.7
Ba2	**-**	22.7
Caa1	**-**	6.6
Caa2	**-**	14.3
Ca	**2.2**	-
	2,531.8	3,020.6

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, recent 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 investment portfolio the Group continues to have no direct sovereign exposure to Greece, Ireland, Italy, Portugal or Spain, and has no direct investment exposure to banks based in those countries. The Group does have 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 building society, the Group is required to obtain the majority of its funding through retail member deposits and the Society retains a strong retail base and less reliance on the wholesale markets.

Retail funding

Prior to the announcement of the Government's Funding For Lending Scheme (FLS) in July 2012, the savings environment had been fiercely competitive for a number of years as institutions who previously relied on wholesale funds were forced to seek a larger share of the retail market; and many savers choose to pay down their debts or chose to invest in higher yielding asset classes. Following the launch of the FLS, competition for retail funding has moderated, but, as a mutual building society, our focus remains on offering competitive products to retain our savings balances as the prime source of a stable funding base.

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At 31 December 2012, £9,462.4m (2011: £9,280.4m) of our funding comes from retail savings representing 83.1% (2011: 80.2%) of our total funding.

In addition to our UK retail funding above, the Group also accepts deposits through our Guernsey based subsidiary, SIL. Whilst the benefits of offshore funding have reduced under the FSA's current liquidity regime, SIL has maintained a stable retail funding base and offshore deposits amounted to £725.7m (2011: £727.1m). These balances are included in 'amounts owed to other customers' in the Group balance sheet.

Wholesale funding

The remainder of the Group's funding comes from the wholesale markets. At 31 December 2012 our wholesale funding balances amounted to £1,810.5m (2011: £2,169.4m), a decrease of £358.9m during the year.

During the period the Group repaid, in full, the £650m of medium term debt issued in 2009 under the Government Guarantee Scheme, and in November 2012, our strong liquidity position allowed us to repay £300m of secured funding acquired through the Beckindale SPV.

In May 2012, the Group completed its second securitisation transaction, raising £475m of funds. Our securitisation capability allows the Group access to this source of funding and provides another option for wholesale funding in the future. The Society has been accepted as a participant in the Bank of England's Discount Window Facility and is now eligible to draw funds under the FLS; at the year end we had not drawn any such funding but have subsequently begun to use this facility in 2013.

As a result of the strong retail performance in the year, and the ability to pay down wholesale funding, the Group's wholesale funding ratio reduced to 16.9% (2011: 19.8%).

The following tables analyse the change in the composition and maturity of our wholesale funding:

	2012 £m	2011 £m
Repo and other secured agreements	**733.0**	807.5
Deposits	**346.6**	310.4
Certificates of deposits	**19.1**	19.1
Medium term notes	**41.0**	712.3
Securitisation	**670.8**	320.1
	1,810.5	2,169.4

	2012 £m	2011 £m
Repayable on demand	**82.8**	45.7
In not more than three months	**347.7**	163.4
In more than three months but not more than one year	**289.5**	893.8
In more than one year but not more than five years	**1,023.4**	1,066.5
In more than five years	**67.1**	-
	1,810.5	2,169.4

The Society is assigned long term credit ratings by two major credit rating agencies, Fitch and Moody's. In October 2012, following its annual review of the building society sector, Fitch downgraded the Society by one notch from BBB to BBB-. Our Moody's rating remains unchanged at Ba1. While Fitch's action is clearly disappointing, it has not had an impact on our ability to retain or raise additional wholesale funding, as the Group's wholesale funding is now much less sensitive to our ratings.

Our securitisations through Darrowby No 1 plc and Darrowby No 2 plc remain Aaa rated by 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 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 regulatory capital at 31 December 2012:

	2012 £m	2011 £m
Tier 1		
Reserves	**827.7**	806.5
Permanent Interest Bearing Shares (note 1)	**90.0**	90.0
Pension fund deficit add back (note 2)	**13.6**	13.5
Deductions from Tier 1 capital (note 3)	**(196.2)**	(196.7)
Unrealised losses / (gains) on available-for-sale debt securities	**2.3**	(6.0)
Unrealised losses on cash flow hedges	**14.6**	19.0
Total Tier 1 capital	**752.0**	726.3
Tier 2		
Subordinated debt (note 1)	**188.9**	197.4
Collective impairment allowance	**11.1**	14.9
Total Tier 2 capital	**200.0**	212.3
Total capital	**952.0**	938.6
Risk weighted assets		
Retail mortgages	**4,037.4**	3,944.9
Commercial loans	**434.6**	467.0
Treasury assets	**274.6**	441.7
Other assets	**471.0**	506.6
Operational risk	**751.0**	675.3
Market risk	**4.4**	7.5
	5,973.0	6,043.0
Core Tier 1 (%) (note 4)	**11.08**	10.53
Tier 1 ratio (%) (note 4)	**12.59**	12.02
Total capital (%) (note 4)	**15.94**	15.53
Tier 2 to Tier 1 ratio (%)	**26.59**	29.23

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. Subordinated debt with less than five years to maturity is amortised from a capital perspective.

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

3. Under FSA rules intangible assets must be deducted from regulatory capital.

4. Calculated as relevant capital divided by risk weighted assets. Core Tier 1 relates to Tier 1 capital excluding PIBS.

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

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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 2012. Both ratios are above the Pillar 1 requirement.

	UK consolidation group		Solo consolidation group	
	2012	2011	**2012**	2011
Capital resources (£m)	**931.8**	921.6	**852.2**	842.1
Minimum Pillar 1 capital resource requirement (£m)	**436.8**	446.4	**401.5**	412.1
Capital ratio (%)	**213.3**	206.5	**212.2**	204.3

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 2012 resulted in a deficit of £45.1m (2011: £43.6m) 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 £21.9m have been paid into the schemes in the last five years between 2008 and 2012.

Additionally, we continue to undertake 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 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.

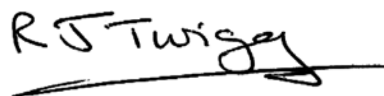
Outlook

The outlook for the UK economy remains uncertain and we continue to believe that both the housing market and interest rate environment will be subdued for some time to come. Whilst the intense competition within the retail savings arena may have abated pursuant to the introduction of the FLS, we expect this to be only temporary and in the medium term banks and building societies will continue to bid aggressively for retail funds, which will place pressure on interest margins. The Society will take advantage of the FLS as appropriate, but remains committed to its stable base of retail funding by offering good value to an increasing number of members whilst also keeping the cost of retail funding at a sustainable level.

The FLS has undoubtedly had a positive impact on the mortgage market, with increased availability of loans in the second half of 2012. However, this is beginning to squeeze margins as lenders compete for market share. Again, the Society will seek to take advantage of the continuing good margins available in the lending arena and will continue to target good quality risks. Whilst the FLS may have freed up funding, lenders' ability to grow their balance sheets may still be constrained by the implementation of the Basel III capital standards, the exact impact of which remains unknown.

The Group is not immune from the challenges facing the broader economy and any significant further weakening and loss of confidence could impact the financial performance of Connells through a fall in property transactions. Whilst sales volumes may decrease, in the absence of a severe triple dip recession, we believe that the shortage of supply of housing in the UK will protect house prices from significant falls.

Nevertheless, the Group has continued to trade profitably during 2012, and we are confident that we will continue to provide value to our members and customers.



R J Twigg

Group Finance Director

27 February 2013

SKIPTON BUILDING SOCIETY

Our Cash ISAs
Key Features
Document

Directors' Report

The Directors have pleasure in presenting their Annual Report and Accounts for the year ended 31 December 2012.

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 2012 and 2011 is set out in the Business Review.

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, including 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.

Key performance indicator	Why?	2012	2011
Group pre-tax profit	Provides the capital to enable the business to develop.	**£36.4m**	£22.2m
Group interest margin (% of mean assets)	Demonstrates the ongoing earning potential of the business.	**0.61%**	0.52%
Group cost income ratio	Managing costs is essential in ensuring that we increase efficiency across the business.	**83.71%**	85.55%
Group impairment charge	Indicates the level of delinquency within the loan portfolio.	**£12.3m**	£30.0m
Gross mortgage advances	Prudent controlled lending ensures the long term security of the business.	**£1,483.7m**	£1,699.7m
Group capital adequacy measures:	Maintaining a strong capital base ensures the Group remains financially strong.		
Core Tier 1 ratio		**11.08%**	10.53%
Tier 1 ratio		**12.59%**	12.02%
Tier 1 capital (before deductions)		**£948.2m**	£923.0m
Tier 1 capital (after deductions)		**£752.0m**	£726.3m
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*		**21.10%**	24.79%
Core liquidity buffer		**£1,240.2m**	£1,236.8m
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.	**83.07%**	80.21%

* The comparatives have been revised as described in note 1b).

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

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. In 2012, 84% (2011: 83%) of customers who responded rated Skipton Building Society as 4 or 5 out of 5 for overall satisfaction.

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 2012 was 80% (2011: 77%) which is above the financial services benchmark of 70-75%.

Profits and capital

Total Group profit before tax for the year ending 31 December 2012 was £36.4m (2011: £22.2m). The profit after tax transferred to the general reserve was £27.6m (2011: £15.5m).

Total Group reserves at 31 December 2012 were £833.7m (2011: £813.7m) including the available-for-sale reserve of £(2.3)m (2011: £6.0m) and the cash flow hedging reserve of £(14.6)m (2011: £(19.0)m).

Gross capital at 31 December 2012 was £1,155.5m (2011: £1,139.9m) including £223.9m (2011: £228.2m) of subordinated liabilities and £96.1m (2011: £95.2m) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings at 31 December 2012 was 9.63% (2011: 9.35%) and the free capital ratio was 7.31% (2011: 7.10%). The Annual Business Statement on page 121 gives an explanation of these ratios.

Mortgage arrears

Group mortgage balances at 31 December 2012 included 406 mortgage cases (2011: 561), either in possession or where payments were 12 months or more in arrears. The capital balances of these loans were £74.7m (2011: £95.4m). The total amount of arrears on those loans was £3.0m (2011: £8.6m).

Charitable donations

During the year the Group made charitable donations of £0.2m (2011: £0.1m) primarily through the Skipton Building Society Charitable Foundation. No contributions were made for political purposes (2011: £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 2012 for the Group was 15 days (2011: 19 days).

Principal risks and uncertainties

As a result of its normal business activities, the Group is exposed to a variety of risks, the most significant of which are conduct and 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.

Directors' Report - continued

Property, plant and equipment

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

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

This statement, which should be read in conjunction with the Independent Auditor's report on page 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 and Society 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)
Mr C N Hutton	(Vice Chairman)
Ms M L Cassoni	(appointed 31 July 2012)
Mr I M Cornelius*	(appointed 11 June 2012)
Mr D J Cutter*	(Group Chief Executive)
Mr R D East	
Mr M R Fleet*	
Mr P R Hales	
Ms A B E Kinney	(resigned 31 October 2012)
Mr G Picken	(appointed 17 January 2012)
Mr P J S Thompson	
Mr R J Twigg*	

* Executive Directors

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

No Director at 31 December 2012 had any interest in the shares of any group undertaking at 31 December 2012.

On 26 February 2013, Ms C C Black and Ms H C Stevenson were appointed to the Board as Non-Executive Directors with effect from 1 March 2013.

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
27 February 2013

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 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) and Conduct and Operational Risk Committee (CORC)) responsible for setting and monitoring the Group's adherence to policy. The independent 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 focussed 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 three years to improve interest margins have assisted in alleviating this pressure.

The introduction of the Government's Funding for Lending Scheme, which has made central funding available to lenders, has eased both competition and rates in the retail savings market, however rates have also fallen in the residential mortgage market as competition for new lending intensifies.

Whilst arrears levels fell slightly in 2012, the Government's austerity measures and general fragility of the economy could still 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, together with the availability of mortgages, particularly for first time buyers. 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 asset management and lettings. The additional funding available through the Funding for Lending Scheme may result in an increase in housing transactions during 2013.

The generally subdued nature of the mortgage and housing market within the UK continues to impact the business performance of the Mortgage Services division. However, there are positive signs for the housing and mortgage market with recent falls in unemployment and the initiation of the Government's Funding for Lending Scheme.

The Financial Advice division is also exposed to the wider UK economy. Whilst the increase in the FTSE, and Stock Markets generally, during 2012 has restored some confidence, the continuing uncertain economy, and ongoing problems within the Eurozone, may still impact the willingness of some customers to invest in longer term, more risky products.

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 and current debt factoring / invoice discounting). The Society ceased new commercial lending in November 2008; and
- wholesale counterparties (including other financial institutions). 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 either increase arrears or mortgage losses. 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 persists and, whilst the Group has some exposure to European entities, we continue to be vigilant and have reduced 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 approach to new lending and will continue to do so whilst current economic conditions remain.

The credit decision process utilises 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 non-prime lending markets. In light of the deteriorating economic conditions in early 2008, we ceased new lending in these portfolios then.

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. 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 people 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. 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.

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 Greece, Ireland, Italy, Portugal or Spain, but does have 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.

Risk Management Report - continued

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 continue to be restricted, particularly to institutions such as Skipton. The introduction of the new regulatory liquidity regime in 2010 also increased 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. Liquidity stress testing is carried out against a number of scenarios including those prescribed by the FSA, considering a wide range of liquidity and economic factors. Early warning indicators are regularly assessed by a variety of functions across the Society to pre-empt potential outflows.

The Group continued to actively manage its funding profile during the year and following the repayment of £650m of medium term debt sourced under the Government Guarantee Scheme, the Group completed its second securitisation transaction raising £475m of funds through its securitisation vehicle Darrowby No 2 plc. Since the year end, the Group has begun to access the Funding for Lending Scheme with the Bank of England. However, 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 83.1% (2011: 80.2%) of our total funding.

We have also maintained the quality of the Group's liquidity portfolio by focussing on high quality UK Government issued debt and, at 31 December 2012, the proportion of our treasury assets rated A3 or above was 99.6% (2011: 98.1%). 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, working closely with the Employer.

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.

Conduct and Operational risk

Conduct risk is the risk of delivering poor or inappropriate outcomes for customers while operational risk is the risk of financial loss or reputational damage arising from inadequate or failed internal processes or systems or human error.

Market background

As a business with a retail franchise in Financial Services the management of Conduct risk is key to the ongoing success of the Group. Central to managing this risk is maintenance of a robust product governance framework to ensure that we develop and market products and services designed to meet the needs of our target market, strong control over advice-giving and efficient administration services.

As well as the core business providing advice on mortgages and general insurance the Society has within the Group a large Estate Agency business also providing advice on mortgages and general insurance and a Financial Advice division consisting of three advisory firms specialising in Pensions and Investments advice. Alert to the loss of customer trust experienced by Financial Services firms as a result of misselling scandals the Group continues to invest and develop its conduct risk management processes and oversight arrangements.

The Financial Services sector also faces heightened levels of fraud and financial crime, particularly in relation to e-distribution channels, which require increasingly sophisticated controls.

Risk mitigation

The role of the Conduct and Operational Risk Committee (CORC) is to ensure that an appropriate framework is in place to manage, control and mitigate the risks that could impact the ability of the Group to meet its business objectives and serve our customers whilst protecting its reputation. The Committee also monitors whether group businesses are operating within the Board approved Conduct and Operational risk appetites.

Through the Conduct and 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
- Conduct
- Financial Management and Management Information
- Fraud
- Information Security
- Information Technology
- Legal and Regulatory
- People
- Premises
- Process
- Third Party Relationships

The Group's Conduct and Operational risk management framework sets out the strategy for identifying, assessing and managing such risks. 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. CORC provides oversight and assesses the Group's exposure to conduct and operational risks based on both quantitative and qualitative considerations. The crystallisation of risks is captured through the recording and analysis of customer outcomes and operational losses (and near misses) which is used to identify any potential systemic weaknesses in operating processes.

Given the nature of the regulated sectors in which the Group operates another key conduct and operational risk 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 the Society's Compliance function which ensures best practice is adhered to and shared across the Group as appropriate.

With the establishment of the Financial Conduct Authority (FCA), we will be working closely with the new Regulator to ensure that we fully understand its expectations and comply positively with all requirements.

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 along with the Group's key strategies. The Board Risk Committee is also provided with the results of stress and scenario tests to ensure progress remains 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 macro-economic

Risk Management Report - continued

conditions, inflexible cost structures, uncompetitive products or pricing and structural inefficiencies.

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:

- by maintaining and investing in its control structures;
- a continued focus on customer outcomes;
- promoting the Society's reputation through Marketing and external communications; and
- 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; and
- 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 changing regulatory environment in which it operates. Key changes on the horizon include the implementation of those recommendations made by the Independent Commission on Banking reforms which the Government chooses to bring into law, the imminent implementation of the 'Twin Peaks' regulatory approach, the replacement of Basel II by CRD IV (Basel III) and the impact upon our capital base, the practical impact of the Retail Distribution Review and the Mortgage Market Review. The Group has allocated resource to ensure continued compliance in these and other areas and we believe we are well placed to meet the new 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 and the impact of stress

and scenario tests under Pillar 2. The Board, Board Risk Committee and the Executive 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 2012 Pillar 3 disclosures will be available from May 2013.

P R Hales
Chairman of Board Risk Committee
27 February 2013

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 by the Financial Services Authority.

The Society's governance arrangements are designed to ensure that it meets the requirements and expectations 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':

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 oversight enabling 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 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 at least 10 times per year 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 regularly reviews its composition to ensure that it remains appropriate. Since the year end the Board has been further strengthened by the appointment of two additional Non-Executive Directors who will join the Board on 1 March 2013. One of the existing Non-Executive Directors is scheduled to retire from the Board in 2013 having completed his term of office. At 1 March 2013 the Board will comprise four Executive and nine Non-Executive Directors. 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 before they can take up their position as a Director.

The roles and responsibilities of Non-Executive Directors are set out in their letters of appointment 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.

Further, internal assessments of Board effectiveness, facilitated by the Secretary, were carried out in early 2012 and again in early 2013. Such reviews are an important means of assessing Board performance and will be conducted annually, with independently facilitated exercises 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

Directors' Report on Corporate Governance - continued

the Group Chief Executive's performance while the Vice Chairman and Senior Independent Director leads the Board evaluation of the Chairman's performance.

Re-election Policy

The Society's Rules require that Directors stand for election at the Annual General Meeting (AGM) following their appointment and for re-election every three years thereafter. Non-Executive Directors are appointed for an initial period of three years and are not expected to serve more than six years, which may be extended to nine years in total. The UK Code recommends that all Directors of FTSE 350 Companies should stand for annual re-election. Following a review of the UK Code's requirements, led by the Secretary, the Board has agreed that all Directors should stand for annual re-election at the AGM. Accordingly, Directors will be presented for re-election on an annual basis starting with the 2013 AGM.

Revisions to the Society's Rules are also being presented to members at the 2013 AGM which, inter alia, will include a Rule formalising the requirement for annual re-election of Directors.

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 set out on page 26.

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 and reviewed, at least, annually.

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 the Chief Financial Risk Officer.

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 2012 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)
Ms Cassoni, Non-Executive Director
Mr East, Non-Executive Director
Mr Hales, Non-Executive Director
Mr Hutton, 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 **Conduct and Operational Risk Committee** is primarily responsible for developing and reviewing the Group's conduct and operational risk management frameworks and monitoring management of the risks arising in these areas. The Committee also recommends changes to the conduct and operational risk appetites and associated policies to the Board Risk Committee. Mr Gibson (Chief Conduct Risk Officer and Secretary) chairs the Committee which comprises senior executives from each of the divisions and the Operational risk and Compliance teams.

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, Commercial Director 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, Commercial Director and senior executives from Risk and the Group's lending businesses.

Each business within the Group is governed by a Board or **Operational Board** which contains at least two Society Executives as Shareholder Directors (appointed by the Society) and the business executive management. These 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 Cassoni, Non-Executive Director (Committee Chairman)
Mr Picken, Non-Executive Director
Mr Thompson, Non-Executive Director

In addition, the Chairman, 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 Cassoni has held senior finance appointments with a number of large organisations, most recently as Group Finance Director at the John Lewis Group prior to her retirement in 2012.

The responsibilities of the Committee are in line with the provisions of the Financial Reporting Council Guidance

Directors' Report on Corporate Governance - continued

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 2012, the Committee met seven 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 minutes of the Audit Committee are distributed to the Board while 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 2012. 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	12/12	-	3/3	-	-
Mr C N Hutton	11/12	-	2/3	10/10	-
Ms M L Cassoni (appointed 31 July 2012)	5/5	1/1	2/2	-	-
Mr I M Cornelius (appointed 11 June 2012)	6/6	-	-	-	-
Mr D J Cutter	12/12	-	-	-	7/8
Mr R D East	12/12	-	3/3	10/10	8/8
Mr M R Fleet	12/12	-	-	-	-
Mr P R Hales	12/12	-	3/3	-	8/8
Ms A B E Kinney (resigned 31 October 2012)	9/10	6/6	1/2	-	-
Mr G Picken (appointed 17 January 2012)	10/11	6/7	3/3	-	7/8
Mr P J S Thompson	12/12	7/7	3/3	9/10	-
Mr R J Twigg	12/12	-	-	-	8/8

Constructive use of the AGM

Each year the Society gives all eligible members at least 21 days' notice of the AGM. At the AGM, the Chairman and Group Chief Executive 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 are expected to attend the AGM and be 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 it easily readable.

Copies of the full Annual Report and Accounts 2012 are also available on request in branches or by post.

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 and market research which is used to identify improvements to our service and strengthen relations with customers.

M H Ellis
Chairman
27 February 2013

Directors' Remuneration Report

This report explains the Group's policies for the remuneration of Directors and discloses the remuneration of Directors. 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 specifically:

- Sets remuneration for the Chairman and the Executive Directors.
- Approves the remuneration policy for senior managers who have a material impact on the Society's risk profile (Code Staff).
- Reviews recommendations from the Group Chief Executive for approval of the remuneration for key executives in the Group.
- Agrees the design and overall targets for any short or long term variable pay schemes applicable to senior executives and Code Staff.

The Committee has established clear remuneration principles which reflect both the requirements of the Society and the Code. These principles, which are reviewed annually, apply Group-wide, setting appropriate standards with regard to remuneration governance, risk management, variable pay structures (and the link to performance) 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 terms of reference of the Remuneration Committee are available, on request, from the Secretary.

The Remuneration Committee met 10 times during 2012. 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 and Chief Human Resources Officer regularly attend by invitation and external advisers are invited to attend meetings as and when appropriate.

In addition to its annual responsibilities, the Committee has been involved during 2012 in the following areas:

- Review and approval of medium and long term incentive schemes for Operational Board members in group subsidiaries.
- Review of total remuneration for the Society's Executive team with particular emphasis on balancing reward for short term objectives with a long term focus on sustainable profit and member value.
- Approval of design changes to the Society's Senior Leadership Team annual bonus scheme.
- Updating of Executive service contracts.

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. The principles were last reviewed in Q4 2012 to reflect the FSA's guidance consultation on the approach to sales incentives.

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 any of the stated Board Risk Appetites or the scope of Board policies.
4. Remuneration practices 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 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.

Our approach to Executive Directors' remuneration is as follows:

Basic salary - basic salary reflects the size of the role and responsibilities, individual performance (assessed annually) and the skills / experience of the individual. The Society uses a recognised job evaluation mechanism to determine the relative size of roles.

In setting appropriate salary levels, the Committee takes into account data for similar positions in comparable organisations. The data is independently commissioned and the Society aims to position Executives competitively within this reference group.

Annual variable pay - the Executive Directors participate in the Senior Leadership Incentive Scheme (the Incentive Scheme) which is a non-pensionable performance incentive scheme designed to reward the achievement of objectives across a balance of financial and non-financial objectives. These are reviewed each year and set by the Committee. In setting target and maximum payments, the Committee considers both the market position and the risk appetite of the Society and sets these levels accordingly.

Currently, annual bonus under the Incentive Scheme is the only variable pay element although this is under review, with proposals for a Long Term Scheme being considered for 2013.

Pensions - the Executive Directors receive contributions payable into defined contribution pension arrangements, or a cash equivalent.

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

2012 Executive Directors' Remuneration review

Basic salary

In 2011, following an external benchmarking survey of executive remuneration in comparable financial services organisations, the Committee agreed to increase the basic salaries of the Group Chief Executive and Group Finance Director to £352,000 and £275,000 respectively with effect 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 and Mr Cornelius' basic salary, following his appointment to the Board as Commercial Director on 11 June 2012, was set at £210,000 based on comparable market data.

There has been no subsequent increase to the Executive Directors' basic salaries.

Variable pay

The Incentive Scheme was introduced in 2011 and therefore ended its first year of operation in December 2011 with payment made in March 2012.

In reviewing the operation of the Incentive Scheme for 2012, a number of changes were made in the following areas:

- Profit – Group profit was retained as a performance target but Society profit was replaced with Mortgages and Savings profit to reflect a broader focus. Individual profit targets were removed from the Incentive Scheme and reflected more appropriately in personal objectives.
- Common Team KPIs were set for all participants, taking into account a balance of conduct and prudential risk factors. The team KPIs reflect people, customers, conduct, financial strength and process measures.

The Incentive Scheme is capped in line with market practice and provides an appropriate balance between base and variable pay. The Incentive Scheme rules include the requirement to defer over three years a portion of the amount earned by any individual if the total amount earned by that individual is greater than £500,000, or the amount earned under the Incentive Scheme is more than 33% of his or her 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. In 2012, the Committee exercised its discretion and reduced the bonuses of Executive Committee members by 10% as a result of conduct risk issues within the Financial Advice division.

Directors' Remuneration Report - continued

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 2012, expressed as a percentage of their basic salary: Mr Cutter 51.4% (2011: 15.0%); Mr Twigg 45.8% (2011: 10.1%); Mr Fleet 47.8% (2011: 17.5%) and Mr Cornelius 50.4% (2011: not applicable).

Long term incentive plan

As part of the review of Executive remuneration, the Committee has been considering the introduction of a long term incentive plan for senior executives in common with many other banking and financial services organisations. This was supported by the benchmarking exercise carried out during the year which concluded that the total remuneration of some Executives is below market largely (but not exclusively) due to the absence of a long term incentive plan. The Committee's aim in introducing a long term incentive plan is to:

- Align reward to the achievement of long term sustainable profit and member interests.
- Provide an appropriate balance between short and long term objectives in the reward package.
- Provide market competitive reward packages which support retention and high performance of key Executives.

The Society intends to implement such a scheme during 2013. The scheme will apply to approximately 13 senior executives. It is intended that, over time, the balance between short and long term incentives will become equal by transferring variable pay from the short term scheme into the long term scheme. This will ensure an appropriate balance in the overall remuneration.

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. 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 Remuneration Committee increased the Non-Executive Directors' basic annual fee from £40,000 to £42,000 from 1 July 2012, the first increase since July 2007.

The Chairman's fees are reviewed and approved by the Remuneration Committee. Mr Ellis' fee was set following comparison with market data at £155,000 per annum when he joined the Board as Chairman on 24 May 2011, and has not been increased since.

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	2012 Fees £000	2012 Committee Fees £000	2012 Total £000	2011 Fees £000	2011 Committee Fees £000	2011 Total £000
Mr M H Ellis (Chairman) (note 1)	**155**	**-**	**155**	94	-	94
Mr A I Findlay (resigned 24 May 2011)	**-**	**-**	**-**	28	-	28
Mr C N Hutton (Vice Chairman) (note 2)	**48**	**4**	**52**	48	4	52
Ms M L Cassoni (note 3)	**18**	**1**	**19**	-	-	-
Mr R D East (note 4)	**41**	**-**	**41**	4	-	4
Mr P R Hales (note 5)	**41**	**8**	**49**	40	5	45
Ms A B E Kinney (note 6)	**34**	**7**	**41**	40	8	48
Mr G Picken (note 7)	**41**	**-**	**41**	-	-	-
Mr P J S Thompson	**41**	**-**	**41**	40	-	40
Mr W R Worsley (retired 3 May 2011)	**-**	**-**	**-**	13	-	13
	419	**20**	**439**	307	17	324

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 is also Chairman of the Remuneration Committee.
3. Ms Cassoni was appointed a Director on 31 July 2012, and was appointed Chairman of the Audit Committee on 31 October 2012.
4. Mr East was appointed a Director on 29 November 2011.
5. Mr Hales is the Chairman of the Board Risk Committee.
6. Ms Kinney resigned as a Director and as Chairman of the Audit Committee on 31 October 2012.
7. Mr Picken was appointed a Director on 17 January 2012.

Executive Directors

2012	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 (note 2)	**352**	**181**	**16**	**549**	**4**	**70**	**623**
Mr I D Cornelius (note 3)	**123**	**62**	**7**	**192**	**-**	**10**	**202**
Mr M R Fleet	**230**	**110**	**26**	**366**	**-**	**18**	**384**
Mr R J Twigg	**275**	**126**	**12**	**413**	**4**	**55**	**472**
	980	**479**	**61**	**1,520**	**8**	**153**	**1,681**

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 4)	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. £72,000 (2011: £nil) of Mr Cutter's annual performance pay was deferred under the rules of the scheme.
3. Mr Cornelius was appointed as an Executive Director on 11 June 2012 and the above table includes his remuneration, annual performance pay and benefits as a Director of the Society from that date.
4. Mr Fleet was appointed as an Executive Director on 6 December 2011 and the above table includes his remuneration, annual performance pay and benefits as a Director of the Society from that date.

Directors' pension benefits

Mr Cutter and Mr Twigg are members of Skipton Building Society Pension & Life Assurance Scheme and the value of their benefits in the Scheme are set out below. 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) 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 2012 £000	Accrued pension entitlement as at 31 December 2012 £000	Transfer value of accrued rights at 31 December 2011 £000	Members' contribution for the year ended 31 December 2012 £000	Transfer values equivalent of increase in accrued pension for the year ended 31 December 2012 £000	Transfer values of accrued rights at 31 December 2012 £000
Mr D J Cutter	**4**	**84**	**903**	**-**	**232**	**1,135**
Mr R J Twigg	**4**	**69**	**646**	**-**	**175**	**821**

	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 R J Twigg	1	65	541	-	105	646

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 their activities. Accordingly, the Society is grouped with banks and building societies with total assets less than £15bn in Tier 3. 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 31 (2011: 38) senior managers who were considered under the rules of the Code to be Code Staff because they have a material impact on the risk profile of the business. 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, or if total remuneration exceeds £500,000, applies to all participants in the Incentive Scheme irrespective of whether they are Code Staff.

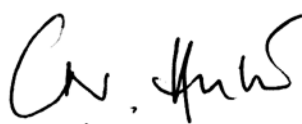
The table below sets out the aggregate remuneration for Code Staff for the year ended 31 December 2012.

2012	**Number of beneficiaries**	**Fixed remuneration £000**	**Variable remuneration[1] £000**	**Total remuneration £000**
Senior management (including Executive Directors)	**8**	**1,867**	**696**	**2,563**
Other Code Staff	**23**	**2,035**	**371**	**2,406**

2011	Number of beneficiaries	Fixed remuneration £000	Variable remuneration[1] £000	Total remuneration £000
Senior management (including Executive Directors)	8	2,037	464	2,501
Other Code Staff	30	2,337	154	2,491

Note

1. Variable remuneration recognised in the year includes £72,000 (2011: £149,000) which is deferred for payment in future periods.



C N Hutton

Chairman of the Remuneration Committee

27 February 2013

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 2012 set out on pages 46 to 120. 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 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 Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

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 2012 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.

John Ellacott (Senior Statutory Auditor)

for and on behalf of KPMG Audit Plc, Statutory Auditor

Chartered Accountants

Leeds

27 February 2013

Income Statements

For the year ended 31 December 2012	Notes	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Interest receivable and similar income	2	**381.2**	373.6	**374.3**	393.7
Interest payable and similar charges	3	**(297.0)**	(302.4)	**(309.1)**	(342.5)
Net interest receivable		**84.2**	71.2	**65.2**	51.2
Fees and commissions receivable	4	**399.4**	369.4	**20.8**	21.6
Fees and commissions payable	5	**(7.4)**	(7.9)	**(2.7)**	(2.6)
Fair value gains / (losses) on financial instruments		**3.6**	3.0	**3.5**	(0.1)
Income from shares in subsidiary undertakings		**-**	-	**40.5**	20.4
Profit on disposal of subsidiary undertakings		**-**	0.9	**-**	-
Share of profits from joint ventures and associates	17c)	**1.6**	0.7	**-**	-
Other income	6	**10.1**	13.2	**4.3**	6.2
Total income		**491.5**	450.5	**131.6**	96.7
Administrative expenses	7	**(410.1)**	(384.8)	**(59.9)**	(61.5)
Operating profit before impairment losses and provisions		**81.4**	65.7	**71.7**	35.2
Impairment losses on loans and advances	16	**(12.3)**	(30.0)	**(9.8)**	(15.2)
Impairment losses on debt securities	13	**(4.0)**	-	**(4.0)**	-
Provisions for liabilities	27	**(28.7)**	(13.5)	**(9.7)**	(6.0)
Provisions against investments in subsidiary undertakings	17a)	**-**	-	**(5.4)**	(11.9)
Provisions against loans to subsidiary undertakings	17a)	**-**	-	**-**	0.8
Profit before tax		**36.4**	22.2	**42.8**	2.9
Tax expense	11	**(8.8)**	(6.7)	**(2.6)**	(0.9)
Profit for the financial year		**27.6**	15.5	**40.2**	2.0
Profit for the financial year attributable to:					
Members of Skipton Building Society		**28.6**	15.4	**40.2**	2.0
Non-controlling interests		**(1.0)**	0.1	**-**	-
		27.6	15.5	**40.2**	2.0

Segmental performance of the Group is shown in note 34.

The profit for the current and comparative year was derived wholly from continuing operations.

The notes on pages 53 to 120 form part of these Accounts.

Statements of Comprehensive Income

For the year ended 31 December 2012	Notes	**Group 2012 £m**	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Profit for the financial year		**27.6**	15.5	**40.2**	2.0
Other comprehensive income:					
Available-for-sale investments: valuation (losses) / gains taken to equity	31	**(4.5)**	17.1	**(5.6)**	14.9
Available-for-sale investments: realised gains transferred to income statement	31	**(6.6)**	(0.1)	**(6.6)**	(0.1)
Cash flow hedges: gains / (losses) taken to equity	31	**6.4**	(25.8)	**6.4**	(25.7)
Exchange differences on translation of foreign operations	31	**0.1**	0.9	**-**	-
Movement in reserves attributable to non-controlling interests	31	**-**	(0.4)	**-**	-
Actuarial loss on retirement benefit obligations	35	**(5.5)**	(18.4)	**(2.0)**	(12.5)
Income tax relating to components of other comprehensive income	31	**1.5**	6.6	**1.0**	5.4
Other comprehensive expense for the year, net of tax		**(8.6)**	(20.1)	**(6.8)**	(18.0)
Total comprehensive income / (expense) for the year		**19.0**	(4.6)	**33.4**	(16.0)
Total comprehensive income / (expense) attributable to:					
Members of Skipton Building Society		**20.0**	(4.7)	**33.4**	(16.0)
Non-controlling interests		**(1.0)**	0.1	**-**	-
		19.0	(4.6)	**33.4**	(16.0)

The notes on pages 53 to 120 form part of these Accounts.

Statements of Financial Position

As at 31 December 2012	Notes	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Assets					
Cash in hand and balances with the Bank of England		**1,014.8**	782.3	**1,014.6**	782.2
Loans and advances to credit institutions	12	**383.1**	361.0	**232.0**	262.2
Debt securities	13	**1,133.9**	1,877.3	**1,694.1**	2,507.3
Derivative financial instruments	14	**202.7**	216.3	**207.9**	216.5
Loans and advances to customers	15	**10,593.5**	10,252.8	**8,221.7**	7,819.7
Current tax asset		**-**	-	**0.8**	-
Deferred tax asset	28	**28.8**	30.7	**16.8**	20.0
Investments in group undertakings	17a)	**-**	-	**1,980.5**	2,166.5
Investments in joint ventures and associates	17c)	**3.1**	2.5	**-**	-
Equity shares	17d)	**3.1**	-	**-**	-
Property, plant and equipment	19	**81.4**	86.2	**31.2**	38.5
Investment property	20	**11.6**	6.8	**32.6**	28.1
Intangible assets	18	**196.2**	196.7	**1.5**	2.2
Other assets	21	**108.0**	97.7	**11.9**	5.4
Total assets		**13,760.2**	13,910.3	**13,445.6**	13,848.6
Liabilities					
Shares	22	**9,462.4**	9,280.4	**9,462.4**	9,280.4
Amounts owed to credit institutions	23	**907.6**	877.4	**969.0**	709.7
Amounts owed to other customers	24	**897.7**	921.6	**1,541.9**	1,678.7
Debt securities in issue	25	**730.9**	1,106.2	**60.1**	786.2
Derivative financial instruments	14	**370.8**	374.4	**304.9**	309.5
Current tax liability		**3.7**	3.1	**-**	1.3
Other liabilities	26	**83.0**	78.0	**7.4**	8.5
Accruals and deferred income		**40.2**	41.4	**7.1**	5.8
Provisions for liabilities	27	**54.5**	34.2	**16.6**	10.5
Deferred tax liability	28	**8.8**	10.1	**4.2**	5.7
Retirement benefit obligations	35	**45.1**	43.6	**20.1**	18.9
Subordinated liabilities	29	**223.9**	228.2	**223.9**	239.7
Subscribed capital	30	**96.1**	95.2	**96.1**	95.2
Total liabilities		**12,924.7**	13,093.8	**12,713.7**	13,150.1
Members' interests					
General reserve		**844.9**	820.8	**750.8**	712.6
Available-for-sale reserve		**(2.3)**	6.0	**(4.3)**	4.9
Cash flow hedging reserve		**(14.6)**	(19.0)	**(14.6)**	(19.0)
Translation reserve		**5.7**	5.9	**-**	-
Attributable to members of Skipton Building Society		**833.7**	813.7	**731.9**	698.5
Non-controlling interests		**1.8**	2.8	**-**	-
Total members' interests		**835.5**	816.5	**731.9**	698.5
Total members' interests and liabilities		**13,760.2**	13,910.3	**13,445.6**	13,848.6

These Accounts were approved by the Board of Directors on 27 February 2013 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 120 form part of these Accounts.

Statements of Changes in Members' Interests

For the year ended 31 December 2012

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 2012	**820.8**	**6.0**	**(19.0)**	**5.9**	**813.7**	**2.8**	**816.5**
Profit / (loss) for the financial year	28.6	-	-	-	**28.6**	(1.0)	**27.6**
Other comprehensive income							
Actuarial loss on retirement benefit obligations	(4.8)	-	-	-	**(4.8)**	-	**(4.8)**
Net (losses) / gains from changes in fair value	-	(3.3)	4.4	-	**1.1**	-	**1.1**
Available-for-sale gains transferred to profit or loss on sale	-	(5.0)	-	-	**(5.0)**	-	**(5.0)**
Exchange differences on translation of foreign operations	-	-	-	0.1	**0.1**	-	**0.1**
Transfer of realised profits	0.3	-	-	(0.3)	**-**	-	**-**
Total other comprehensive income (note 31)	**(4.5)**	**(8.3)**	**4.4**	**(0.2)**	**(8.6)**	**-**	**(8.6)**
Total comprehensive income for the year	**24.1**	**(8.3)**	**4.4**	**(0.2)**	**20.0**	**(1.0)**	**19.0**
Balance at 31 December 2012	**844.9**	**(2.3)**	**(14.6)**	**5.7**	**833.7**	**1.8**	**835.5**
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

Statements of Changes in Members' Interests - continued

For the year ended 31 December 2012
Society

	General reserve £m	Available-for-sale financial assets £m	Cash flow hedges £m	Total £m
Balance at 1 January 2012	**712.6**	**4.9**	**(19.0)**	**698.5**
Profit for the financial year	40.2	-	-	**40.2**
Other comprehensive income				
Actuarial loss on retirement benefit obligations	(2.0)	-	-	**(2.0)**
Net (losses) / gains from changes in fair value	-	(4.2)	4.4	**0.2**
Available-for-sale gains transferred to profit or loss on sale	-	(5.0)	-	**(5.0)**
Total other comprehensive income (note 31)	**(2.0)**	**(9.2)**	**4.4**	**(6.8)**
Total comprehensive income for the year	**38.2**	**(9.2)**	**4.4**	**33.4**
Balance at 31 December 2012	**750.8**	**(4.3)**	**(14.6)**	**731.9**
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

The notes on pages 53 to 120 form part of these Accounts.

Statements of Cash Flows

For the year ended 31 December 2012	Notes	**Group 2012 £m**	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Cash flows from operating activities					
Profit before taxation		**36.4**	22.2	**42.8**	2.9
Adjustments for:					
Impairment losses on loans and advances	16	**12.3**	30.0	**9.8**	15.2
Impairment losses on debt securities	13	**4.0**	-	**4.0**	-
Loans and advances written off, net of recoveries	16	**(27.6)**	(21.3)	**(11.7)**	(4.2)
Provisions against investments in subsidiary undertakings	17a)	**-**	-	**5.4**	11.9
Provisions against loans to subsidiary undertakings	17a)	**-**	-	**-**	(0.8)
Goodwill impairment	18	**-**	1.0	**-**	-
Depreciation and amortisation	18,19,20	**19.2**	20.6	**3.7**	5.6
Impairment of investment property	20	**1.3**	0.1	**1.3**	0.1
Dividends received from group undertakings		**-**	-	**(40.5)**	(20.4)
Interest on subscribed capital and subordinated liabilities	3	**23.9**	24.2	**23.9**	24.2
Profit on sale of property, plant and equipment and investment properties	6	**(0.2)**	(1.4)	**(0.2)**	(1.6)
Share of profits from joint ventures and associates	17c)	**(1.6)**	(0.7)	**-**	-
Profit on disposal of subsidiary undertakings		**-**	(0.9)	**-**	-
Other non-cash movements		**(0.4)**	(11.4)	**(3.5)**	(24.2)
		67.3	62.4	**35.0**	8.7
Changes in operating assets and liabilities:					
Movement in prepayments and accrued income		**3.1**	(3.8)	**5.7**	(3.6)
Movement in accruals and deferred income		**(5.2)**	5.0	**(3.9)**	0.5
Movement in provisions for liabilities		**20.3**	2.9	**6.1**	2.4
Movement in loans and advances to customers		**(365.2)**	(409.5)	**(437.6)**	(461.0)
Movement in shares		**183.6**	(136.9)	**183.6**	(136.9)
Net movement in amounts owed to credit institutions and other customers		**6.9**	(141.7)	**123.4**	(121.6)
Net movement in debt securities in issue		**(358.2)**	288.3	**(708.1)**	(31.0)
Net movement in loans and advances to credit institutions		**51.4**	(70.0)	**51.4**	(70.9)
Net movement in other assets		**(7.7)**	(12.9)	**(1.7)**	(4.6)
Net movement in other liabilities		**6.3**	15.7	**(1.1)**	1.1
Income taxes (paid) / received		**(4.9)**	(0.4)	**(1.8)**	3.7
Net cash flows from operating activities		**(402.3)**	(400.9)	**(749.0)**	(813.2)

Statements of Cash Flows - continued

For the year ended 31 December 2012	Notes	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Net cash flows from operating activities		**(402.3)**	(400.9)	**(749.0)**	(813.2)
Cash flows from investing activities					
Purchase of debt securities	13	**(2,280.5)**	(4,075.2)	**(2,176.4)**	(4,719.3)
Proceeds from disposal of debt securities	13	**3,031.3**	4,637.1	**2,995.8**	4,618.6
Purchase of intangible assets	18	**(7.8)**	(7.9)	**(0.3)**	(0.3)
Purchase of property, plant and equipment and investment property	19,20	**(12.0)**	(10.5)	**(1.8)**	(1.5)
Proceeds from disposal of property, plant and equipment and investment property		**1.6**	4.9	**0.8**	3.7
Dividends received from group undertakings		**-**	-	**40.5**	20.4
Dividends received from joint ventures		**1.0**	0.4	**-**	-
Dividends paid to non-controlling interests	26	**(1.3)**	(1.8)	**-**	-
Purchase of subsidiary undertakings	17a)	**(0.2)**	(7.0)	**-**	-
Net cash acquired with subsidiaries		**-**	0.6	**-**	-
Further investment in subsidiary undertakings	17a)	**-**	(0.3)	**-**	(0.8)
Investment in joint ventures and equity shares	17c), 17d)	**(3.1)**	(0.7)	**-**	-
Purchase of other business units		**-**	(0.3)	**-**	-
Cash received from sale of subsidiary undertakings	17b)	**3.3**	1.1	**-**	-
Net cash disposed on sale of subsidiary undertakings		**-**	(0.5)	**-**	-
Net cash flows from investing activities		**732.3**	539.9	**858.6**	(79.2)
Cash flows from financing activities					
Repayment of subordinated liabilities		**-**	-	**(12.5)**	-
Decrease in loans to subsidiary undertakings	17a)	**-**	-	**180.6**	1,033.7
Write back of loans to subsidiary undertakings	17a)	**-**	-	**-**	0.8
Interest paid on subordinated liabilities		**(15.6)**	(16.0)	**(15.6)**	(16.0)
Interest paid on Permanent Interest Bearing Shares		**(8.3)**	(8.2)	**(8.3)**	(8.2)
Net cash flows from financing activities		**(23.9)**	(24.2)	**144.2**	1,010.3
Net increase in cash and cash equivalents		**306.1**	114.8	**253.8**	117.9
Cash and cash equivalents at 1 January		**870.1**	755.3	**771.2**	653.3
Cash and cash equivalents at 31 December		**1,176.2**	870.1	**1,025.0**	771.2

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

	Notes	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Cash in hand and balances with the Bank of England		**1,014.8**	782.3	**1,014.6**	782.2
Mandatory reserve deposit with the Bank of England		**(11.1)**	(11.0)	**(11.1)**	(11.0)
		1,003.7	771.3	**1,003.5**	771.2
Loans and advances to credit institutions	12	**172.5**	98.8	**21.5**	-
Cash and cash equivalents as at 31 December		**1,176.2**	870.1	**1,025.0**	771.2

The notes on pages 53 to 120 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 2012; 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.

There have been no new standards adopted by the Group during the year. Note 36 to the accounts sets out details of forthcoming standards and interpretations, which are relevant to the Group, and have been adopted by the EU but are not effective as at 31 December 2012.

b) Adjustments to comparative information

Certain comparatives have been reclassified to be presented on a basis which is consistent with the current year. The fair value for hedged risk previously reported in 'Debt securities in issue' has been reclassified and allocated between amounts owed to other customers, debt securities in issue, subordinated liabilities and subscribed capital. The impact of the reclassifications is not material and details are included below. The reclassifications have not impacted the net assets of the Group or Society.

Statement of Financial Position at 31 December 2011	**Group**		**Society**	
	Previously published £m	**Reclassified £m**	**Previously published £m**	**Reclassified £m**
Amounts owed to other customers	921.3	**921.6**	1,678.4	**1,678.7**
Debt securities in issue	1,129.9	**1,106.2**	809.9	**786.2**
Subordinated liabilities	214.2	**228.2**	225.7	**239.7**
Subscribed capital	85.8	**95.2**	85.8	**95.2**
	2,351.2	**2,351.2**	2,799.8	**2,799.8**

This reclassification also impacts the following key ratios:

	Previously published £m	**Reclassified £m**
Gross capital (£m)	1,116.5	**1,139.9**
Gross capital %	9.14%	**9.35%**
Free capital (£m)	841.6	**865.0**
Free capital %	6.89%	**7.10%**
Liquidity as % of SDL	24.74%	**24.79%**

c) 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.

Notes to the Accounts - continued

1. Accounting policies (continued)

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, the put option liability).

In accordance with IAS 27 (amended), *Consolidated and Separate Financial Statements*, for business combinations which take place from 1 January 2010 onwards, all transactions with non-controlling interests are recorded in equity if there has been no change in control. In accordance with IFRS 3 (2008), *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 was issued by the Group are credited or charged through the Income Statement. All transaction or acquisition costs are written off to the Income Statement as incurred. Put options issued prior to 1 January 2010 are accounted for in accordance with IAS 27 (2003) and IFRS 3 (2004) and any adjustment to the Group's estimation of the present value of the put option liability will result in an adjustment to goodwill.

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.

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.

Equity shares

An equity share investment is an investment in a company where the Group holds a small shareholding and does not have significant influence.

Equity shares are accounted for in these consolidated financial statements as available-for-sale financial assets. As such they 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.

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.

1. Accounting policies (continued)

d) 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 five years (adjusted for non-cash items) and assumed growth thereafter for the next 10 years generally in line with long term growth rates. The Group estimates discount rates based upon the weighted average cost of capital which is then adjusted to take account of the market risks associated with each cash generating unit. A 15 year time horizon has been used to reflect that cash generating units are held for the long term.

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

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

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

Computer software, databases and customer contracts

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

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

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

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

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

e) 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:

Available-for-sale

Available-for-sale assets are non-derivative financial assets that are not classified as loans and receivables or as fair value through profit and loss. 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.

Notes to the Accounts - continued

1. Accounting policies (continued)

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.

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, higher lending charges 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 Darrowby No 2 plc, special purpose entities, which are consolidated into the Group Accounts. The loans secure debt securities issued by the special purpose entities. 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.

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.

Derivatives that do not qualify for hedge accounting are held at fair value with changes in fair value recognised in the Income Statement.

Derivative financial instruments (both assets and liabilities) are held at fair value in the Statement of Financial Position. 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 hedge effectiveness 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.

1. Accounting policies (continued)

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.

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

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

Held to maturity

The Group has not classified any assets as held to maturity.

f) 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.

g) 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.

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.

Notes to the Accounts - continued

1. Accounting policies (continued)

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. 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.

h) 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 as detailed in note 1c). Financial liabilities are derecognised only when the obligation is discharged, cancelled or has expired.

i) Foreign currency transactions

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

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

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

j) 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 and disclosed in the Statement of Comprehensive Income.

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,

1. Accounting policies (continued)

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.

k) 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 administrative expenses in the year in which the expenditure is incurred.

l) Employee benefits

Defined contribution pension arrangements

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

Defined benefit schemes

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

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

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.

Notes to the Accounts - continued

1. Accounting policies (continued)

m) 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.

Estate Agency commissions earned on the sales of properties, land and auction income are recognised on the date contracts are exchanged. Property management income is recognised on cleared cash funds. Mortgage Services income is recognised when cash is received and insurance commission is recognised upon fulfilment of contractual obligations with a provision for future clawback repayment in the event of early termination by the customer.

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.

Revenue from software licence fees is recognised on the transfer of significant risks and rewards of ownership of the licensed software under an agreement between the Group and the customer. Revenue from implementation and consulting services is recognised in proportion to their stage of completion, typically in accordance with the achievement of contract milestones or days expended. Customer support revenue and systems management revenue are recognised on a straight-line basis over the period of the service.

n) Government grants

Grants received which related 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 received which relate to revenue expenditure are matched with the expenditure to which they relate.

o) 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 freehold 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.

p) 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 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.

1. Accounting policies (continued)

q) Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash comprises cash in hand and unrestricted loans and advances to credit institutions repayable on demand. Cash equivalents comprise highly-liquid unrestricted 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.

r) 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.

s) 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.

t) 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.

u) 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 £1.7m (2011: £2.5m) increase in the Group's interest income and a £1.1m (2011: £1.7m) increase in the Society's interest income.

During the year a credit of £1.2m (2011: £1.7m) for the Group and a debit of £2.4m (2011: £1.4m debit) 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 the performance of its residential loan portfolios to assess the level of impairment. In determining whether an impairment loss should be recorded in the Income Statement, management makes judgements as to whether there is any objective data indicating that there is a measurable impairment loss. Specifically, management regularly assesses key assumptions such as the probability of an account going into possession, the time period over which an account will exhibit objective evidence of impairment loss (the 'emergence period') and the eventual loss incurred in the event of forced sale or write off.

Notes to the Accounts - continued

1. Accounting policies (continued)

A critical estimate in calculating the eventual loss incurred in the event of sale is the future level of house prices which is assumed to fall by 2.5% in 2013 and remain flat in 2014 and 2015. Based upon the loss provisioning model used by the Group, a further 10% fall in house prices in 2013 would increase the year end residential impairment provision by £5.6m (2011: £7.8m). Other sensitivities include the emergence period, where an increase of three months would increase the loan impairment provision by £3.9m (2011: £4.2m), and the loss given default rate, where a 10% increase equates to a £4.0m (2011: £5.2m) 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 (2011: £1.4m). A 10% increase in the aggregate market value of these businesses would increase the put option liability by £1.3m (2011: £1.3m).

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 five 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 2012, to the extent that discount rates were to increase by 10%, the impairment charge would increase by £0.3m (2011: £0.3m). In addition, a reduction in the long term growth rate assumption from 2.5% to 0% would increase the impairment charge by £0.3m (2011: £1.0m).

Fair value of financial instruments

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

The most reliable fair values of financial instruments 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 forward risk-free and benchmark interest rates, foreign currency exchange rates, equity index prices, expected price volatilities and the retail price index.

1. Accounting policies (continued)

Taxation

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

Retirement benefit obligations

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

One key assumption is the discount rate used to discount future plan liabilities where currently a 0.25% increase in the discount rate would reduce the pension obligation by £9.3m (2011: £8.8m) and vice versa. Another key assumption surrounds mortality rates where a one year increase in expected lives would increase the pension obligation by £4.1m (2011: £3.9m) and vice versa.

Financial Services Compensation Scheme

The ultimate liability for levies payable to the Financial Services Compensation Scheme (FSCS) to safeguard protected deposits from the deposit takers which failed still remains uncertain. The FSCS continues to have significant borrowings of some £16bn in the form of loans from HM Treasury to cover the compensation costs paid and payable in respect of the major bank defaults. The FSCS now expect a capital shortfall of approximately £802m. This will be levied against UK retail deposit takers as a capital levy over a three year period.

Following FSA guidance, the Society provides for an estimate of the management expense levy for those scheme years triggered by the reporting date, and in 2012 has also provided for one third of the estimated capital levy payable.

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

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

The impact of a 1% (e.g. 0.5% to 1.5%) increase in the estimate of the 12 month LIBOR rate would increase the provision by £1.9m (2011: £2.0m) and vice versa.

Other provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the reporting date, and are discounted to present value where the effect is material. The provisions made within the Group cover provisions for the cost of surplus properties, commission reclaims / rebates, customer claims and customer compensation.

Included in the Group's customer compensation provision is a gross provision of £11.6m (2011: £1.8m), relating to a past business review which is currently underway within the Financial Advice division. Provisions in relation to past business reviews are determined using a risk based approach to identify the potential population of clients impacted by the review. Compensation payments are estimated based upon historical levels of compensation payment or management's best estimate of the likely settlement per case.

Given the early nature of the advice suitability reviews and associated compensation provision, there is uncertainty regarding its quantum and timing and the provision made at 31 December 2012 represents management's best estimate of the expenditure arising from the review, including the costs of remediation. The provision requires significant judgement by management in determining appropriate assumptions and the extent of the required expenditure will also depend on the facts and circumstances of each individual customer's case. The provision is calculated gross of professional indemnity insurance, for which a receivable of £8.5m has been included within other assets. Management believe that the insurance asset meets the virtually certain test in accordance with the accounting standard and that recoveries will be made under the terms of the insurance policies in place.

The key assumptions in determining the provision are the uphold rate, average payment and number of professional indemnity insurance excess payments. Further details are included in note 27.

Notes to the Accounts - continued

2. Interest receivable and similar income

	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
On loans fully secured on residential property	**402.3**	401.1	**312.8**	306.5
On other loans:				
To subsidiary undertakings	**-**	-	**86.6**	96.5
Other	**13.6**	17.7	**11.2**	15.7
On debt securities	**38.7**	41.7	**38.0**	41.1
On other liquid assets	**7.4**	7.6	**6.5**	6.6
Net expense on derivative financial instruments	**(80.8)**	(94.5)	**(80.8)**	(72.7)
	381.2	373.6	**374.3**	393.7

Included within interest receivable and similar income on debt securities is income from fixed income securities in the Group of £16.5m (2011: £25.5m) and in Society of £15.7m (2011: £25.4m).

Included within interest receivable and similar income is interest accrued on impaired financial assets in the Group of £7.8m (2011: £9.9m) and in Society of £1.5m (2011: £2.3m).

3. Interest payable and similar charges

	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
On shares held by individuals	**240.1**	236.1	**240.1**	236.1
On subscribed capital	**8.3**	8.2	**8.3**	8.2
On deposits and other borrowings:				
Subordinated liabilities	**15.6**	16.0	**15.6**	16.0
Subsidiary undertakings	**-**	-	**70.4**	77.8
Wholesale and other funding	**53.0**	56.3	**18.8**	33.6
Net income on derivative financial instruments	**(20.2)**	(14.5)	**(44.1)**	(29.2)
Other	**0.2**	0.3	**-**	-
	297.0	302.4	**309.1**	342.5

4. Fees and commissions receivable

	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Mortgage origination related fees	**20.7**	15.7	**6.6**	7.2
General insurance fees	**32.4**	28.2	**5.4**	4.4
Commissions earned on property sales	**104.2**	98.2	**-**	-
Commissions earned on property lettings	**23.1**	19.6	**-**	-
Mortgage servicing fees	**54.5**	59.9	**-**	-
Financial advice fees	**52.3**	53.4	**-**	-
Other fees and commissions	**112.2**	94.4	**8.8**	10.0
	399.4	369.4	**20.8**	21.6

The 2011 comparative figures have been reclassified following a review during the year.

5. Fees and commissions payable

	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Mortgage origination related fees	**0.3**	0.4	**0.3**	0.4
Other fees and commissions	**7.1**	7.5	**2.4**	2.2
	7.4	7.9	**2.7**	2.6

6. Other income

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Property rents received	**2.0**	1.9	**2.0**	2.5
Expected return on pension scheme assets (note 35)	**8.1**	10.2	**4.1**	5.2
Interest on pension scheme liabilities (note 35)	**(9.1)**	(10.0)	**(4.6)**	(4.8)
Government grants	**0.4**	0.6	**-**	-
Net profit on sale of property, plant and equipment and investment properties	**0.2**	1.4	**0.2**	1.6
Other	**8.5**	9.1	**2.6**	1.7
	10.1	13.2	**4.3**	6.2

7. Administrative expenses

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Employee costs:				
Wages and salaries	**229.4**	220.8	**37.1**	35.3
Social security costs	**21.8**	21.1	**3.4**	3.4
Pension costs:				
Defined contribution arrangements (note 35)	**6.7**	6.5	**2.4**	2.2
Defined benefit schemes service costs (note 35)	**-**	1.8	**-**	1.3
Settlement gain (note 35)	**-**	(4.5)	**-**	(2.1)
	257.9	245.7	**42.9**	40.1
Other administrative expenses	**152.2**	139.1	**17.0**	21.4
	410.1	384.8	**59.9**	61.5
Other administrative expenses include:				
Amortisation / write offs of intangible assets (note 18)	**9.9**	10.1	**1.0**	1.5
Depreciation of property, plant and equipment (note 19) and investment properties (note 20)	**9.3**	10.5	**2.7**	4.1
Impairment of investment properties (note 20)	**1.3**	0.1	**1.3**	0.1
Impairment of goodwill (note 18)	**-**	1.0	**-**	-
Auditors' and their associates' remuneration (excluding VAT):				
Audit of the Society and Group annual accounts	**0.2**	0.2	**0.2**	0.2
Audit of the Group's subsidiary undertakings' accounts pursuant to legislation	**0.5**	0.5	**-**	-
Tax advisory services	**0.1**	-	**-**	-
Audit-related assurance services	**0.1**	0.1	**0.1**	-
All other non-audit services	**0.4**	0.3	**-**	-
Amounts payable under operating leases:				
Plant and machinery	**3.1**	3.8	**2.5**	3.3
Other	**18.0**	19.2	**4.4**	4.1

The Society 2011 comparative figures have been reclassified following a review of the allocation of intragroup recharges during the year.

8. Employee numbers

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

	Group 2012	Group 2011	**Society 2012**	Society 2011
Principal office and administration centres	**786**	774	**786**	774
Society branch offices	**642**	645	**642**	645
Subsidiary undertakings	**7,010**	6,750	**-**	-
	8,438	8,169	**1,428**	1,419

Notes to the Accounts - continued

9. Directors' emoluments

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

Total Directors' emoluments amounted to £2.1m (2011: £1.2m).

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:

	2012 £m	2011 £m
Short term employee benefits such as wages and bonuses	**1.9**	1.1
Employer pension contributions	**0.2**	0.1
	2.1	1.2

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:

	2012 £m	2011 £m
Mortgage loans outstanding at 31 December	**0.1**	0.1
Savings balances at 31 December	**1.2**	1.1

Interest receivable and payable on the above accounts:	**2012 £000**	2011 £000
Interest receivable	**6**	7
Interest payable	**32**	29

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 2012 there were outstanding mortgage loans granted in the ordinary course of business amounting in aggregate to £0.1m (2011: £0.1m) to two (2011: two) 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 £11.7m (2011: £10.2m) and £3.7m (2011: £4.3m) respectively to pension schemes, which are classified as related parties.

10. Related party transactions (continued)

Related party transactions

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

	2012 £m	2011 £m
Rendering and receiving of services	**6.7**	7.9
Recharges of central costs	**23.0**	13.1
Interest receivable	**86.6**	96.5
Interest payable	**(70.4)**	(77.8)
Other income	**3.1**	2.6
Collateral transferred for covered bond programme	**-**	(780.8)
Collateral transferred to securitisation vehicles	**595.2**	1,578.2
Purchase of debt securities*	**(71.0)**	(850.0)
Repayment of debt securities	**122.6**	121.4
Repayment of subordinated debt	**(12.5)**	-

* During the year, the Society purchased £71.0m of debt securities from the Group's special purpose securitisation vehicle, Darrowby No 2 plc. During 2011, the Society purchased £850.0m of debt securities from the Group's special purpose securitisation vehicle, Darrowby No 1 plc.

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 2012 the Society owed subsidiary undertakings £1,431.3m (2011: £1,616.7m) and was owed £1,850.0m (2011: £2,030.6m) 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:

	2012 £m	2011 £m
Services provided to the Group	**1.3**	0.2
Services provided by the Group	**2.0**	1.6

11. Taxation expense

	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Current tax	**10.0**	2.1	**3.0**	(3.0)
Deferred tax (note 28)	**(1.2)**	4.6	**(0.4)**	3.9
	8.8	6.7	**2.6**	0.9

Notes to the Accounts - continued

11. Taxation expense (continued)

A reconciliation of the tax expense on profit before tax at the standard UK Corporation tax rate to the actual tax expense is as follows:

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Profit before tax from continuing operations	**36.4**	22.2	**42.8**	2.9
Less share of profits of joint ventures and associates net of tax	**(1.6)**	(0.7)	**-**	-
	34.8	21.5	**42.8**	2.9
Tax calculated at UK standard rate of 24.5% (2011: 26.5%)	**8.5**	5.7	**10.5**	0.8
Effects of:				
Expenses not deductible for tax purposes	**1.6**	2.3	**1.7**	3.5
Adjustment to tax expense in respect of prior periods	**(0.4)**	0.3	**-**	0.4
Non-taxable income	**(0.3)**	(1.1)	**(9.9)**	(5.6)
Corporation tax rate change	**(0.3)**	(0.5)	**0.3**	0.3
Other	**(0.3)**	-	**-**	1.5
Tax expense	**8.8**	6.7	**2.6**	0.9

The effective tax rate for the Group for the year ended 31 December 2012 is 25.3% (2011: 31.2%). The major impacts on the effective rate for the year are expenditure which is not deductible for tax purposes, offset by non-taxable income, prior period adjustments, the impact of the Corporation tax rate change on the deferred tax asset and lower overseas tax rates.

The effective rate for the Society for the year ended 31 December 2012 is 6.1% (2011: 31.0%). The major impacts on the effective rate are the non-taxable dividend income received of £40.5m (2011: £20.4m) and the non-tax deductible £5.4m (2011: £11.9m) written off investments during the year.

The future reduction in the Corporation tax rate to 23% effective from 1 April 2013 results in a charge of £0.5m in the Income Statement in respect of the Group's net deferred tax asset. No account has been taken of any further planned reductions in Corporation tax rates as these have not yet been substantively enacted.

12. Loans and advances to credit institutions

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Repayable on demand	**330.2**	337.1	**209.1**	238.3
In not more than three months	**30.0**	6.1	**-**	6.1
In more than three months but not more than one year	**-**	0.6	**-**	0.6
In more than one year	**22.9**	17.2	**22.9**	17.2
	383.1	361.0	**232.0**	262.2
Amounts included within cash and cash equivalents	**172.5**	98.8	**21.5**	-

The comparatives have been reclassified following a review of maturity splits during the year.

At 31 December 2012 £210.5m (2011: £236.4m) of cash has been pledged by the Group and Society against derivative contracts.

13. Debt securities

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Gilts	**278.7**	187.3	**278.7**	187.3
Treasury bills	**23.2**	40.4	**23.2**	40.4
Certificates of deposit	**55.1**	414.6	**-**	379.5
Fixed rate bonds	**255.8**	396.3	**255.8**	396.3
Floating rate notes	**204.5**	543.8	**192.3**	529.8
Residential mortgage backed securities	**295.2**	256.6	**922.7**	935.7
Commercial mortgage backed securities	**21.4**	38.3	**21.4**	38.3
	1,133.9	1,877.3	**1,694.1**	2,507.3
Debt securities have remaining maturities as follows:				
In not more than one year	**202.2**	945.9	**134.8**	896.9
In more than one year	**931.7**	931.4	**1,559.3**	1,610.4
	1,133.9	1,877.3	**1,694.1**	2,507.3
Transferable debt securities comprise:				
Listed on a recognised investment exchange	**1,068.8**	1,462.3	**1,694.1**	2,092.3
Unlisted	**65.1**	415.0	**-**	415.0
	1,133.9	1,877.3	**1,694.1**	2,507.3
Market value of listed transferable debt securities	**1,069.9**	1,467.1	**1,695.2**	2,097.2
Carrying value of securities pledged as collateral under sale and repurchase agreements	**417.8**	164.9	**849.0**	763.5

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 £417.8m (2011: £164.9m), 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 are £556.5m (2011: £679.1m) and £71.0m (2011: £nil) of notes purchased by the Society from the Group's securitisation vehicles, Darrowby No 1 plc and Darrowby No 2 plc respectively.

The Society also holds £59.7m (2011: £127.2m) of securities which are pledged as collateral with Group subsidiary, Skipton International Limited, in a repurchase agreement.

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

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
At 1 January	**1,877.3**	2,421.2	**2,507.3**	2,391.7
Additions	**2,280.5**	4,075.2	**2,176.4**	4,719.3
Disposals	**(3,031.3)**	(4,637.1)	**(2,995.8)**	(4,618.6)
Impairment losses	**(4.0)**	-	**(4.0)**	-
Changes in fair value	**11.4**	18.0	**10.2**	14.9
At 31 December	**1,133.9**	1,877.3	**1,694.1**	2,507.3

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% (2011: 0.90%).

Notes to the Accounts - continued

13. Debt securities (continued)

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

	Group and Society	
	2012 £m	2011 £m
Carrying value of reclassified assets	**173.3**	224.4
Fair value of reclassified assets	**168.1**	200.3

If these assets had not been reclassified, the fair value gain arising in the Statement of Comprehensive Income would have been £20.6m (2011: £8.3m loss).

14. Derivative financial instruments

	Group		Society	
	Positive market value 2012 £m	**Negative market value 2012 £m**	**Positive market value 2012 £m**	**Negative market value 2012 £m**
Derivatives designated as fair value hedges:				
Interest rate swaps	77.4	250.4	77.4	250.5
Currency swaps	5.8	-	5.8	-
	83.2	**250.4**	**83.2**	**250.5**
Derivatives designated as cash flow hedges:				
Interest rate swaps	5.8	4.2	5.8	4.2
Basis swaps	-	0.8	-	0.8
	5.8	**5.0**	**5.8**	**5.0**
Other derivatives held at fair value:				
Quanto swaps	-	0.1	-	0.1
Equity swaps	21.5	14.7	21.5	14.7
Investment products - embedded derivatives	14.3	20.9	14.3	20.9
Interest rate swaps	77.9	79.7	83.1	13.7
	113.7	**115.4**	**118.9**	**49.4**
	202.7	**370.8**	**207.9**	**304.9**

14. Derivative financial instruments (continued)

	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

All derivatives that are not accounted for under hedge accounting rules under IAS 39 are measured at fair value through the Income Statement. All derivatives are held for economic hedging purposes.

Notes to the Accounts - continued

15. Loans and advances to customers

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Loans fully secured on residential property	**9,860.7**	9,472.9	**7,580.5**	7,122.2
Other loans:				
Loans fully secured on land	**433.2**	460.4	**433.2**	460.4
Other loans	**89.4**	78.6	**2.4**	3.2
Fair value adjustment for hedged risk	**210.2**	240.9	**205.6**	233.9
	10,593.5	10,252.8	**8,221.7**	7,819.7
The remaining maturity of loans and advances to customers from the reporting date is as follows:				
On call and at short notice	**55.8**	52.6	**6.7**	9.2
In not more than three months	**15.8**	36.1	**8.3**	28.9
In more than three months but not more than one year	**79.7**	58.1	**52.6**	33.6
In more than one year but not more than five years	**571.0**	474.7	**372.6**	331.5
In more than five years	**9,944.0**	9,719.4	**7,820.9**	7,457.8
	10,666.3	10,340.9	**8,261.1**	7,861.0
Less: Impairment (note 16)	**(72.8)**	(88.1)	**(39.4)**	(41.3)
	10,593.5	10,252.8	**8,221.7**	7,819.7

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			
	2012		2011	
	Assets pledged £m	**Secured funding £m**	Assets pledged £m	Secured funding £m
Securitisations and other secured lending	**1,334.9**	**947.8**	1,423.5	966.2

At 31 December 2012, loans and advances to customers include £1,334.9m (2011: £1,423.5m) for both the Group and Society which have been used in secured funding arrangements and transferred to Darrowby No 1 plc (£829.1m; 2011: £1,043.5m), Beckindale No 1 Limited (£nil; 2011: £380.0m) and Darrowby No 2 plc (£505.8m; 2011: £nil) which are special purpose vehicles consolidated into the Group Accounts. The loans secure £947.8m (2011: £966.2m) of funding for the Group.

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 to customers

Group	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans £m	Total £m
At 1 January 2012				
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**
Amounts written off during the year				
Individual impairment	(21.4)	(4.6)	(1.6)	**(27.6)**
	(21.4)	**(4.6)**	**(1.6)**	**(27.6)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	13.2	3.1	-	**16.3**
Collective impairment	(3.5)	(0.2)	-	**(3.7)**
	9.7	**2.9**	**-**	**12.6**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.3)	-	-	**(0.3)**
Charge for the year	**9.4**	**2.9**	**-**	**12.3**
At 31 December 2012				
Individual impairment	**37.8**	**3.7**	**20.2**	**61.7**
Collective impairment	**9.8**	**1.3**	**-**	**11.1**
	47.6	**5.0**	**20.2**	**72.8**
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

Notes to the Accounts - continued

16. Impairment losses on loans and advances to customers (continued)

Society	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans £m	Total £m
At 1 January 2012				
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**
Amounts written off during the year				
Individual impairment	(5.6)	(4.6)	(1.5)	**(11.7)**
	(5.6)	**(4.6)**	**(1.5)**	**(11.7)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	7.0	3.1	(0.2)	**9.9**
Collective impairment	0.4	(0.2)	-	**0.2**
	7.4	**2.9**	**(0.2)**	**10.1**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.3)	-	-	**(0.3)**
Charge for the year	**7.1**	**2.9**	**(0.2)**	**9.8**
At 31 December 2012				
Individual impairment	**8.5**	**3.7**	**19.5**	**31.7**
Collective impairment	**6.4**	**1.3**	**-**	**7.7**
	14.9	**5.0**	**19.5**	**39.4**
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

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 £1.0m (2011: £1.3m); for the Society it amounted to £0.4m (2011: £0.7m).

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**	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Cost						
At 1 January	**186.9**	186.1	**2,030.6**	3,065.1	**2,217.5**	3,251.2
Amounts written off	**-**	-	**-**	(0.8)	**-**	(0.8)
Additions	**-**	0.8	**24.9**	129.5	**24.9**	130.3
Repayments	**-**	-	**(205.5)**	(1,163.2)	**(205.5)**	(1,163.2)
At 31 December	**186.9**	186.9	**1,850.0**	2,030.6	**2,036.9**	2,217.5
Provisions						
At 1 January	**51.0**	39.1	**-**	0.8	**51.0**	39.9
Provided / (released) in the year	**5.4**	11.9	**-**	(0.8)	**5.4**	11.1
At 31 December	**56.4**	51.0	**-**	-	**56.4**	51.0
Net book value at 31 December	**130.5**	135.9	**1,850.0**	2,030.6	**1,980.5**	2,166.5

The Society reviews the carrying value of its investments in subsidiary undertakings at each reporting date. During the year, the Society provided £5.4m (2011: £10.3m) against the carrying value of its investment in the specialist lending company Amber Homeloans Limited. In 2011 a further £1.6m was provided against the cost of investment of a number of smaller businesses based upon an 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 2012, the Group held a controlling interest in the following principal trading subsidiary undertakings:

Name of subsidiary undertaking	Principal business activity	Percentage of ownership interest 2012	2011
Amber Homeloans Limited	Lending body	**100.0**	100.0
Bailey Computer Services Limited	Provider of IT services	**100.0**	100.0
Connells Limited and subsidiary undertakings*	Estate agency and related businesses	**99.6**	100.0
Darrowby No 1 plc	Funding vehicle	**(See below)**	(See below)
Darrowby No 2 plc	Funding vehicle	**(See below)**	(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**	56.8
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 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 put options issued prior to 1 January 2010 in accordance with IAS 27 (2003) and IFRS 3 (2004)) or a profit or loss in the Income Statement (for put options issued after 1 January 2010 in accordance with IFRS 3 (2008 revised) and IAS 27 (2008)). The estimate of the 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.

During the year five members of Connells Limited senior management purchased equity shares in the company for £1.3m, which reduced the Group's shareholding to 99.6%. At the same time options were issued that require SGHL to purchase this shareholding at some future date, with further details provided in note 26.

At 31 December 2012 the total financial liability for all of the options detailed above was £13.3m (2011: £11.6m).

The remaining subsidiary undertakings are 100% owned except for Jade Software Corporation Limited where the Group holds a 56.8% interest (2011: 56.8%) and no put options exist.

The Society's interests in the special purpose vehicles (SPVs) Darrowby No 1 plc and Darrowby No 2 plc are, in substance, no different than if they were 100% held subsidiary undertakings and consequently they are consolidated into the Group Accounts. During the year the funding secured through the SPV, Beckindale No 1 Limited, was repaid in full.

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; Northwest Investments NZ Limited, which is incorporated, registered and operates in New Zealand; and Jade Software Corporation Limited, which is incorporated and registered in New Zealand, and operates worldwide.

17. Investments in group undertakings (continued)

All the above subsidiary undertakings have prepared accounts to 31 December 2012 and their audited results have been included in the Group Accounts.

On 19 April 2012, Sequence (UK) Limited (a Connells group subsidiary) acquired a 100% shareholding in Ian Sinclair Limited, a Norfolk-based property sales and lettings business, at a cost of £0.2m, which generated £0.2m of goodwill.

The Group made no further increases in its shareholding in existing subsidiary undertakings (2011: £0.3m) during the period. However, the reassessment of the expected future payments under the put option agreements resulted in a further £1.4m (2011: £4.2m) of goodwill being recognised.

b) Disposals

In 2011, Jade Software Corporation Limited sold its entire holding in Empower HR Limited for £4.1m. This included £3.3m of deferred consideration which was received during 2012.

Subsequent to the year end, in February 2013, the Group sold the business and certain assets of Sterling International Brokers Limited for a nominal amount, which then ceased trading. There is no material impact on the financial statements as in 2012 the Group recognised total charges amounting to £3.4m to write down the assets to their estimated recoverable amount.

c) Joint ventures and associates

At 31 December 2012, the Group held interests in the following companies:

Name of investment	Principal business activity	Percentage of ownership interest 2012	2011
TMG Holdings Limited	Property search provider	**33.3**	33.3
Cybele Solutions Limited	Conveyancing services	**33.3**	33.3
Vibrant Energy Matters Limited	Energy assessor	**46.5**	45.0

On 18 October 2012, Connells Limited acquired an additional 1.5% of the share capital of Vibrant Energy Matters Limited, increasing its holding to 46.5%.

	Group 2012 £m	Group 2011 £m
Share of joint ventures' and associates'		
Gross assets	**5.5**	5.5
Gross liabilities	**(2.4)**	(3.0)
At 31 December	**3.1**	2.5
Share of joint ventures' and associates'		
Income	**21.1**	13.5
Expense	**(19.0)**	(12.6)
Taxation	**(0.5)**	(0.2)
Share of joint ventures' and associates' profit after tax	**1.6**	0.7

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.

d) Equity shares

	Group 2012 £m	Group 2011 £m
At 1 January	**-**	-
Acquisitions	**3.1**	-
At 31 December	**3.1**	-

The equity shares are in unlisted companies and are held as available-for-sale financial assets.

Notes to the Accounts - continued

18. Intangible assets

	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Software, databases and customer contracts	**23.6**	25.7	**1.5**	2.2
Goodwill	**172.6**	171.0	**-**	-
	196.2	196.7	**1.5**	2.2

Software, databases and customer contracts	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Cost				
At 1 January	**73.5**	65.2	**13.1**	12.8
Acquisition of subsidiary undertakings	**-**	6.7	**-**	-
Acquisition of business assets	**-**	0.8	**-**	-
Additions	**7.8**	7.9	**0.3**	0.3
Disposals	**(0.3)**	(1.7)	**-**	-
Disposals of subsidiary undertakings	**-**	(5.4)	**-**	-
At 31 December	**81.0**	73.5	**13.4**	13.1
Amortisation and impairment				
At 1 January	**47.8**	42.8	**10.9**	9.4
Charge for the year	**9.9**	10.1	**1.0**	1.5
Disposals	**(0.3)**	(1.2)	**-**	-
Disposal of subsidiary undertakings	**-**	(3.9)	**-**	-
At 31 December	**57.4**	47.8	**11.9**	10.9
Net book value at 1 January	**25.7**	22.4	**2.2**	3.4
Net book value at 31 December	**23.6**	25.7	**1.5**	2.2

Goodwill	Group 2012 £m	Group 2011 £m
Cost less amortisation to 1 January 2004		
At 1 January	**187.5**	190.2
Acquisitions of subsidiary undertakings and business units	**0.2**	1.9
Additions and revaluations of put options	**1.4**	4.2
Amounts written off	**(0.1)**	-
Disposals	**-**	(8.8)
At 31 December	**189.0**	187.5
Impairment losses		
At 1 January	**16.5**	21.7
Provisions for impairment losses in the year	**-**	1.0
Amounts written off	**(0.1)**	-
Disposals	**-**	(6.2)
At 31 December	**16.4**	16.5
Net book value at 1 January	**171.0**	168.5
Net book value at 31 December	**172.6**	171.0

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	**Cost of Goodwill £m**	**Group 2012 Impairment £m**	**Carrying value £m**
Mortgage Services	**2.9**	**-**	**2.9**
Estate Agency	**126.7**	**3.3**	**123.4**
Financial Advice	**31.0**	**3.1**	**27.9**
Investment Portfolio	**28.4**	**10.0**	**18.4**
Cost of goodwill	**189.0**	**16.4**	**172.6**

Operating segment	Cost of Goodwill £m	Group 2011 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

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 five years, which take into account the risks inherent in the businesses, and extrapolates cash flows for subsequent years (up to an additional 10 years) based on a long term growth rate of 2.5% (2011: 2.5%) or specific where circumstances dictate.

The financial budgets are based upon the following key drivers:

Operating segment	**Key drivers**
Mortgage Services	Assets under management, arrears levels, level of unemployment and interest rates
Estate Agency	Volume of UK property transactions, house price inflation, level of unemployment and interest rates
Financial Advice	Volume of new business, recurring income and FTSE levels
Investment Portfolio	Level of unemployment and interest rates

These key drivers are discussed further in the Risk Management Report on pages 28 to 33.

The Group estimates discount rates based upon the weighted average cost of capital which is then adjusted to take account of the market risks associated with each cash generating unit.

The pre-tax discount rates are as follows:

Operating segment	**Group 2012 %**	Group 2011 %
Mortgage Services	**10**	10
Estate Agency	**14**	15
Financial Advice	**11-12**	12-13
Investment Portfolio	**12-15**	12-16

Notes to the Accounts - continued

19. Property, plant and equipment

Group

	2012			2011		
	Land and buildings £m	**Equipment, fixtures and fittings £m**	**Total £m**	Land and buildings £m	Equipment, fixtures and fittings £m	Total £m
Cost						
At 1 January	90.0	97.9	**187.9**	90.8	99.6	190.4
Acquisitions	-	-	**-**	-	0.3	0.3
Additions	1.9	10.1	**12.0**	2.7	7.8	10.5
Disposals	(0.1)	(7.6)	**(7.7)**	(2.7)	(9.8)	(12.5)
Transfer to investment property	(8.2)	-	**(8.2)**	(0.8)	-	(0.8)
At 31 December	**83.6**	**100.4**	**184.0**	90.0	97.9	187.9
Depreciation						
At 1 January	20.9	80.8	**101.7**	18.3	82.7	101.0
Charge for the year	2.7	6.5	**9.2**	3.8	6.6	10.4
Disposals	-	(6.9)	**(6.9)**	(1.0)	(8.5)	(9.5)
Transfer to investment property	(1.4)	-	**(1.4)**	(0.2)	-	(0.2)
At 31 December	**22.2**	**80.4**	**102.6**	20.9	80.8	101.7
Net book value at 1 January	69.1	17.1	86.2	72.5	16.9	89.4
Net book value at 31 December	**61.4**	**20.0**	**81.4**	69.1	17.1	86.2

Society

	2012			2011		
	Land and buildings £m	**Equipment, fixtures and fittings £m**	**Total £m**	Land and buildings £m	Equipment, fixtures and fittings £m	Total £m
Cost						
At 1 January	48.4	29.3	**77.7**	50.3	29.0	79.3
Additions	-	1.8	**1.8**	1.1	0.4	1.5
Disposals	-	(1.8)	**(1.8)**	(2.2)	(0.1)	(2.3)
Transfer to investment property	(8.3)	-	**(8.3)**	(0.8)	-	(0.8)
At 31 December	**40.1**	**29.3**	**69.4**	48.4	29.3	77.7
Depreciation						
At 1 January	11.4	27.8	**39.2**	9.1	27.4	36.5
Charge for the year	1.7	0.5	**2.2**	2.8	0.6	3.4
Disposals	-	(1.8)	**(1.8)**	(0.3)	(0.2)	(0.5)
Transfer to investment property	(1.4)	-	**(1.4)**	(0.2)	-	(0.2)
At 31 December	**11.7**	**26.5**	**38.2**	11.4	27.8	39.2
Net book value at 1 January	37.0	1.5	38.5	41.2	1.6	42.8
Net book value at 31 December	**28.4**	**2.8**	**31.2**	37.0	1.5	38.5

19. Property, plant and equipment (continued)

The net book value of land and buildings comprises:

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Freehold	**57.1**	64.2	**25.3**	33.4
Long leasehold	**2.7**	2.6	**1.9**	1.8
Short leasehold	**1.6**	2.3	**1.2**	1.8
	61.4	69.1	**28.4**	37.0

20. Investment property

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Cost				
At 1 January	**10.1**	9.8	**32.6**	32.1
Disposals	**(0.7)**	(0.5)	**(0.7)**	(0.3)
Transfer from property, plant and equipment	**8.2**	0.8	**8.3**	0.8
At 31 December	**17.6**	10.1	**40.2**	32.6
Depreciation				
At 1 January	**3.3**	3.0	**4.5**	3.6
Charge for the year	**0.1**	0.1	**0.5**	0.7
Impairment	**1.3**	0.1	**1.3**	0.1
Disposals	**(0.1)**	(0.1)	**(0.1)**	(0.1)
Transfer from property, plant and equipment	**1.4**	0.2	**1.4**	0.2
At 31 December	**6.0**	3.3	**7.6**	4.5
Net book value at 1 January	**6.8**	6.8	**28.1**	28.5
Net book value at 31 December	**11.6**	6.8	**32.6**	28.1

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

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Market value of investment property	**15.6**	11.3	**36.1**	32.0

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

21. Other assets

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Trade receivables	**34.8**	35.5	**0.8**	0.2
Prepayments	**16.4**	13.8	**9.2**	4.3
Accrued income	**12.7**	8.5	**-**	-
Other	**44.1**	39.9	**1.9**	0.9
	108.0	97.7	**11.9**	5.4

Included within Group other assets are £31.0m (2011: £29.5m) of undrawn advances to debt factoring clients.

Notes to the Accounts - continued

21. Other assets (continued)

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

	Group 2012 £m	%	Group 2011 £m	%
Neither past due nor individually impaired	**18.7**	**47.9**	19.1	47.9
Past due but not individually impaired:				
Up to 30 days	**11.2**	**28.7**	8.9	22.3
30 to 120 days	**4.1**	**10.5**	5.8	14.5
Over 120 days	**0.8**	**2.1**	1.7	4.3
	34.8	**89.2**	35.5	89.0
Individually impaired	**4.2**	**10.8**	4.4	11.0
	39.0	**100.0**	39.9	100.0

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

	Group 2012 £m	Group 2011 £m
At 1 January	**(4.4)**	(5.1)
Provisions made during the year	**(1.6)**	(1.0)
Receivables written off during the year	**1.6**	1.5
Provisions no longer required	**0.2**	0.2
At 31 December	**(4.2)**	(4.4)

The Society has £0.8m (2011: £0.2m) of trade receivables, £0.7m (2011: £0.2m) of which are neither past due nor impaired. £0.1m (2011: £nil) are past due but not individually impaired.

22. Shares

	Group and Society 2012 £m	Group and Society 2011 £m
Held by individuals	**9,329.1**	9,144.5
Other shares	**90.4**	86.3
Fair value adjustment for hedged risk	**42.9**	49.6
	9,462.4	9,280.4
Shares are repayable from the reporting date in the ordinary course of business as follows:		
On demand	**2,767.2**	2,523.3
In not more than three months	**3,690.5**	3,657.8
In more than three months but not more than one year	**1,372.7**	881.9
In more than one year but not more than five years	**640.5**	1,332.8
In more than five years	**991.5**	884.6
	9,462.4	9,280.4

23. Amounts owed to credit institutions

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Amounts owed to subsidiary undertakings	**-**	-	**61.4**	132.5
Other	**907.6**	877.4	**907.6**	577.2
	907.6	877.4	**969.0**	709.7
Amounts owed to credit institutions are repayable from the reporting date in the ordinary course of business as follows:				
Repayable on demand	**43.6**	32.4	**105.0**	164.9
In not more than three months	**278.2**	75.8	**278.2**	75.4
In more than three months but not more than one year	**205.5**	122.7	**205.5**	122.7
In more than one year but not more than five years	**313.2**	646.5	**313.2**	346.7
In more than five years	**67.1**	-	**67.1**	-
	907.6	877.4	**969.0**	709.7

Amounts owed to credit institutions by the Group includes an amount of £277.0m (2011: £646.1m) of external funding facilitated through the Group's securitisation vehicle Darrowby No 1 plc. This is secured on debt securities and loans and advances to customers originated by the Group. The funding facilitated through Beckindale No 1 Limited in 2011 has been repaid during the year.

At 31 December 2012 £30.6m (2011: £13.9m) of cash has been received by the Group against derivative contracts.

24. Amounts owed to other customers

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Amounts owed to subsidiary undertakings	**-**	-	**1,369.9**	1,484.2
Other	**897.1**	920.9	**171.8**	194.2
Fair value adjustment for hedged risk	**0.6**	0.7	**0.2**	0.3
	897.7	921.6	**1,541.9**	1,678.7
Amounts owed to other customers are repayable from the reporting date in the ordinary course of business as follows:				
Repayable on demand	**197.9**	224.4	**1,409.1**	1,497.6
In not more than three months	**215.2**	410.2	**69.5**	87.6
In more than three months but not more than one year	**407.4**	194.8	**63.3**	80.8
In more than one year but not more than five years	**77.2**	92.2	**-**	12.7
	897.7	921.6	**1,541.9**	1,678.7

The comparatives have been revised as described in note 1b).

Notes to the Accounts - continued

25. Debt securities in issue

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Certificates of deposit	**19.1**	19.1	**19.1**	19.1
Other debt securities	**711.8**	1,078.7	**41.0**	758.7
Fair value adjustment for hedged risk	**-**	8.4	**-**	8.4
	730.9	1,106.2	**60.1**	786.2
Debt securities in issue are repayable from the reporting date in the ordinary course of business as follows:				
In not more than one year	**20.7**	690.2	**19.1**	690.2
In more than one year	**710.2**	416.0	**41.0**	96.0
	730.9	1,106.2	**60.1**	786.2

The comparatives have been revised as described in note 1b).

Group debt securities in issue include £670.8m (2011: £320.1m) of funding secured on certain loans and advances to customers through the Group's securitisation vehicles, Darrowby No 1 plc and Darrowby No 2 plc.

Included in Group and Society other debt securities is 1 (2011: 2) floating rate note issued to the capital markets totalling £40.8m (2011: £45.7m).

26. Other liabilities

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Trade payables	**6.3**	7.2	**0.2**	0.6
Tax deducted at source from interest paid	**2.9**	3.7	**2.9**	3.7
Fair value of put option obligation	**13.3**	11.6	**-**	-
Debt factoring liabilities	**31.0**	29.5	**-**	-
Other	**29.5**	26.0	**4.3**	4.2
	83.0	78.0	**7.4**	8.5

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

	Group 2012 £m	Group 2011 £m
At 1 January	**11.6**	9.3
Unwind of the discount factor	**1.5**	1.5
Exercise of put options by non-controlling shareholders	**-**	(0.3)
Revaluation of market value and future exercise dates	**0.2**	2.9
Issue of further put option*	**1.3**	-
Dividends paid to non-controlling shareholders	**(1.3)**	(1.8)
At 31 December	**13.3**	11.6

* During the year five members of Connells Limited senior management purchased equity shares in the company, and at the same time the Group issued options to these shareholders to require SGHL to purchase their shareholdings in Connells Limited at some future date. All options remain outstanding at the year end, with the maximum option length being 10 years. In accordance with IFRS 2 *Share-based Payment*, this is a cash-settled scheme in the Group accounts, with the fair value of the liability being spread over the period to exercise. The fair value of the liability will be subsequently remeasured at each reporting date with any changes in fair value recognised in the Income Statement for the period.

27. Provisions for liabilities

	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Provision for the costs of surplus properties	**7.9**	6.8	**3.4**	0.5
Financial Services Compensation Scheme	**12.9**	9.7	**12.2**	9.4
Commission clawbacks / rebates	**5.9**	4.1	**-**	-
Survey and valuation claims	**12.1**	8.6	**-**	-
Customer compensation	**13.5**	2.8	**1.0**	0.6
Other provisions	**2.2**	2.2	**-**	-
	54.5	34.2	**16.6**	10.5

Movements in provisions during the year were as follows:

Group	**Provision for the costs of surplus properties 2012 £m**	**FSCS 2012 £m**	**Commission clawbacks / rebates 2012 £m**	**Survey and valuation claims 2012 £m**	**Customer compensation 2012 £m**	**Other provisions 2012 £m**	**Total 2012 £m**
At 1 January	**6.8**	**9.7**	**4.1**	**8.6**	**2.8**	**2.2**	**34.2**
Reclassified from other liabilities and accruals	**0.8**	**-**	**1.2**	**-**	**-**	**-**	**2.0**
Charge for the year (gross)	**2.3**	**7.9**	**6.2**	**8.4**	**12.2**	**0.6**	**37.2**
Utilised during the year	**(2.0)**	**(4.3)**	**(5.6)**	**(4.9)**	**(1.5)**	**(0.6)**	**(18.9)**
At 31 December	**7.9**	**12.9**	**5.9**	**12.1**	**13.5**	**2.2**	**54.5**

A reconciliation of the gross charge for provisions in the table above to the net charge within the Income Statement is as follows:

Group	**Provision for the costs of surplus properties 2012 £m**	**FSCS 2012 £m**	**Commission clawbacks / rebates 2012 £m**	**Survey and valuation claims 2012 £m**	**Customer compensation 2012 £m**	**Other provisions 2012 £m**	**Total 2012 £m**
Charge for the year (gross)	**2.3**	**7.5**	**6.2**	**8.4**	**12.2**	**0.6**	**37.2**
PI recoverability asset recognised during the year	**-**	**-**	**-**	**-**	**(8.5)**	**-**	**(8.5)**
Net charge to Income Statement	**2.3**	**7.5**	**6.2**	**8.4**	**3.7**	**0.6**	**28.7**

The Board considers that PI insurance recovery is virtually certain, as required by IAS 37 when accounting for an expected reimbursement of some or all expenditure required to settle a provision.

Group	Provision for the costs of surplus properties 2011 £m	FSCS 2011 £m	Commission clawbacks / rebates 2011 £m	Survey and valuation claims 2011 £m	Customer compensation 2011 £m	Other provisions 2011 £m	Total 2011 £m
At 1 January	7.3	8.1	5.4	5.8	1.0	3.7	31.3
Acquisition of subsidiary undertakings	0.2	-	-	-	-	-	0.2
Charge for the year	0.1	5.8	(0.2)	6.1	2.1	(0.4)	13.5
Utilised during the year	(0.8)	(4.2)	(1.1)	(3.3)	(0.3)	(1.1)	(10.8)
At 31 December	6.8	9.7	4.1	8.6	2.8	2.2	34.2

Notes to the Accounts - continued

27. Provisions for liabilities (continued)

Society	**Provision for the costs of surplus properties 2012 £m**	**FSCS 2012 £m**	**Customer compensation 2012 £m**	**Total 2012 £m**
At 1 January	**0.5**	**9.4**	**0.6**	**10.5**
Provisions transferred from subsidiary undertaking	**0.6**	**-**	**-**	**0.6**
Charge for the year	**2.9**	**6.1**	**0.7**	**9.7**
Utilised during the year	**(0.6)**	**(3.3)**	**(0.3)**	**(4.2)**
At 31 December	**3.4**	**12.2**	**1.0**	**16.6**

Society	Provision for the costs of surplus properties 2011 £m	FSCS 2011 £m	Customer compensation 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

27. Provisions for liabilities (continued)

Provision for the costs of surplus properties

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.

Financial Services Compensation Scheme

The Society and other subsidiaries pay levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it as described in note 32b).

The Society FSCS provision reflects market participation up to the reporting date. Following the payment of the 2011/2012 scheme year levy in August, the £12.2m provision at the year end relates to the estimated Management Expense Levy for scheme year 2012/2013 and the estimated Management Expense Levy and Capital Levy for scheme year 2013/2014. The Society's provision does not include management expense levies for any further scheme years, nor for any compensation levies which may arise from any ultimate payout on the claims.

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.

Commission clawbacks / rebates

The commission clawback provision represents an estimate of the repayment of commission to suppliers as a result of cancelled policies sold by the Financial Advice and Estate Agency divisions. These are estimated based upon anticipated cancellation rates.

Survey and valuation claims

Provision is made for professional indemnity claims and potential claims that arise during the normal course of business in relation to surveys and valuations performed by the Group. The provision is based upon the expected level of future professional indemnity claims relating to services provided by the Group. Where a formal letter of claim has been received a provision is made on a case by case basis, taking into account the strength of the Group's case, and its history of successfully defending claims. Where an initial notification has been received, an estimate is made of the proportion of these expected to lead to a formal claim based upon historical trends. A final provision is also made for the estimated level of future claims, taking into account market conditions and a prudent attitude to risk.

The professional indemnity provision is stated at the Directors' best estimate of eventual liability. While the level of future claims is uncertain, the Group has robust processes in place that aims to restrict both the number and magnitude of these.

Due to the nature of the professional indemnity claims it is difficult to indicate approximate payment timescales or claims received in future years. The provision will be utilised as individual claims are settled.

Customer compensation

The customer compensation provision includes provision for the potential claims on payment protection insurance sold by the Group. The Group has experienced a rise in complaint levels during 2012 and although uphold rates are low, the number of cases being referred to the Financial Ombudsman Service (FOS) have increased, with each referral incurring an £850 fee.

In addition, within the Financial Advice division, we are currently undertaking a review of advisory processes. Initial enquiries have identified documentation issues in a number of cases and have indicated that these may result in some amounts being paid by the division.

The provision made at 31 December 2012 represents management's best estimate of the expenditure arising from the review, including the costs of remediation. The liability included within the provision is calculated gross of professional indemnity insurance, for which a receivable of £8.5m has been included within other assets. Management believe that the insurance asset meets the virtually certain test in accordance with the accounting standard and that recoveries will be made under the terms of the insurance policies in place.

The provision requires significant judgement by management in determining appropriate assumptions. The key assumptions include:

- Uphold rate. The percentage of cases which, following review, require a compensation calculation to be undertaken.
- Average payment. This is the average expected payment to customers for upheld cases.
- Number of professional indemnity insurance excesses applicable under the policies.

In addition to these factors and assumptions, the extent of the required expenditure will also depend on the facts and circumstances of each individual customer's case. For this reason, there is currently a high degree of uncertainty as to the eventual costs of compensation for this matter.

Notes to the Accounts - continued

28. Deferred tax

Deferred taxes are calculated on timing differences under the liability method using an effective tax rate of 23% (2011: 25%) 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 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
At 1 January	**20.6**	16.3	**14.3**	9.7
Income Statement (note 11)	**1.2**	(4.6)	**0.4**	(3.9)
Items taken directly to reserves	**(1.8)**	9.0	**(2.1)**	8.5
Disposals	**-**	(0.1)	**-**	-
At 31 December	**20.0**	20.6	**12.6**	14.3

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

Deferred tax assets	**Group 2012 £m**	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Fixed asset temporary differences	**1.4**	1.6	**-**	-
Pension benefits	**10.7**	10.9	**4.7**	4.7
Provisions for loan impairment	**1.9**	1.9	**0.2**	0.5
Corporation tax losses	**6.8**	6.0	**4.9**	4.7
Derivatives and loans	**7.0**	10.2	**7.0**	10.1
Other	**1.0**	0.1	**-**	-
	28.8	30.7	**16.8**	20.0

Deferred tax liabilities	**Group 2012 £m**	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Fixed asset temporary differences	**2.2**	2.2	**1.8**	2.2
Derivatives and loans	**4.3**	5.9	**2.4**	3.5
Other	**2.3**	2.0	**-**	-
	8.8	10.1	**4.2**	5.7
Net deferred tax asset	**20.0**	20.6	**12.6**	14.3

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

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Fixed asset temporary differences	**(0.5)**	0.5	**(0.4)**	(0.1)
Provisions	**(0.1)**	0.1	**0.1**	-
Unwind of merger fair value adjustments	**(0.3)**	0.1	**-**	-
Other	**(0.3)**	3.9	**(0.1)**	4.0
	(1.2)	4.6	**(0.4)**	3.9

Unrecognised deferred tax relating to trading losses carried forward at 31 December 2012 is £0.3m (2011: £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 five 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	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Subordinated floating rate notes	**-**	-	**-**	11.5
Subordinated fixed rate notes 2014	**15.2**	15.2	**15.2**	15.2
Subordinated fixed rate notes 2015	**20.1**	20.1	**20.1**	20.1
Subordinated fixed rate notes 2017	**10.2**	10.3	**10.2**	10.3
Subordinated fixed rate notes 2018	**128.1**	128.1	**128.1**	128.1
Subordinated fixed rate notes 2019	**10.1**	10.2	**10.1**	10.2
Subordinated fixed rate notes 2022	**31.2**	31.2	**31.2**	31.2
	214.9	215.1	**214.9**	226.6
Unamortised discount on issue	**(0.7)**	(0.9)	**(0.7)**	(0.9)
Fair value adjustment for hedged risk	**9.7**	14.0	**9.7**	14.0
	223.9	228.2	**223.9**	239.7

The comparatives have been revised as described in note 1b).

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 (2011: £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.

During the year the Society repaid at par subordinated floating rate notes of £11.5m (2011: £nil) held by Skipton International Limited.

All the values in the above table have been calculated using the nominal 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	
	2012 £m	2011 £m
6.875% Permanent Interest Bearing Shares	**44.5**	44.3
8.500% Permanent Interest Bearing Shares	**16.2**	15.2
12.875% Permanent Interest Bearing Shares	**26.3**	26.3
	87.0	85.8
Fair value adjustment for hedged risk	**9.1**	9.4
	96.1	95.2

The comparatives have been revised as described in note 1b).

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

	2012			2011		
	Before-tax amount £m	**Tax benefit / (expense) £m**	**Net-of-tax amount £m**	Before-tax amount £m	Tax (expense) / benefit £m	Net-of-tax amount £m
Available-for-sale financial assets	**(11.1)**	**2.8**	**(8.3)**	17.0	(4.1)	12.9
Cash flow hedges	**6.4**	**(2.0)**	**4.4**	(25.8)	6.5	(19.3)
Actuarial (loss) / gains on retirement benefit obligations	**(5.5)**	**0.7**	**(4.8)**	(18.4)	4.2	(14.2)
Translation of foreign operations	**0.1**	**-**	**0.1**	0.9	-	0.9
Movement of reserves attributable to non-controlling interests	**-**	**-**	**-**	(0.4)	-	(0.4)
Other comprehensive income	**(10.1)**	**1.5**	**(8.6)**	(26.7)	6.6	(20.1)

Society

	2012			2011		
	Before-tax amount £m	**Tax benefit / (expense) £m**	**Net-of-tax amount £m**	Before-tax amount £m	Tax (expense) / benefit £m	Net-of-tax amount £m
Available-for-sale financial assets	**(12.2)**	**3.0**	**(9.2)**	14.8	(3.9)	10.9
Cash flow hedges	**6.4**	**(2.0)**	**4.4**	(25.7)	6.4	(19.3)
Actuarial (loss) / gains on retirement benefit obligations	**(2.0)**	**-**	**(2.0)**	(12.5)	2.9	(9.6)
Other comprehensive income	**(7.8)**	**1.0**	**(6.8)**	(23.4)	5.4	(18.0)

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 insofar 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 2012.

b) In common with all regulated UK deposit takers, the Society pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it. The FSCS levy consists of two parts: a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it. During 2008 and 2009 claims 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 HM Treasury. 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 Society FSCS provision reflects market participation up to the reporting date. £9.6m of the provision relates to the estimated management expense levy for the scheme years 2012/13 and 2013/14. This amount was calculated on the basis of the Society's current share of protected deposits taking into account the FSA's estimate of total management expense levies for each scheme year.

The management expenses levy for scheme year 2011/12, which formed part of the provision at 31 December 2011, was calculated using the agreed funding rate of 12 month LIBOR + 30bps. Following the expiry of the initial three year fixed interest term, extensive negotiations between HMT and FSCS resulted in an agreed funding rate of 12 month LIBOR + 100bps which is the rate that will be charged for the HMT loans for the period from 1 April 2012, on which the management expenses levy for scheme year 2012/13 and 2013/14 has been based.

32. Other financial commitments and contingent liabilities (continued)

In addition to the management levies, from scheme year 2013/14, triggered by participation in the market at 31 December 2012, the FSCS is to levy over three years the current estimated shortfall on capital loans outstanding of £802m. In common with the management expenses levy, the capital loan repayment was calculated on the basis of the Society's current share of UK protected deposits. The Society has therefore recognised a provision of £2.6m related to the compensation levy.

c) Within the Financial Advice division, we are undertaking a review of past advisory processes, and initial enquiries have identified documentation issues in a number of cases. The Group has made provisions for the expected cost of liabilities which may arise from this review and these are included in customer compensation provisions gross of Professional Indemnity Insurance recovery, for which a receivable has been recognised in other assets.

The provision made at 31 December 2012 represents management's best estimate of the expenditure arising from the review although the extent of the required expenditure will also depend on the facts and circumstances of each individual customer's case. For this reason, there is currently a high degree of uncertainty as to the eventual costs of compensation for this matter.

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

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Contracted but not provided for	**0.7**	1.2	**-**	-

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

	Land and buildings 2012 £m	**Other 2012 £m**	Land and buildings 2011 £m	Other 2011 £m
Group				
Amounts falling due:				
Within one year	**15.9**	**0.9**	16.6	3.8
Within two to five years inclusive	**47.9**	**1.6**	49.8	4.1
Over five years	**26.7**	**-**	32.3	0.6
	90.5	**2.5**	98.7	8.5
Society				
Amounts falling due:				
Within one year	**4.9**	**0.3**	5.4	2.2
Within two to five years inclusive	**17.5**	**0.9**	20.3	0.1
Over five years	**13.5**	**-**	18.1	-
	35.9	**1.2**	43.8	2.3

f) Total amounts receivable under non-cancellable operating sub-leases on land and buildings are as follows:

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Amounts falling due:				
Within one year	**0.8**	1.3	**0.3**	0.3
Within two to five years inclusive	**1.5**	1.6	**0.8**	0.6
Over five years	**0.7**	0.7	**0.5**	0.5
	3.0	3.6	**1.6**	1.4

Notes to the Accounts - continued

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 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	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
Basis swaps	Sensitivity to changes in the relationship between interest rates which have similar but not identical characteristics (e.g. LIBOR and Bank of England Base Rate)	Floating rate mortgage lending and asset investment

Derivative products, which are combinations of more basic derivatives, are used only in circumstances where the underlying position being hedged contains similar risk features. In such cases the derivative used will be designed to minimise the risks of the underlying asset or liability.

Controls over financial instruments

The Group has a formal structure for 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 fixed savings products prior to receipt of funds. Basis swaps used to reduce the Society's exposure to changes in Bank Base Rate are also accounted for under cash flow hedging. The weighted average maturity of interest rate swaps being cash flow hedged at 31 December 2012 was approximately 1.9 years (2011: 1.9 years); the amounts held in the cash flow hedging reserve will be recognised in the Income Statement over this period.

33. Financial instruments (continued)

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 current and future 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 beyond their contractual notice 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 to ALCO, 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 & Liquidity Risk function and overseen by ALCO under a series of delegated authorities;
- the Group's Market & Liquidity 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 (ILG) 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.

Notes to the Accounts - continued

33. Financial instruments (continued)

The table below analyses the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. In practice, customer deposits are likely to be repaid later than on the earliest date on which repayment can be required.

Group			2012			
	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Assets						
Cash in hand and balances with the Bank of England	**1,014.8**	**-**	**-**	**-**	**-**	**1,014.8**
Loans and advances to credit institutions	**330.2**	**30.0**	**-**	**22.9**	**-**	**383.1**
Debt securities	**-**	**69.8**	**132.4**	**542.7**	**389.0**	**1,133.9**
Derivative financial instruments	**-**	**7.5**	**18.5**	**98.6**	**78.1**	**202.7**
Loans and advances to customers	**55.4**	**15.7**	**79.2**	**567.1**	**9,876.1**	**10,593.5**
Total financial assets	**1,400.4**	**123.0**	**230.1**	**1,231.3**	**10,343.2**	**13,328.0**
Liabilities						
Shares	**2,767.2**	**3,690.5**	**1,372.7**	**640.5**	**991.5**	**9,462.4**
Amounts owed to credit institutions	**43.6**	**278.2**	**205.5**	**313.2**	**67.1**	**907.6**
Amounts owed to other customers	**197.9**	**215.2**	**407.4**	**77.2**	**-**	**897.7**
Debt securities in issue	**-**	**10.1**	**10.6**	**710.1**	**0.1**	**730.9**
Derivative financial instruments	**-**	**0.4**	**11.1**	**132.9**	**226.4**	**370.8**
Subordinated liabilities	**-**	**-**	**77.2**	**94.0**	**52.7**	**223.9**
Subscribed capital	**-**	**-**	**-**	**53.5**	**42.6**	**96.1**
Total financial liabilities	**3,008.7**	**4,194.4**	**2,084.5**	**2,021.4**	**1,380.4**	**12,689.4**
Net liquidity gap	**(1,608.3)**	**(4,071.4)**	**(1,854.4)**	**(790.1)**	**8,962.8**	**638.6**

Group			2011			
	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Assets						
Cash in hand and balances with the Bank of England	782.3	-	-	-	-	782.3
Loans and advances to credit institutions	337.1	6.1	0.6	17.2	-	361.0
Debt securities	-	646.5	299.4	461.2	470.2	1,877.3
Derivative financial instruments	-	5.8	18.5	98.9	93.1	216.3
Loans and advances to customers	52.2	35.8	57.6	470.7	9,636.5	10,252.8
Total financial assets	1,171.6	694.2	376.1	1,048.0	10,199.8	13,489.7
Liabilities						
Shares	2,523.3	3,657.8	881.9	1,332.8	884.6	9,280.4
Amounts owed to credit institutions	32.4	75.8	122.7	646.5	-	877.4
Amounts owed to other customers	224.4	410.2	194.8	92.2	-	921.6
Debt securities in issue	-	20.5	669.7	369.6	46.4	1,106.2
Derivative financial instruments	-	1.9	9.6	123.6	239.2	374.3
Subordinated liabilities	-	-	-	125.9	102.3	228.2
Subscribed capital	-	-	-	-	95.2	95.2
Total financial liabilities	2,780.1	4,166.2	1,878.7	2,690.6	1,367.7	12,883.3
Net liquidity gap	(1,608.5)	(3,472.0)	(1,502.6)	(1,642.6)	8,832.1	606.4

33. Financial instruments (continued)

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

Group **2012**

Liabilities	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	6,457.8	1,373.0	699.1	1,022.6	9,552.5
Amounts owed to credit institutions, customers and debt securities in issue	535.9	559.2	1,460.7	165.8	2,721.6
Derivative financial instruments	26.4	74.4	241.9	253.3	596.0
Subordinated liabilities	3.0	12.2	100.7	186.5	302.4
Subscribed capital	1.6	6.3	80.0	44.9	132.8
	7,024.7	2,025.1	2,582.4	1,673.1	13,305.3

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

Society **2012**

Liabilities	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	6,457.8	1,373.0	699.1	1,022.6	9,552.5
Amounts owed to credit institutions, customers and debt securities in issue	633.3	577.2	1,439.2	21.9	2,671.6
Derivative financial instruments	20.7	63.1	179.9	163.5	427.2
Subordinated liabilities	3.0	12.2	100.7	186.5	302.4
Subscribed capital	1.6	6.3	80.0	44.9	132.8
	7,116.4	2,031.8	2,498.9	1,439.4	13,086.5

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

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 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 which is overseen by ALCO. ALCO approves the market risk policy and receives regular reports on all aspects of market risk exposure, 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 into 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 throughout the reporting period were as follows:

	As at 31 December 2012 £m	Average 2012 £m	High 2012 £m	Low 2012 £m	As at 31 December 2011 £m
Static earnings-at-risk	1.4	1.5	3.3	-	2.9
Historical value-at-risk	5.5	5.7	7.4	3.8	2.8
2% parallel interest rate shift	2.8	2.8	14.0	-	-*

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

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

The Group has 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 past commercial lending and current debt factoring / invoice discounting). The Society ceased new commercial lending in November 2008; and
- wholesale counterparties (including other financial institutions). 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 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 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 £210.2m (2011: £240.9m) 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 Skipton International Limited 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 cautious approach to new lending.

The credit decision process utilises 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 the Board's risk appetite.

The Group also has credit exposures through Amber Homeloans Limited and North Yorkshire Mortgages Limited which comprise residential UK mortgages, including buy-to-let, across prime and non-prime lending markets. In light of the deteriorating economic conditions in early 2008, we ceased new lending in these portfolios then.

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 people to ensure these loans are managed appropriately and their credit performance is actively monitored.

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.

Notes to the Accounts - continued

33. Financial instruments (continued)

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. Since the onset of the global financial crisis, we have continued to review and monitor 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 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			
	2012		2011	
	£m	**%**	£m	%
Total residential mortgages	**9,908.3**	**94.8**	9,532.5	94.4
Commercial loans	**438.2**	**4.2**	467.1	4.6
Other lending:				
Debt factoring loans	**48.2**	**0.4**	42.0	0.4
Other loans	**61.4**	**0.6**	58.4	0.6
Gross balances	**10,456.1**	**100.0**	10,100.0	100.0
Impairment provisions	**(72.8)**		(88.1)	
Fair value adjustment for hedged risk	**210.2**		240.9	
	10,593.5		10,252.8	

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, Skipton International Limited, which lends in the Channel Islands, and the specialist mortgage lending in Amber Homeloans Limited and North Yorkshire Mortgages Limited.

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

Lending analysis	Group	
	2012	2011
	£m	£m
Society residential lending:		
Prime	**6,105.2**	5,736.4
Buy-to-let	**1,490.2**	1,399.2
Intra-group adjustment	**(1.3)**	0.8
Offshore lending:		
Prime	**518.1**	474.2
Buy-to-let	**64.9**	63.1
Specialist lending:		
Prime	**299.2**	330.9
Buy-to-let	**309.4**	325.0
Self certified	**947.9**	1,017.5
Sub prime	**116.6**	123.7
Self build	**58.1**	61.7
	9,908.3	9,532.5

33. Financial instruments (continued)

Geographical analysis

	Group		Society	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Total book:				
North	**369.6**	343.7	**318.2**	288.7
Yorkshire	**1,059.3**	1,012.3	**937.2**	885.1
East Midlands	**644.4**	596.7	**531.4**	476.5
East Anglia	**603.5**	562.8	**488.9**	437.8
London	**1,239.0**	1,175.6	**932.8**	853.1
South East	**1,836.1**	1,940.6	**1,428.0**	1,531.1
South West	**868.4**	795.2	**723.9**	645.3
West Midlands	**579.8**	554.9	**462.0**	423.8
North West	**1,056.4**	1,032.6	**875.2**	834.5
Wales	**192.9**	188.3	**124.3**	111.3
Scotland	**800.9**	690.8	**728.4**	613.6
Northern Ireland	**75.0**	68.7	**45.1**	34.8
Channel Islands	**583.0**	570.3	**-**	-
	9,908.3	9,532.5	**7,595.4**	7,135.6

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

Indexed loan-to-value analysis

	Group		Society	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Total book:				
<70%	**4,045.6**	3,980.9	**3,527.6**	3,497.6
70% - 80%	**1,589.9**	1,437.1	**1,363.0**	1,196.8
80% - 90%	**1,776.5**	1,579.3	**1,444.9**	1,248.9
>90%	**2,496.3**	2,535.2	**1,259.9**	1,192.3
	9,908.3	9,532.5	**7,595.4**	7,135.6

Indexed loan-to-value analysis

	Group		Society	
	2012	2011	**2012**	2011
	%	%	**%**	%
Total book:				
<70%	**40.9**	41.7	**46.5**	49.0
70% - 80%	**16.0**	15.1	**17.9**	16.8
80% - 90%	**17.9**	16.6	**19.0**	17.5
>90%	**25.2**	26.6	**16.6**	16.7
Average indexed loan-to-value	**57.0**	55.5	**53.0**	50.9

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			
	2012		2011		**2012**		2011	
	£m	**%**	£m	%	**£m**	**%**	£m	%
Neither past due nor individually impaired	**9,415.6**	**95.1**	8,981.6	94.2	**7,454.1**	**98.2**	6,967.5	97.7
Past due but not individually impaired:								
Up to 3 months	**67.3**	**0.7**	74.2	0.8	**54.1**	**0.7**	57.6	0.8
3 to 6 months	**11.4**	**0.1**	12.2	0.1	**6.4**	**0.1**	7.1	0.1
6 to 9 months	**4.6**	**-**	5.0	0.1	**2.8**	**-**	3.5	-
9 to 12 months	**1.3**	**-**	2.3	-	**0.2**	**-**	0.8	-
Over 12 months	**2.0**	**-**	3.3	-	**0.4**	**-**	0.9	-
Total	**9,502.2**	**95.9**	9,078.6	95.2	**7,518.0**	**99.0**	7,037.4	98.6
Individually impaired	**384.8**	**3.9**	420.8	4.4	**71.4**	**0.9**	89.6	1.3
Possessions	**21.3**	**0.2**	33.1	0.4	**6.0**	**0.1**	8.6	0.1
	9,908.3	**100.0**	9,532.5	100.0	**7,595.4**	**100.0**	7,135.6	100.0

Where appropriate for customers' needs, the Group 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 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.

The table below provides further information on the residential loans existing at the 2012 reporting date by types of account renegotiations applied to our customers over the last two years. 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	2012	Capitali-sation	Reduced payment	Transfer to interest only	Term extension	Total renego-tiations	
	£m	£m	£m	£m	£m	£m	%
Neither past due nor individually impaired	**9,415.6**	45.6	54.6	75.9	151.6	**327.7**	**3.5**
Past due but not individually impaired:							
Up to 3 months	**67.3**	4.9	8.4	8.6	3.9	**25.8**	**38.3**
3 to 6 months	**11.4**	0.7	1.2	1.5	0.9	**4.3**	**37.7**
6 to 9 months	**4.6**	0.4	0.6	0.4	0.4	**1.8**	**39.1**
9 to 12 months	**1.3**	-	0.2	0.3	0.1	**0.6**	**46.2**
Over 12 months	**2.0**	-	-	0.5	0.1	**0.6**	**30.0**
	9,502.2	**51.6**	**65.0**	**87.2**	**157.0**	**360.8**	**3.8**
Individually impaired	**384.8**	16.6	20.9	18.5	6.6	**62.6**	**16.3**
Possessions	**21.3**	1.3	1.0	0.6	0.1	**3.0**	**14.1**
	9,908.3	**69.5**	**86.9**	**106.3**	**163.7**	**426.4**	**4.3**
Collective impairment	**(9.8)**	-	(1.0)	(0.3)	(0.1)	**(1.4)**	**14.3**
Individual impairment	**(37.8)**	(1.1)	(2.4)	(2.6)	(1.1)	**(7.2)**	**19.0**
	9,860.7	**68.4**	**83.5**	**103.4**	**162.5**	**417.8**	**4.2**

33. Financial instruments (continued)

Group	2011	Capitali-sation	Reduced payment	Transfer to interest only	Term extension	Total renego-tiations	
	£m	£m	£m	£m	£m	£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

Society	**2012**	**Capitali-sation**	**Reduced payment**	**Transfer to interest only**	**Term extension**	**Total renego-tiations**	
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**%**
Neither past due nor individually impaired	**7,454.1**	29.1	42.6	51.3	144.8	**267.8**	**3.6**
Past due but not individually impaired:							
Up to 3 months	**54.1**	2.6	6.7	5.0	2.8	**17.1**	**31.6**
3 to 6 months	**6.4**	0.5	1.1	0.5	0.7	**2.8**	**43.8**
6 to 9 months	**2.8**	0.2	0.3	0.2	0.4	**1.1**	**39.3**
9 to 12 months	**0.2**	-	0.1	-	0.1	**0.2**	**100.0**
Over 12 months	**0.4**	-	-	0.2	0.1	**0.3**	**75.0**
	7,518.0	**32.4**	**50.8**	**57.2**	**148.9**	**289.3**	**3.8**
Individually impaired	**71.4**	5.6	7.2	7.8	6.3	**26.9**	**37.7**
Possessions	**6.0**	0.3	-	0.3	0.1	**0.7**	**11.7**
	7,595.4	**38.3**	**58.0**	**65.3**	**155.3**	**316.9**	**4.2**
Collective impairment	**(6.4)**	-	(0.1)	(0.1)	(0.1)	**(0.3)**	**4.7**
Individual impairment	**(8.5)**	(0.2)	(0.5)	(1.0)	(1.1)	**(2.8)**	**32.9**
	7,580.5	**38.1**	**57.4**	**64.2**	**154.1**	**313.8**	**4.1**

Notes to the Accounts - continued

33. Financial instruments (continued)

Society	2011	Capitali-sation	Reduced payment	Transfer to interest only	Term extension	Total renego-tiations	
	£m	£m	£m	£m	£m	£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**		**Society**	
	2012	2011	**2012**	2011
	£m	£m	**£m**	£m
Not individually impaired	**16,966.7**	16,711.6	**14,237.7**	13,914.7
Impaired	**384.2**	424.2	**77.1**	96.1
Possessions	**18.9**	29.5	**5.3**	7.4
	17,369.8	17,165.3	**14,320.1**	14,018.2

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			
	2012		2011	
	£m	%	£m	%
Leisure and hotel	**42.5**	**9.7**	44.5	9.5
Retail	**15.7**	**3.6**	16.5	3.5
Nursing / residential homes	**22.0**	**5.0**	25.4	5.4
Offices	**14.2**	**3.2**	15.6	3.4
Commercial investment and industrial units	**321.9**	**73.5**	341.5	73.1
Miscellaneous	**21.9**	**5.0**	23.6	5.1
	438.2	**100.0**	467.1	100.0

Geographical analysis	Group and Society			
	2012		2011	
	£m	%	£m	%
Total book:				
North	**21.6**	**4.9**	22.7	4.9
Yorkshire	**39.3**	**9.0**	42.1	9.0
East Midlands	**30.1**	**6.9**	31.7	6.8
East Anglia	**17.0**	**3.9**	17.9	3.8
London	**100.8**	**23.0**	104.9	22.5
South East	**88.1**	**20.1**	95.0	20.3
South West	**52.3**	**11.9**	55.4	11.9
West Midlands	**30.9**	**7.1**	32.4	6.9
North West	**43.1**	**9.8**	49.1	10.5
Wales	**8.3**	**1.9**	8.8	1.9
Scotland	**6.7**	**1.5**	7.1	1.5
	438.2	**100.0**	467.1	100.0

The 2011 comparatives have been reclassified following a review during the year.

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

Loan-to-value analysis	Group and Society			
	2012		2011	
	£m	%	£m	%
Total book:				
<75%	**345.6**	**78.9**	407.1	87.1
75% - 80%	**10.7**	**2.4**	24.3	5.2
80% - 90%	**27.1**	**6.2**	10.6	2.3
>90%	**54.8**	**12.5**	25.1	5.4
	438.2	**100.0**	467.1	100.0
Average loan-to-value		**71.3**		73.8

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			
	2012		2011	
	£m	**%**	£m	%
Neither past due nor individually impaired	**425.5**	**97.1**	441.0	94.5
Past due but not individually impaired:				
Up to 3 months	**6.0**	**1.4**	12.4	2.7
3 to 6 months	**3.5**	**0.8**	0.1	-
6 to 9 months	**-**	**-**	0.5	0.1
9 to 12 months	**-**	**-**	0.1	-
Over 12 months	**-**	**-**	1.1	0.2
Total	**435.0**	**99.3**	455.2	97.5
Individually impaired	**3.2**	**0.7**	11.9	2.5
Possessions	**-**	**-**	-	-
	438.2	**100.0**	467.1	100.0

Where appropriate for customers' needs, the Group 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 considered to be 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.

The table below provides further information on the commercial loans existing at the 2012 reporting date by types of account renegotiations applied to our customers over the last two years. 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	**2012**	**Capitalisation**	**Transfer to interest only**	**Total renegotiations**	
	£m	**£m**	**£m**	**£m**	**%**
Neither past due nor individually impaired	**425.5**	1.9	19.2	**21.1**	**5.0**
Past due but not individually impaired:					
Up to 3 months	**6.0**	-	4.0	**4.0**	**66.7**
3 to 6 months	**3.5**	-	3.4	**3.4**	**97.1**
6 to 9 months	**-**	-	-	**-**	**-**
9 to 12 months	**-**	-	-	**-**	**-**
Over 12 months	**-**	-	-	**-**	**-**
	435.0	**1.9**	**26.6**	**28.5**	**6.6**
Individually impaired	**3.2**	-	2.0	**2.0**	**62.5**
	438.2	**1.9**	**28.6**	**30.5**	**7.0**
Collective impairment	**(1.3)**	-	(0.1)	**(0.1)**	**7.7**
Individual impairment	**(3.7)**	-	(1.5)	**(1.5)**	**40.5**
	433.2	**1.9**	**27.0**	**28.9**	**6.7**

33. Financial instruments (continued)

Group and Society

	2011 £m	Capitalisation £m	Transfer to interest only £m	Total renegotiations £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

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**	
	2012 £m	2011 £m
Not individually impaired	**611.5**	625.2
Individually impaired	**2.9**	8.0
	614.4	633.2

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			
	2012		2011	
	Gross £m	**Impairment £m**	Gross £m	Impairment £m
Factored debt and invoice discounting	**48.2**	**(0.7)**	42.0	(0.6)
Other loans	**61.4**	**(19.5)**	58.4	(21.2)
	109.6	**(20.2)**	100.4	(21.8)

	Society			
	2012		2011	
	Gross £m	**Impairment £m**	Gross £m	Impairment £m
Other loans	**21.9**	**(19.5)**	24.4	(21.2)
	21.9	**(19.5)**	24.4	(21.2)

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.

Notes to the Accounts - continued

33. Financial instruments (continued)

The balances of those assets within our factored debt and invoice discounting business which are individually impaired amount to £2.7m (2011: £1.5m). 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 £21.7m (2011: £23.5m) 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 2012 £7.4m (2011: £7.4m) of the Group's treasury portfolio exposure was either past due or impaired. There is £1.6m (2011: £1.8m) of assets that would otherwise be past due had the terms not 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 sectoral performance.

As at 31 December 2012, 99.6% (2011: 98.1%) of the Group's treasury investment assets were rated A3 or better. The Group continues to have no exposure to emerging markets and only limited exposure to non-investment grade debt.

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

Rating	2012		2011	
	£m	%	£m	%
Aaa	**1,933.2**	**76.4**	2,082.9	68.9
Aa1	**26.0**	**1.0**	74.1	2.5
Aa2	**106.7**	**4.2**	279.0	9.2
Aa3	**104.1**	**4.1**	144.4	4.8
A1	**-**	**-**	126.4	4.1
A2	**188.5**	**7.4**	226.0	7.5
A3	**164.5**	**6.5**	33.6	1.1
Baa1	**2.0**	**0.1**	1.9	0.1
Baa2	**1.1**	**-**	4.5	0.1
Baa3	**1.8**	**0.1**	2.5	0.1
Ba1	**1.7**	**0.1**	1.7	0.1
Ba2	**-**	**-**	22.7	0.8
Caa1	**-**	**-**	6.6	0.2
Caa2	**-**	**-**	14.3	0.5
Ca	**2.2**	**0.1**	-	-
	2,531.8	**100.0**	3,020.6	100.0

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

33. Financial instruments (continued)

Industry sector / asset class	2012		2011	
	£m	%	£m	%
Cash in hand and balances with the Bank of England	**1,014.8**	**40.1**	782.3	25.9
Cash with banks and building societies	**383.1**	**15.1**	361.0	12.0
Gilts	**278.7**	**11.0**	187.3	6.2
Treasury bills	**23.2**	**0.9**	40.4	1.3
Certificates of deposit	**55.1**	**2.2**	414.6	13.7
Fixed rate bonds	**255.8**	**10.1**	396.3	13.1
Floating rate notes	**204.5**	**8.1**	543.8	18.0
Residential mortgage backed securities	**295.2**	**11.7**	256.6	8.5
Commercial mortgage backed securities	**21.4**	**0.8**	38.3	1.3
	2,531.8	**100.0**	3,020.6	100.0

Geographical exposure	2012		2011	
	£m	%	£m	%
UK	**2,050.9**	**81.0**	2,190.6	72.5
Rest of Europe	**409.5**	**16.2**	725.1	24.0
North America	**36.0**	**1.4**	84.1	2.8
Australasia	**35.4**	**1.4**	17.0	0.6
Far East	**-**	**-**	3.8	0.1
	2,531.8	**100.0**	3,020.6	100.0

Within the treasury investments portfolio, the Group has no direct sovereign exposure to Greece, Ireland, Italy, Portugal or Spain as at 31 December 2012 (2011: £nil).

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 addresses 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.

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	**2012**				
	Positive book value £m	**Positive fair value £m**	**Negative book value £m**	**Negative fair value £m**	**Notional value / principal £m**
Cash in hand and balances with the Bank of England	1,014.8	1,014.8	-	-	1,014.4
Debt securities	1,133.9	1,134.2	-	-	1,113.6
Loans and advances to customers	10,593.5	10,568.4	-	-	10,440.7
Loans and advances to credit institutions	383.1	383.1	-	-	383.1
Equity shares	3.1	3.1	-	-	3.1
Trade receivables	34.8	34.8	-	-	39.0
Shares	-	-	(9,462.4)	(9,547.0)	9,349.7
Amounts owed to credit institutions	-	-	(907.6)	(907.6)	906.7
Amounts owed to other customers	-	-	(897.7)	(904.9)	896.2
Debt securities in issue	-	-	(730.9)	(744.3)	734.6
Subordinated liabilities and subscribed capital	-	-	(320.0)	(295.9)	300.0
Trade payables	-	-	(6.3)	(6.3)	6.3
Derivatives designated as fair value hedges	83.2	83.2	(250.4)	(250.4)	6,951.2
Derivatives designated as cash flow hedges	5.8	5.8	(5.0)	(5.0)	1,273.6
Other derivatives and embedded derivatives	113.7	113.7	(115.4)	(115.4)	4,732.1
	13,365.9	**13,341.1**	**(12,695.7)**	**(12,776.8)**	

Group	2011				
	Positive book value £m	Positive fair value £m	Negative book value £m	Negative fair value £m	Notional value / principal £m
Cash in hand and balances with the Bank of England	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)	

33. Financial instruments (continued)

Society

	2012				
	Positive book value £m	**Positive fair value £m**	**Negative book value £m**	**Negative fair value £m**	**Notional value / principal £m**
Cash in hand and balances with the Bank of England	1,014.6	1,014.6	-	-	1,014.2
Debt securities	1,694.1	1,695.2	-	-	1,675.9
Loans and advances to customers	8,221.7	8,241.0	-	-	8,044.2
Loans and advances to credit institutions	232.0	232.0	-	-	232.0
Trade receivables	0.8	0.8	-	-	0.8
Shares	-	-	(9,462.4)	(9,547.0)	9,349.7
Amounts owed to credit institutions	-	-	(969.0)	(969.0)	968.1
Amounts owed to other customers	-	-	(1,541.9)	(1,543.0)	1,540.4
Debt securities in issue	-	-	(60.1)	(58.1)	59.9
Subordinated liabilities and subscribed capital	-	-	(320.0)	(295.9)	300.0
Trade payables	-	-	(0.2)	(0.2)	0.2
Derivatives designated as fair value hedges	83.2	83.2	(250.5)	(250.5)	6,951.2
Derivatives designated as cash flow hedges	5.8	5.8	(5.0)	(5.0)	1,273.6
Other derivatives and embedded derivatives	118.9	118.9	(49.4)	(49.4)	3,627.4
	11,371.1	**11,391.5**	**(12,658.5)**	**(12,718.1)**	

Society

	2011				
	Positive book value £m	Positive fair value £m	Negative book value £m	Negative fair value £m	Notional value / principal £m
Cash in hand and balances with the Bank of England	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)	

The fair value of loans and advances to customers 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:

	2012			
	Amortised cost £m	**Held at fair value as available-for-sale assets £m**	**Fair value through profit or loss £m**	**Total £m**
Cash in hand and balances with the Bank of England	1,014.8	-	-	**1,014.8**
Trade receivables	34.8	-	-	**34.8**
Loans and advances to credit institutions	383.1	-	-	**383.1**
Loans and advances to customers	10,593.5	-	-	**10,593.5**
Debt securities	173.3	960.6	-	**1,133.9**
Derivative financial instruments	-	-	202.7	**202.7**
Equity shares	-	3.1	-	**3.1**
Shares	(9,462.4)	-	-	**(9,462.4)**
Amounts owed to credit institutions and other customers	(1,805.3)	-	-	**(1,805.3)**
Trade payables	(6.3)	-	-	**(6.3)**
Debt securities in issue	(730.9)	-	-	**(730.9)**
Subordinated liabilities	(223.9)	-	-	**(223.9)**
Derivative financial instruments	-	-	(370.8)	**(370.8)**
	(29.3)	**963.7**	**(168.1)**	

	2011			
	Amortised cost £m	Held at fair value as available-for-sale assets £m	Fair value through profit or loss £m	Total £m
Cash in hand and balances with the Bank of England	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	(1,799.0)	-	-	(1,799.0)
Trade payables	(7.2)	-	-	(7.2)
Debt securities in issue	(1,106.2)	-	-	(1,106.2)
Subordinated liabilities	(228.2)	-	-	(228.2)
Derivative financial instruments	-	-	(374.4)	(374.4)
	(765.0)	1,652.9	(158.1)	

The comparatives have been revised as described in note 1b).

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 as the risk is significantly mitigated because all swaps are cash collateralised. Examples of level 2 instruments are certificates of deposit and interest rate swaps.

In considering which similar instruments to use, the Market and Liquidity Risk function take into account the sensitivity of the instrument to changes in market rates and the credit quality of the instrument.

Basis swaps are valued using discounted cash flow models, including observable market data.

Level 3

These are valuation techniques for which any one or more significant input is not based on observable market data.

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	2012			
	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	905.5	55.1	-	960.6
Equity shares	-	-	3.1	3.1
Financial assets at fair value through profit and loss:				
Derivative financial instruments	-	202.7	-	202.7
	905.5	257.8	3.1	1,166.4
Financial liabilities				
Financial liabilities at fair value through profit and loss:				
Derivative financial instruments	-	370.8	-	370.8
	-	370.8	-	370.8

Notes to the Accounts - continued

33. Financial instruments (continued)

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

Included in the Level 3 portfolio are equity shares held in unlisted companies. The table below analyses the movements in the year:

	Group	
	2012 £m	2011 £m
At 1 January	**-**	-
Gain / (loss) recognised in the Income Statement	**-**	-
Additions	**3.1**	-
At 31 December	**3.1**	-

34. Group segmental reporting

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 Limited and North Yorkshire Mortgages Limited and deposit taking and mortgage lending in the Channel Islands through Skipton International Limited. The division also includes the Group's special purpose vehicles formed to acquire funds from wholesale markets, Darrowby No 1 plc, Darrowby No 2 plc and Beckindale No 1 Limited, and the intermediate holding company Skipton Group Holdings Limited.
- Estate Agency – including surveys and valuations, conveyancing, lettings, asset management and mortgage broking carried out through the Connells group.
- Mortgage Services – mortgage administration services, principally Homeloan Management Limited.
- Financial Advice – provision of financial advice and broking services through three separate financial advice businesses, Skipton Financial Services Limited, Pearson Jones Plc and Torquil Clark Limited.
- 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.

34. Group segmental reporting (continued)

No geographical analysis is presented because substantially all of the Group's activities are conducted within the UK. Of the total external income, £23.9m (2011: £31.3m) was generated outside the UK.

A more detailed breakdown of the allocation of goodwill to each segmental area is given within note 18.

	2012						
	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	0.9	-	0.2	2.3	(1.8)	381.2
Interest payable and similar charges	(297.7)	(0.1)	-	(0.3)	(1.0)	2.1	(297.0)
Fair value gains on financial instruments	3.6	-	-	-	-	-	3.6
Fees and commissions receivable	22.3	253.4	61.7	53.4	29.1	(20.5)	399.4
Fees and commissions payable	(8.0)	(3.2)	(1.4)	(8.9)	(0.9)	15.0	(7.4)
Share of profits from joint ventures	-	1.6	-	-	-	-	1.6
Other income	3.8	0.9	0.3	-	7.0	(1.9)	10.1
Total income	103.6	253.5	60.6	44.4	36.5	(7.1)	491.5
Employee and pension costs	(44.7)	(128.6)	(33.3)	(26.1)	(25.2)	-	(257.9)
Depreciation and amortisation	(5.5)	(6.1)	(4.3)	(1.4)	(3.2)	-	(20.5)
Other administrative expenses	(24.7)	(71.7)	(21.9)	(10.0)	(9.8)	6.4	(131.7)
Operating profit / (loss) before impairment losses and provisions	28.7	47.1	1.1	6.9	(1.7)	(0.7)	81.4
Impairment losses / provisions for liabilities	(23.8)	(10.9)	(0.3)	(7.8)	(2.2)	-	(45.0)
Profit / (loss) before tax	4.9	36.2	0.8	(0.9)	(3.9)	(0.7)	36.4
Taxation	(0.7)	(9.0)	-	0.2	0.1	0.6	(8.8)
Profit / (loss) after tax	4.2	27.2	0.8	(0.7)	(3.8)	(0.1)	27.6
Total assets	13,524.4	178.2	23.5	34.2	125.3	(125.4)	13,760.2
Total liabilities	12,766.9	81.0	1.6	12.0	98.8	(35.6)	12,924.7
Capital expenditure	2.5	9.1	3.2	1.3	3.9	(0.2)	19.8

Total income can be analysed as follows:

	2012						
	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	3.7	3.7	4.7	(7.3)	1.7	(6.5)	-
External income	99.9	249.8	55.9	51.7	34.8	(0.6)	491.5
Total income	103.6	253.5	60.6	44.4	36.5	(7.1)	491.5

Notes to the Accounts - continued

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 administrative 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

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: £6.7m (2011: £6.5m) and Society: £2.4m (2011: £2.2m).

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 2011 for the Skipton Scheme
- 30 April 2011 for the Connells Scheme
- 5 April 2011 for the Sequence 1997 Scheme
- 1 April 2010 for the Sequence Staff Scheme
- 31 December 2010 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	
	2012 %	2011 %
Retail price inflation	**2.90**	2.90
Consumer price inflation	**2.00**	2.00
Discount rate	**4.60**	4.80
Expected return on assets	**5.26-6.19**	5.18-6.17
Increases to pension payment:		
RPI max 5%	**2.80**	2.80
RPI min 3% max 5%	**3.55**	3.55
RPI max 2.5%	**2.40**	2.40
CPI max 5%	**2.00**	2.00
CPI min 3% max 5%	**3.30**	3.30
CPI max 2.5%	**1.90**	1.90
Rate of increase deferred pensions (RPI link)	**N/A**	N/A
Rate of increase deferred pensions (CPI link)	**2.00**	2.00

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 2012, 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. 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	**2012**	2011
Males	**24.6**	24.5
Females	**25.8**	25.7

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

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Fair value of plan assets	**157.9**	148.5	**81.2**	78.1
Present value of defined benefit obligations	**(203.0)**	(192.1)	**(101.3)**	(97.0)
Net pension liability	**(45.1)**	(43.6)	**(20.1)**	(18.9)

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 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
At 1 January	**148.5**	166.2	**78.1**	86.7
Expected return on assets	**8.1**	10.2	**4.1**	5.2
Actuarial gains / (losses)	**1.9**	(11.1)	**0.9**	(4.2)
Contributions by employer	**5.0**	3.7	**1.3**	2.1
Contributions by employees	**-**	-	**-**	-
Benefits paid	**(5.6)**	(4.2)	**(3.2)**	(2.7)
Assets distributed on settlements	**-**	(16.3)	**-**	(9.0)
At 31 December	**157.9**	148.5	**81.2**	78.1

35. Pensions (continued)

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

	Group 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
At 1 January	**192.1**	198.0	**97.0**	96.4
Current service cost	**-**	-	**-**	-
Past service cost	**-**	1.8	**-**	1.3
Interest cost	**9.1**	10.0	**4.6**	4.8
Contributions by employees	**-**	-	**-**	-
Actuarial losses	**7.4**	7.3	**2.9**	8.3
Actual benefit payments	**(5.6)**	(4.2)	**(3.2)**	(2.7)
Liabilities extinguished on settlements	**-**	(20.8)	**-**	(11.1)
At 31 December	**203.0**	192.1	**101.3**	97.0

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 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Actual return on assets	**10.0**	(0.9)	**5.0**	1.0
Expected return on assets	**(8.1)**	(10.2)	**(4.1)**	(5.2)
Actuarial gain / (loss) on assets	**1.9**	(11.1)	**0.9**	(4.2)

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	**2012**		2011	
	£m	**% pa**	£m	% pa
Equities	**5.7**	**6.45**	30.3	6.55
Property	**1.4**	**4.75**	1.8	4.85
Corporate bonds	**32.7**	**4.60**	23.4	4.80
Government bonds	**23.9**	**2.70**	29.4	2.80
Diversified growth vehicle*	**93.1**	**6.45**	62.3	6.55
Cash	**1.1**	**3.00**	1.3	3.00
	157.9	**5.46**	148.5	5.48

* 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.

Notes to the Accounts - continued

35. Pensions (continued)

The actual return on the scheme assets over the year ended 31 December 2012 was estimated as 6.5% (2011: (0.5)%).

Society	**2012**		2011	
	£m	**% pa**	£m	% pa
Equities	**1.5**	**6.45**	12.9	6.55
Property	**0.6**	**4.75**	0.9	4.85
Corporate bonds	**16.7**	**4.60**	14.8	4.80
Government bonds	**14.7**	**2.70**	18.3	2.80
Diversified growth vehicle	**47.5**	**6.45**	30.7	6.55
Cash	**0.2**	**3.00**	0.5	3.00
	81.2	**5.37**	78.1	5.30

The actual return on the scheme assets over the year ended 31 December 2012 was estimated as 6.3% (2011: 1.9%).

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 2012 £m	Group 2011 £m	**Society 2012 £m**	Society 2011 £m
Current service cost	**-**	-	**-**	-
Past service cost	**-**	1.8	**-**	1.3
Gains on settlements	**-**	(4.5)	**-**	(2.1)
Interest on liabilities	**9.1**	10.0	**4.6**	4.8
Expected return on assets	**(8.1)**	(10.2)	**(4.1)**	(5.2)
Total pension expense / (income)	**1.0**	(2.9)	**0.5**	(1.2)

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

Group	**2012 £m**	2011 £m	2010 £m	2009 £m	2008 £m
Experience gains / (losses) on scheme assets	**1.9**	(11.1)	6.0	13.6	(37.5)
Experience gains / (losses) on defined benefit obligation	**0.5**	1.7	0.9	(0.7)	(1.6)
(Losses) / gains from change in assumptions	**(7.9)**	(9.0)	2.8	(30.8)	13.5
Total amount of surplus not recoverable	**-**	-	-	-	1.5
Total (losses) / gains recognised in Statement of Comprehensive Income during the year	**(5.5)**	(18.4)	9.7	(17.9)	(24.1)
Cumulative actuarial losses recognised at end of year	**(52.6)**	(47.1)	(28.7)	(38.4)	(20.5)

Society	**2012 £m**	2011 £m	2010 £m	2009 £m	2008 £m
Experience gains / (losses) on scheme assets	**0.9**	(4.2)	3.2	6.8	(16.0)
Experience gains / (losses) on defined benefit obligation	**0.9**	(2.2)	0.4	(0.1)	(1.5)
(Losses) / gains from change in assumptions	**(3.8)**	(6.1)	1.0	(16.0)	5.8
Total (losses) / gains recognised in Statement of Comprehensive Income during the year	**(2.0)**	(12.5)	4.6	(9.3)	(11.7)
Cumulative actuarial losses recognised at end of year	**(29.3)**	(27.3)	(14.8)	(19.4)	(10.1)

35. Pensions (continued)

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

Group	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Fair value of plan assets	**157.9**	148.5	166.2	148.8	115.7
Present value of defined benefit obligations	**(203.0)**	(192.1)	(198.0)	(196.2)	(153.6)
Net pension liability	**(45.1)**	(43.6)	(31.8)	(47.4)	(37.9)

Society	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Fair value of plan assets	**81.2**	78.1	86.7	76.4	54.2
Present value of defined benefit obligations	**(101.3)**	(97.0)	(96.4)	(95.9)	(72.3)
Net pension liability	**(20.1)**	(18.9)	(9.7)	(19.5)	(18.1)

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 2013:

	Group 2013 £m	Society 2013 £m
Estimated employer contributions	**2.8**	**1.2**
Estimated employee contributions	**-**	**-**
Estimated total contributions	**2.8**	**1.2**

36. Adoption of new and revised International Financial Reporting Standards

There have been no new standards or interpretations adopted during the year.

Disclosed below are the new IFRS and amendments which at 31 December 2012 have been endorsed by the EU but were not effective and have therefore not been applied in preparing these financial statements:

- Amendments to IAS 1, *Presentation of items of Other Comprehensive Income*. This amendment is effective from 1 January 2013 and requires entities to group items presented in the Statement of Other Comprehensive Income on the basis of whether they are potentially reclassifiable to profit or loss in subsequent periods. The impact of this amendment on the financial statements will be immaterial to the Group.
- Amendments to IAS 19, *Employee Benefits*. This amendment is effective from 1 January 2013 and updates the recognition, presentation and disclosures of retirement benefit plans. The most significant impact for the Group is the replacement of the expected return on plan assets and interest cost with a single measure of net interest income (or expense) based on the net retirement benefit asset (or obligation). If the revised standard had applied in the year ended 31 December 2012, net interest income would have been approximately £1.0m lower with an equivalent increase in Other Comprehensive Income. There would have been no impact on the Group's net assets or reserves.
- IFRS 10, *Consolidated Financial Statements*. This new standard is effective from 1 January 2014 and replaces IAS 27, *Consolidated and Separate Financial Statements* and SIC 12, *Consolidation - Special Purpose Entities*. The new standard defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. The IFRS also sets out the accounting requirements for the preparation of consolidated financial statements. With the exception of additional disclosure requirements, the new standard is not expected to have a significant impact for the Group.
- IFRS 11, *Joint Arrangements*. This new standard is effective from 1 January 2014 and replaces IAS 31, *Interests in Joint Ventures* and SIC 13, *Jointly Controlled Entities - Non-Monetary Contributions by Venturers*. The new standard removes the choice to apply the proportionate consolidation method, requiring all joint arrangements to be accounted for under the equity method. The new standard will have minimal impact on the financial statements of the Group.
- IFRS 12, *Disclosure of Interests in Other Entities*. This standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity, and is effective from 1 January 2014. This standard will have an impact on the disclosure requirements of the Group but these are not expected to be extensive.

Notes to the Accounts - continued

36. Adoption of new and revised International Financial Reporting Standards - continued

- IFRS 13, *Fair Value Measurement*. This new standard defines fair value and sets out in a single framework comprehensive guidance for measuring fair value. It will also require increased disclosure about fair value measurements. The standard does not change the requirements with regards to which financial and non-financial assets and liabilities will be measured at fair value. The standard is effective from 1 January 2013, and again, with the exception of some additional disclosure requirements, is expected to have minimal impact on the financial statements of the Group.
- IFRS 7, *Financial Instruments – Disclosures*. Amendments to IFRS 7 '*Disclosures – Offsetting Financial Assets and Financial Liabilities*' is effective from 1 January 2013 and requires new disclosures for all recognised financial instruments that are offset in the Statement of Financial Position. The impact of the amendment to IFRS 7 is unlikely to be material to the Group.

The Group notes that there are also new accounting standards on the horizon, which are neither adopted by the EU nor effective at 31 December 2012 including IFRS 9. IFRS 9 is still subject to EU endorsement, the timing of which is uncertain, but is 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 Group financial statements.

37. Subsequent events

There have been no material subsequent events between 31 December 2012 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 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 regulatory capital at 31 December 2012:

	2012 £m	2011 £m
Tier 1		
Reserves	**827.7**	806.5
Permanent Interest Bearing Shares (note 1)	**90.0**	90.0
Pension fund deficit add back (note 2)	**13.6**	13.5
Deductions from Tier 1 capital (note 3)	**(196.2)**	(196.7)
Unrealised losses / (gains) on available-for-sale debt securities	**2.3**	(6.0)
Unrealised losses on cash flow hedges	**14.6**	19.0
Total Tier 1 capital	**752.0**	726.3
Tier 2		
Subordinated debt (note 1)	**188.9**	197.4
Collective impairment allowance	**11.1**	14.9
Total Tier 2 capital	**200.0**	212.3
Total capital	**952.0**	938.6

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 2012 %	Statutory limit %
Lending limit	**10.02**	25.00
Funding limit	**16.93**	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

	2012 %	2011 %
As a percentage of shares and borrowings:		
(i) Gross capital	**9.63**	9.35*
(ii) Free capital	**7.31**	7.10*
(iii) Liquid assets	**21.10**	24.79*
As a percentage of mean total assets:		
(i) Group profit after taxation	**0.20**	0.11
(ii) Group management expenses	**2.96**	2.78
(iii) Society management expenses	**0.44**	0.44

* The comparatives have been revised as described in note 1b).

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 hedging 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 2012 and 2011 total assets.

Management expenses represent administrative expenses.

Annual Business Statement - continued

3. Information relating to Directors and other officers at 31 December 2012

The Board of Directors at 31 December 2012, 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
I M Cornelius*	11 February 1969	11 June 2012
M L Cassoni	27 December 1951	31 July 2012
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
G Picken	21 April 1949	17 January 2012
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 2012 and their business occupations were:

R Allsop	Head of Customer Strategy and Planning
S P Barker	Head of Group Tax
M Beech	Group Financial Control Manager
E A Blythe	General Manager, Audit Services
K Brewster	Head of Products
A Chapman	Group Treasurer
C J Davey	Head of Skipton Direct
R Fawcett	Chief Human Resources Officer
P Fenn	Branch and Intermediary Distribution Director
V French	Head of Group Finance
J J Gibson	Chief Conduct Risk Officer and Secretary
I D Le Roux	Head of Group Insurance
B Ndawula	Chief Financial Risk Officer
A Nelson	General Manager, Finance
R Ramsden	Head of Marketing
A C Robinson	Group Commercial Director
H Varney	Chief Operating Officer
A K Wiggans	Group Specialist Lending Director

The Directors' business occupations and other Directorships at 31 December 2012 were:

M L Cassoni	Non-Executive Director	GFI Group Inc Jacob's Island (Providence Square Blocks A, B & C) Limited John Lewis Partnership Residential Clubs Limited Peabody (Services) Limited Peabody Enterprises Limited Skipton Group Holdings Limited
I M Cornelius	Building Society Commercial Director	Amber Homeloans Limited Medical Care Direct Limited North Yorkshire Mortgages Limited Red Arc Assured Limited Skipton Group Holdings Limited Skipton International Limited The Private Health Partnership Limited

D J Cutter	Building Society Group Chief Executive	Bailey Computer Services Limited Baseline Capital Limited Connells Limited Homeloan Management Limited Incresco Limited KB Analytics Limited Leeds Share Shop Limited Malsis School Trust Mortgage Systems Limited North West Investments NZ Limited Savings Management Limited Sequence (UK) Limited Scarborough Properties 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 Thomson Shepherd Limited Thomson Shepherd Holdings 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 Recordpoint Limited Scottish Bureau of Investigation Limited Shopacheck Financial Services Limited Shopacheck Limited Skipton Group Holdings Limited 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

Annual Business Statement - continued

M H Ellis	Non-Executive Director Chairman	M H Ellis Consulting Limited Skipton Group Holdings Limited W H Smith Plc
M R Fleet	Building Society Distribution Director	Baseline Capital Limited Homeloan Management Limited Incresco Limited KB Analytics Limited Life Policies Direct Limited Mortgage Systems Limited PS Employee Benefits Limited PACE Financial Solutions Limited PACE Mortgage Solutions Limited Parnell Fisher Child & Co Limited Parnell Fisher Child Holdings Limited Pearson Jones Plc Savings Management Limited Skipton Financial Services Limited Skipton Group Holdings Limited Specialist Mortgage Services Limited The Independent Mortgage Shop Limited Torquil Clark Holdings Limited Torquil Clark Limited Torquil Clark Pension Trustees Limited Torquil Clark Professional Connections Limited TQ Management Services Limited
P R Hales	Chartered Insurer	Clear View Assured Limited Sandringham Financial Partners Limited Skipton Group Holdings Limited The Chartered Insurance Institute Pension Scheme UNUM Limited UNUM Select Limited
C N Hutton	Retired Solicitor	Ben Rhydding Sports Club Limited Moorfield School Limited Skipton Group Holdings Limited
G Picken	Non-Executive Director	HICL Infrastructure Company Limited Skipton Group Holdings Limited
P J S Thompson	Non-Practising Solicitor	Giggleswick School Henderson Insurance Brokers Limited Judicium Business Services Limited Judicium Plc NG Bailey Group Limited NG Bailey and Company (Overseas) Limited Rushbond Plc Skipton Group Holdings Limited TEP Electrical Distributors Limited

R J Twigg	Building Society Group Finance Director	Amber Homeloans Limited
		Beckindale No 1 Limited
		Cashflow4business.com Limited
		Connells Limited
		Connell Financial Services Limited
		Darrowby No 1 plc
		Darrowby No 2 plc
		Jade Direct UK Limited
		Jade Software Corporation Limited
		Leeds Share Shop Limited
		MBO 1994 Limited
		North West Investments NZ Limited
		North Yorkshire Mortgages 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 Mortgages Corporation Limited
		Skipton Mortgages Limited
		Skipton Premier Mortgages Limited
		Skipton Premises Limited
		Skipton Share Dealing Services Limited
		Skipton Trustees Limited
		Specialist Investment Services Limited
		Sterling Brokers Limited
		Sterling International Brokers Limited
		Thomson Shepherd Limited
		Thomson Shepherd Holdings Limited
		Yorkshire Factors Limited

Messrs Cornelius, Cutter, Fleet and Twigg have service contracts entered into on 7 December 2012, 1 January 2000, 7 December 2012 and 1 March 2002 respectively which may be terminated by either party giving one year's notice.

Annual Business Statement - continued

Directorships of the Society's officers at 31 December 2012 were as follows:

R Allsop	RA Marketing Consultancy Limited
R Fawcett	Display Techniques Limited
J J Gibson	Connell Financial Services Limited Skipton Pension Trustees Limited
A Nelson	AWN Interim Limited
R Ramsden	Skipton Building Society Charitable Foundation
A C Robinson	Alegra Fine Products Limited Bailey Computer Services Limited Cashflow4business.com Limited Jade Software Corporation Limited Life Policies Direct Limited MBO 1994 Limited Medical Care Direct Limited Mutual One Limited North East Trustees Limited Pace Financial Solutions Limited Pace Mortgage Solutions Limited Parnell Fisher Child & Co Limited Parnell Fisher Child Holdings Limited Pearson Jones Plc PS Employee Benefits Limited Red Arc Assured Limited Skipton Business Finance Limited Skipton Group Holdings Limited Sterling Brokers Limited Sterling International Brokers Limited The Independent Mortgage Shop Limited The Private Health Partnership 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
I D Le Roux	Skipton Pension Trustees Limited
H Varney	Bailey Computer Services Limited Mutual One Limited The Old Saw Mill Management Limited
A K Wiggans	Amber Homeloans Limited North Yorkshire Mortgages Limited Optym Consulting Limited Specialist Mortgage Services 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:

Term	Definition
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 once the Basel III rules have been finalised.
Buy-to-let mortgages	Mortgages offered to customers purchasing residential property as a rental income.
Code staff	A group of employees to which the FSA's Remuneration Code applies. Code staff consist of executive directors, non-executive directors and certain senior managers in control functions who could have a material impact on the firm's risk profile.
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 has previously issued 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.

Glossary - continued

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 for Lending Scheme	A scheme launched by the Bank of England and HM Treasury in August 2012 which provides cheap loans to banks and building societies with the aim of stimulating lending within the economy.
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 hedging 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.
Individual 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.
Individual Liquidity Adequacy Assessment (ILAA)	The Group's own assessment that current and projected levels of liquidity are sufficient and appropriate for the Group's plans, under a variety of stress scenarios. It also details the Group's compliance with the FSA's regulatory BIPRU 12 requirements.
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	The total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.
Liquidity ratio	Liquid assets as a percentage of shares and borrowings.
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 an entity 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.
Net interest margin	Net interest income as a percentage of mean total assets.
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 an 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.

Glossary - continued

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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Skipton Building Society is a member of the Building Societies Association.
Authorised and regulated by the Financial Services Authority (FSA) under registration number 153706 for accepting deposits, advising on and arranging mortgages and insurance.

*To help maintain service and quality, some telephone calls may be recorded and monitored.

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