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Annual Report & Accounts 2013

SKIPTON
MY BUILDING SOCIETY

Contents

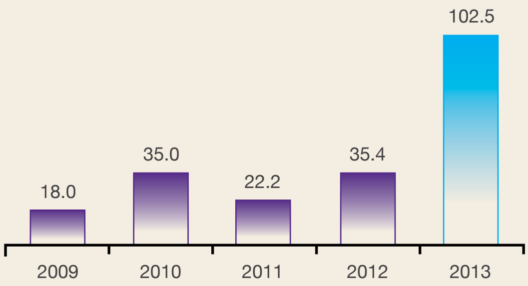
Five Year Highlights

Year ended 31 December	2013	2012	2011	2010	2009
Net interest income	**£142.6m**	£84.2m	£71.2m	£54.9m	£53.3m
Net interest margin	**1.01%**	0.61%	0.52%	0.37%	0.36%
Administrative expenses	**£455.3m**	£410.1m	£384.8m	£395.5m	£383.7m
Cost income ratio	**79.32%**	83.88%	85.55%	89.50%	87.24%
Impairment losses	**£22.7m**	£16.3m	£30.0m	£14.9m	£42.3m
Provisions for liabilities	**£20.6m**	£28.7m	£13.5m	£1.1m	£(4.0)m
Profit before tax from continuing operations	**£102.5m**	£35.4m	£22.2m	£35.0m	£18.0m
As at 31 December					
Member savings balances	**£10,260m**	£9,462m	£9,280m	£9,389m	£10,470m
Loans and advances to customers	**£11,417m**	£10,456m	£10,100m	£9,688m	£10,713m
Total assets	**£14,487m**	£13,760m	£13,910m	£13,740m	£15,569m
Liquidity	**18.61%**	21.10%	24.79%	27.75%	28.95%
Wholesale funding	**15.37%**	16.93%	19.79%	17.63%	20.58%
Core Tier 1 capital ratio	**12.32%**	11.08%	10.53%	11.06%	9.37%
Total capital ratio	**15.91%**	15.94%	15.53%	16.60%	14.48%

Key Financial Highlights

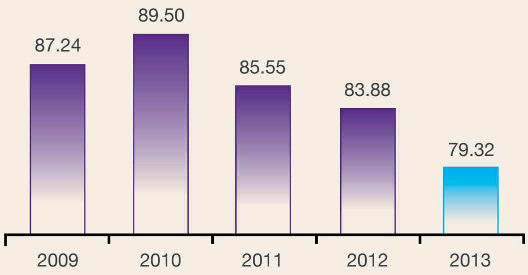
- Group profit before tax **up £67.1m** to **£102.5m** (2012: £35.4m)
- Group net interest margin **up 66%** to **1.01%** (2012: 0.61%)
- Gross mortgage advances **increased** to **£2,415.4m** (2012: £1,483.7m)
- Net mortgage lending **increased** to **£960.6m** (2012: £356.1m)
- Retail savings balances **increased** by **£797.7m** to **£10,260.1m** (2012: £9,462.4m)
- Group retail funding **increased** to **84.63%** (2012: 83.07%) of total funding
- Liquidity ratio **managed down** to **18.61%** (2012: 21.10%) of shares, deposits and liabilities
- Mortgages in arrears by more than 2.5% of the total outstanding balance **fallen** to **1.04%** (2012: 1.30%)
- Core Tier 1 capital ratio **up** to **12.32%** (2012: 11.08%)

Profit before tax from continuing operations (£m)



Net interest margin (%)

Cost income ratio (%)



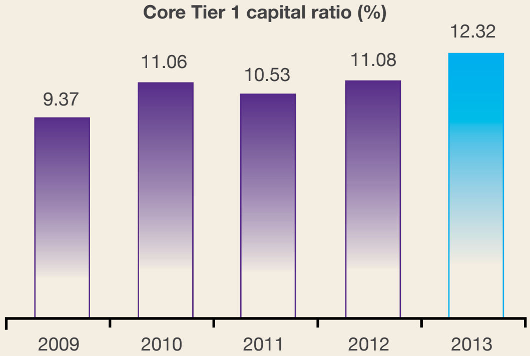
Total assets (£m)

Loans and advances to customers (£m)

Member savings balances (£m)

Liquidity ratio (%)

Core Tier 1 capital ratio (%)



Chairman's Statement

This is my third report as your Chairman and I am delighted to present an improving and robust financial performance on behalf of an increasing number of members.

2013 saw our profitability increase significantly, along with our overall financial strength – all balanced, importantly, with a strategy centred on our members' needs and delivering to the best of our ability.

More details regarding our financial performance are to be found in the Strategic Report and Business Review but I would like to highlight the strong performance of our core business of Mortgages and Savings, as well as our estate agency business, as being particularly commendable.

Even more pleasing was the growth in the number of saving and borrowing members as more people saw the attraction of our products and service and becoming part of the UK's fourth largest building society. This comes after almost four years of declining numbers and we look forward to welcoming even more members in the years to come.

The Society is now in a demonstrably stronger financial position in terms of underlying profitability and capital resources. Our approach to funding, liquidity and capital management remains cautious and provides the stability required to sustain future growth in our business.

Our improved performance is against the backcloth of an improving UK economy that appears to have entered into a sustainable recovery phase. Unemployment has fallen, although still at relatively high levels and of concern to those most directly impacted; and inflation is lower which eases the pressure for an increase in interest rates.

Low interest rates have benefitted the housing market in terms of mortgage affordability and we have seen an improving arrears performance while ensuring customers are treated fairly. The housing market has strengthened with increased mortgage availability fuelling increasing house prices and transactions.

The housing market has also benefitted from government initiatives such as the Funding for Lending Scheme (FLS) and 'Help to Buy' schemes. The FLS has been revised by removing the direct incentives to expand household lending in 2014, but this is not expected to have a significant impact on the Society's lending plans. In 2014, the Society will participate in the 'Help to Buy equity loan' scheme, and we are keeping a watching brief on the more recent and broader 'Help to Buy mortgage guarantee' scheme. The Society continues to offer a wide range of mortgage products suitable for a variety of borrowers.

While low interest rates – the Bank of England Base Rate has remained at its historic low of 0.5% for almost five years – have helped borrowers, the reverse is the case for savers who make up the vast majority of our membership. The Society has sought to mitigate the impact of low interest rates on investors and, in so doing, has attracted more savings members, but we remain acutely aware of the pressure on savers.

In due course, interest rates should rise, which ought to benefit savers. However, at this stage, nobody can accurately predict the timing and extent of any interest rate increases. We will do our best to continue mitigating the impact on savers, but we do have to be mindful of the impact of interest rate rises on our borrowers and try to achieve a balance for both.

The global financial services sector is by no means out of the woods and we cannot rule out further shocks either in the UK or globally, but I do believe that there are reasons to be more optimistic for the short to medium term. As always, we will continue to run the Society vigilantly and prudently. Our members can take reassurance from this year's performance that they are doing business with a solid organisation which has their interests at its core.

As foreshadowed in last year's report, our regulatory landscape changed in 2013 with the replacement of the Financial Services Authority (FSA) by two new regulators; the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA). As always, we will seek to work within the spirit as well as the detail of regulation and seek continuous improvement in the way we do business to meet our customers' needs.

The Mortgage Market Review (MMR) will result in changes to be implemented in April this year. We are well prepared to advise our customers appropriately and anticipate a smooth transition for the Society. Changes arising from the

“Our members can take reassurance from this year’s performance that they are doing business with a solid organisation which has their interests at its core.”

Retail Distribution Review (RDR) were introduced from the beginning of 2013 and we continue to offer financial advice through our wholly owned Skipton Financial Services (SFS) subsidiary, which has 110 advisers operating within the Society’s branches or through home visits. The continued provision of financial advice distinguishes us from many of our competitors.

As a Society, we understand that our customers very much value the personal service they receive from us, particularly through our national branch network but also via Skipton Direct, our telephone customer service centre, and online. We are committed to further enhancing the experience they receive from us, through measures such as our ‘Delivering Service Excellence’ programme for our customer-facing teams, and improvements to our direct and online channels as part of our digital strategy. We seek to ensure that our commitment to keeping members’ needs at the heart of everything we do is actively brought to life through our interactions on a daily basis.

Standing out from our peers and competitors based on the way we do business is important to us at Skipton, and our Community & Corporate Responsibility Strategy is integral to this. Through our new Grassroots Giving initiative, we gave 160 donations of £500 to community groups voted for by the public, to mark our 160th anniversary year in 2013, in line with our founding ethos of ‘helping people to help themselves’.

We also continued to support a number of key community partners, including the Great Yorkshire Show, which brings over 100,000 tourists to the region each year. The Skipton Building Society Camerata benefitted once again; introducing new audiences to the delights of classical music through concerts in unusual venues ranging from railway stations to public houses, as well as educational programmes for young people.

During 2013, the Society also donated £120,000 to our Charitable Foundation which helps to support many people; particularly the young and the elderly.

I have a number of Board changes to report. Noel Hutton retired from his role as Deputy Chairman after nine years of service and I would like to thank him for his significant contribution to the development of the Society. He has been replaced as Deputy Chairman by Nimble Thompson, who has been a member of the Skipton Board since 2009.

As mentioned in last year’s Annual Report, two new Non-Executive Directors, Cheryl Black and Helen Stevenson, were appointed to the Board on 1 March 2013. These appointments ensure that our Board continues to have the depth and breadth of knowledge and experience required to run a complex and diverse customer-facing business such as Skipton.

Since the end of the year, our Group Finance Director, Richard Twigg, has decided to take up an appointment as Group Finance and Commercial Director at our estate agency subsidiary, Connells, with effect from the end of the first quarter of 2014, and will then stand down from the Board. He is therefore, not standing for re-election at the forthcoming AGM. Richard has been an Executive Director of the Society since 2002 and has made an enormous contribution to its success, particularly in helping to guide the Group through the Global Financial Crisis. The Board wishes him well in his new role and are delighted to see him remain a key executive with the wider Skipton Group. We are currently in the process of recruiting a new Group Finance Director for the Society.

I would also like to thank the team of colleagues who have gone out of their way to make 2013 such a successful year for the Society. Skipton people demonstrate daily that blend of committed determination to doing a good job on behalf of our members and friendly camaraderie and teamwork in the way they go about it that, in my opinion, goes a long way towards making Skipton special.

All in all, we start our 161st year confident and optimistic regarding the future, while ever mindful of the economic uncertainties that require our continued vigilance. I look forward to updating you in 12 months’ time.

M H Ellis
Chairman

25 February 2014

Group Chief Executive's Report

Introduction

As a mutual, run for the benefit of both existing and future members, we are constantly balancing the needs of borrowers and savers, while at the same time ensuring we invest appropriately in the business and retain sufficient profits (being our principal source of capital). Key measures of success are to see a growing membership base and good growth in both savings and mortgage balances, as well as strong capital levels and decent profits that enable the business to continue to prosper in a sustainable manner.

After the recent challenges emanating from the Global Financial Crisis, I am pleased to report that in 2013 the Society saw significant improvement in all of the following measures of success:

- Our customer base resumed growth, by a net 21,046, to 763,407.
- Group mortgage and savings balances increased by 9.2% and 8.4% respectively. This was well in excess of the Society's market share of balances and a strong indicator of its competitiveness.
- Group pre-tax profits increased to £102.5m, from £35.4m.
- Our Core Tier 1 ratio increased to 12.3%, from 11.1%, whilst the Leverage ratio at 5.3% was comfortably ahead of the Regulator's expected minimum.

Importantly, these results were achieved while involving and seeking feedback from our members, including an extensive engagement programme via our online Customer Panel and face-to-face Customer Forums. Our members told us that what they particularly dislike about UK financial services is 'pushy sales'. We have therefore introduced our new customer commitment entitled '**No Pressure Promise**', which gives them the information, time and space to make their own decisions.

In addition, we carried out 26,300 '**My** Reviews' during 2013, a free financial review service aimed at understanding and meeting our customers' financial needs. We also continue to provide financial advice on the high street in every branch, through our subsidiary Skipton Financial Services Limited, at a time when many other providers have withdrawn this service.

Continued growth

During 2013 we continued to grow in our two key areas of mortgage lending and retail savings. Total residential mortgage lending in the year was £2.4bn, up 63% from £1.5bn in 2012. Our net lending, being the growth in mortgage balances, more than doubled during the year, to almost £1.0bn from £0.4bn, an increase in balances of 9.2%. This represented 9.3% of the growth in the UK net residential mortgage market, compared to our 0.8% market share of mortgage balances, based on Bank of England statistics. Consequently, our total mortgage portfolio ended the year at £11.4bn, compared to £10.5bn at 31 December 2012.

Meanwhile, our savings balances increased to £10.3bn, from £9.5bn at the end of 2012, a growth rate of 8.4%. As a percentage of the growth in the UK market, this increase represented more than twice our market share of savings balances, as we continued to offer competitively priced savings accounts to our members.

Profitability

- Group pre-tax profits of £102.5m, an increase of £67.1m, from £35.4m in 2012.
- £58.4m improvement in Group net interest income (to £142.6m) which, when measured as a percentage of mean assets, increased to 1.01% from 0.61%.
- The core Mortgages and Savings division increased its pre-tax profits by £45.9m, to £50.4m from £4.5m. The improved interest margin noted above was only partially offset by an increase in loan loss provisions, particularly against our equity release portfolio.
- Connells, our Estate Agency division, increased profits by 41% to £50.2m, from £35.6m in 2012.
- We recognised a profit of £24.8m on the flotation of Wynyard Group Limited on the New Zealand Stock Exchange, this company having been spun off from our IT subsidiary Jade Software Corporation (the supplier of the Society's core IT systems).
- We made a goodwill impairment charge of £16.6m following a review of the carrying value of certain of our subsidiary investments.

“…run for the benefit of both existing and future members, we are constantly balancing the needs of borrowers and savers, while at the same time ensuring we invest appropriately in the business and retain sufficient profits.”

Financial strength

- Group total assets increased by 5.3% year-on-year to £14.5bn (2012: £13.8bn).
- Basel II Core Tier 1 full Group capital ratio of 12.3%, compared to 11.1% at the end of 2012, based on the standardised approach ratings methodology.
- Under Basel III CRD IV the Common Equity Tier 1 ratio for the prudential consolidation group was 14.1% at 1 January 2014.
- Leverage ratio of 5.3% (2012: 4.8%), which compares well with our industry peers and comfortably exceeds the expected new regulatory requirements.
- Our financial strength allowed us, during the year, to repay £75m and repurchase a further £16.7m of subordinated debt, the majority of which no longer counts towards regulatory capital from 1 January 2014.
- Our increasing financial strength has also enabled us to cost effectively reduce our liquidity from the very high levels operated in recent years. Our liquidity position remains robust and of high quality, and represents 18.6% of shares, deposits and liabilities (2012: 21.1%).
- Our prudent approach to lending, coupled with an improvement in UK house prices, has resulted in the average indexed loan-to-value ratio of residential mortgages across our Mortgages and Savings portfolio improving to 53% (2012: 57%).
- Residential mortgage arrears, where the arrears balance is more than 2.5% of outstanding balances, have fallen to 1.04% (2012: 1.30%), compared to the Council of Mortgage Lenders (CML) industry average of 1.29%.

Listening to our members and investing in our people

During 2013, the Society made considerable investments in two important areas. Firstly, we launched a major programme seeking, and responding to, members' feedback, which included carrying out 18,000 interviews with our customers. Independent research by Nunwood showed that 93% of our branch customers are highly satisfied by the service they receive. In addition, also according to Nunwood, Skipton Building Society ranked 36th out of 260 leading UK brands based on 7,500 people surveyed. We were positioned 4th out of 42 financial services providers, outperforming all the major banks.

Secondly, we have made a substantial investment in our people, especially in developing their leadership skills and ensuring they listen to and understand our customers to help them identify their financial needs under our ‘Delivering Service Excellence’ programme.

I know how much effort our people put into ensuring that they deliver excellent service to our customers, and I would like to thank them all for their dedication and unwavering focus during the past 12 months.

Support for savers

Market conditions throughout 2013 had a significant impact on UK savers. Not only was Bank Base Rate maintained at 0.5% but the existence of the Government's Funding for Lending Scheme reduced the need for banks and building societies to attract retail funds, causing downwards pressure on rates paid to savers. The average savings rate paid across all of our accounts reduced by 0.36% during the 12-month period, but nevertheless averaged 2.24% during the year. Based on the CACI Savings Market Database data which best enables us to make market comparisons, the Society paid on average 0.43% higher interest than the market average for banks and building societies during the 10-month period to 31 October 2013. The competitiveness of the Society's savings range was demonstrated by an 8.4% increase in retail balances to £10.3bn.

Our savings rates were highlighted by 357 independent media best buy table mentions over the course of the year. We were judged ‘Best Junior/Children's Savings provider’ in the Personal Finance Awards 2013/14 for our suite of Junior Cash ISA, Child Trust Fund, Children's Savings Bond and Leap children's accounts.

Group Chief Executive's Report
Continued

However, I am acutely aware that UK savers have continued to suffer as a result of measures taken by the authorities to support growth and stave off any threat of deflation and economic contraction. Savers are vital to the UK's continued recovery, providing the funds which can then be lent to borrowers to support a sustainable housing market and economy, a point that I have frequently made to policymakers during my tenure as Chairman of the Building Societies Association trade body.

Promoting homeownership

Conversely, the Funding for Lending Scheme had a favourable impact on the pricing of new mortgage products. Although UK gross residential mortgage lending increased by 21%, according to Bank of England data, the increase in net lending was less than 1%, implying that whilst activity levels showed renewed life in the mortgage market, the overall size of the market remains stagnant. I am, therefore, pleased to report that Skipton's mortgage book grew by 9.2%, as we helped 14,109 homeowners to purchase or remortgage their properties, including 2,283 first time buyers. We achieved this without relaxing our lending policy for the maximum loan-to-value ratio (90%) we will grant. The rental market remained strong and 17% of our new lending was on buy-to-let mortgages.

Subsidiary performance

Our Estate Agency division, the Connells group, saw non-interest income increase by 13% to £281.9m, and pre-tax profits rise by 41% to £50.2m. House sales increased by 23% compared to 2012, helped by an improving housing market. Strong performances were seen in most areas of the Connells group, reflecting investments made in recent years, with income from mortgage services growing by 20%, survey and valuation up 16%, and lettings up 20%.

Our Financial Advice division, comprising our three financial advice companies Skipton Financial Services, Pearson Jones and Torquil Clark, achieved pre-tax profits of £3.9m, compared to a loss of £0.9m for the year ended 31 December 2012. Although income reduced by 9% to £40.5m, careful cost control and the release of provisions previously made for customer redress resulted in total costs reducing by £8.7m.

Our Mortgage Services division, principally mortgage servicer Homeloan Management Limited, achieved £0.9m in profit, similar to 2012, in an ongoing subdued marketplace, with income down 3% to £58.6m.

The Investment Portfolio reported a pre-tax profit of £20.5m, due to the one-off gain from the flotation of Wynyard. Within this division, Skipton Business Finance and The Private Health Partnership (PHP) continue to trade profitably, however the division's results were impacted in 2013 by revenue investment in Wynyard in advance of its listing and the write down of the carrying value of one of PHP's subsidiaries.

Further rationalisation of the Group took place during the year with the disposal of Sterling International Brokers and Mutual One.

Cost control

In 2013, we reduced the overall Group cost income ratio to 79.3% from 83.9%. We remain ever vigilant on controlling costs, however total Group administrative expenses for the year increased to £455.3m, up 11% from £410.1m in 2012. A key driver of this increase was an £18.9m increase within Connells, due to increased business volumes and further investment in mortgage services and lettings capability. Also included within Group administrative expenses is goodwill impairment of £16.6m (2012: £nil) and the cost of the Connells management incentive scheme of £7.7m (2012: £nil).

The Mortgages and Savings division saw expenditure rise by £7.0m to support the growth in the business and as a result of the investments in customer service and people mentioned above, together with the costs of us further strengthening our compliance and risk management capability to address the ever increasing regulatory demands. Consequently, the management expense ratio of the Mortgages and Savings division increased to 0.59% from 0.55% per £100 of mean assets.

We also increased the average number of people employed by the Group in the year by 262 to 8,700.

Conclusion and outlook

2013 was a very successful year for Skipton Building Society. We delivered strong profits and further strengthened our capital and the Society is now in robust health after a difficult trading environment in recent years. We are ever mindful of the impact of the low interest rate environment on savers but the Society's competitiveness is demonstrated by a strong growth in retail balances.

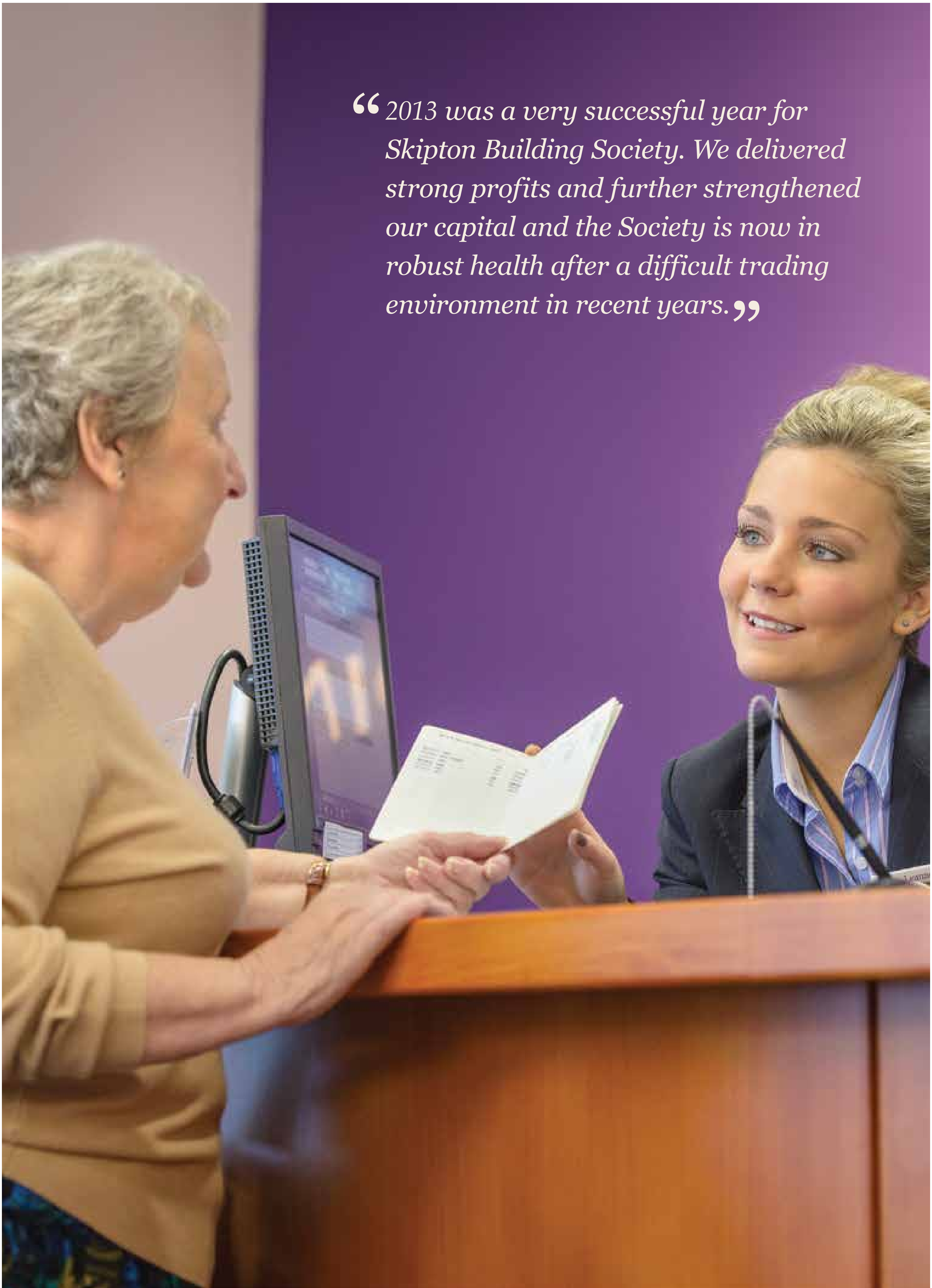
There are now sufficient signs to indicate that economic recovery is underway in the UK but many uncertainties remain, in particular any impact from government measures used to reduce its borrowing, weaknesses in many Eurozone economies and the consequences of actions taken by central banks around the world to extricate the markets from the extraordinary measures of support provided in recent years.

However, Skipton Building Society is well positioned to face such uncertainties and continue to provide a rewarding and compelling proposition to our members, in line with our vision of 'Building a Better Society'.

David Cutter

D J Cutter
Group Chief Executive
25 February 2014

“2013 was a very successful year for Skipton Building Society. We delivered strong profits and further strengthened our capital and the Society is now in robust health after a difficult trading environment in recent years.”



The Board of Directors

David Cutter 52

Joined Board 2000

Responsibilities: Group Chief Executive, Chairman of the Executive and Retail Credit Committees and member of the Asset & Liability and Board Risk Committees.

Previous experience: A Chartered Accountant, joined the Society as Head of Internal Audit.

Other roles: Chairman of the Building Societies Association and Governor of Malsis School.

What I bring to the Board: 20 years' experience working in many areas of the business, including periods as Operations Director and Group Corporate Development Director.

Mike Ellis 62

Joined Board 2011

Responsibilities: Chairman of the Board and Nominations Committee.

Previous experience: Held various senior executive positions with Halifax Building Society and its successor Halifax plc. Board member of Halifax plc 1997-2001 and HBOS plc, where he was Group Finance Director from 2001-4 and 2008-9.

Other directorships: M H Ellis Consulting Limited.

What I bring to the Board: Over 25 years' experience in financial services.

Cheryl Black 55

Joined Board 2013

Responsibilities: Member of Audit and Nominations Committees.

Previous experience: Senior customer service and operations roles at Orange and NTL, member of Scottish Water Board 2006-11, Customer Service Director for Telefonica O$_2$ 2006-11.

Other major directorships: Non-Executive Director at Southern Water Services Ltd, Director of Telefonica UK Pension Trustee, Non-Executive Board Adviser to EDF Energy Nuclear Generation Ltd.

What I bring to the Board: I'm passionate about using great customer service as a route to business success.

Marisa Cassoni 62

Joined Board 2012

Responsibilities: Chairman of Audit Committee and member of Nominations Committee.

Previous experience: Group Finance Director of John Lewis Partnership, senior positions at Royal Mail, Britannic Assurance and the Prudential.

Other major directorships: Non-Executive Director of GFI Group Inc.

What I bring to the Board: Chartered Accountant with 40 years' experience as a financial professional and 20 as a Board director across various industries including financial services.

Ian Cornelius 45

Joined Board 2012

Responsibilities: Commercial Director, member of the Executive Committee, Chairman of our subsidiaries Amber Homeloans Limited and North Yorkshire Mortgages Limited and member of the Skipton International Limited Board.

Previous experience: Commercial Director of Homeloan Management Limited (HML), senior roles at Virgin Money, Bradford & Bingley, Capital One and Boots.

What I bring to the Board: A strong and clear focus on customers ensuring that we continually improve our products and services.

Robert East 53

Joined Board 2011

Responsibilities: Member of Risk, Nominations and Remuneration Committees.

Previous experience: Senior roles in retail and commercial banking with Barclays PLC.

Other major directorships: Chief Executive of Cattles Limited.

What I bring to the Board: Extensive experience in, and understanding of, retail and commercial banking in the UK and internationally over 35 years.

Mark Fleet 50

Joined Board 2011

Responsibilities: Distribution Director and member of the Executive Committee. Chairman of HML and all three financial advice subsidiaries.

Previous experience: Managing Director of Skipton Financial Services Limited, our financial advice subsidiary. Senior distribution, customer services and credit management roles in subsidiaries of Standard Chartered Bank, Lloyds TSB and Bank of Ireland.

What I bring to the Board: A passion for delivering great service through great people.

Peter Hales 67

Joined Board 2007

Responsibilities: Chairman of Board Risk Committee and member of the Nominations Committee.

Previous experience: Sales and Marketing Director of Norwich Union, Director of General Accident and CGU.

Other major directorships: Director of Unum Limited, Chairman of Sandringham Financial Partners Limited, Trustee of Chartered Insurance Pensions Scheme and member of Simply Biz PLC Advisory Board.

What I bring to the Board: Experience of working at a senior level in regulated financial services for over 25 years.

Graham Picken 64

Joined Board 2012

Responsibilities: Member of Audit, Risk and Nominations Committees and a Non-Executive Director of Connells Limited.

Previous experience: Senior positions at HSBC, including Executive Chairman of First Direct and Chief Executive of Forward Trust Group. Non-Executive Director then Chief Executive of Derbyshire Building Society, 2005-9.

Other directorships: Chairman of the FTSE listed HICL Infrastructure Company Limited.

What I bring to the Board: Wide experience of financial services and business management generally.

Helen Stevenson 53

Joined Board 2013

Responsibilities: Member of Remuneration and Nominations Committees.

Previous experience: 19 years with Mars Inc, Group Marketing Director of Lloyds TSB 2003-6, Chief Marketing Officer of Yell Group 2006-11.

Other directorships: Non-Executive Director of St Ives PLC, Non-Executive Director of Trinity Mirror PLC and member of Henley Business School Advisory Board.

What I bring to the Board: A passion for maintaining a strong connection in the board room between the customer and commercial agendas.

Peter (Nimble) Thompson 67

Joined Board 2009

Responsibilities: Deputy Chairman, Chairman of the Remuneration Committee and member of the Audit and Nominations Committees.

Previous experience: Senior Partner and then Deputy Chairman of Eversheds before retiring in 1999.

Other directorships: Deputy Chairman of the Institute of Directors and a number of other Non-Executive positions.

What I bring to the Board: I try to bring a straightforward, common sense approach, backed by a wide business and legal experience.

Richard Twigg 49

Joined Board 2002

Responsibilities: Group Finance Director, Chairman of Asset & Liability Committee, member of Executive and Retail Credit Committees, Chairman of Skipton International Limited and responsible for Investment Portfolio.

Previous experience: Chartered Accountant and Finance Director of our subsidiaries HML and Connells Limited.

Other directorships: Trustee of Society's Charitable Foundation and Chair of Governors of Menston Primary School, Director of Wynyard Group Limited.

What I bring to the Board: Group-wide understanding from 20 years working in the Society and our major subsidiaries.

Strategic Report and Business Review

Business model and Group strategy

Skipton Building Society is the UK's fourth largest building society, with £14.5bn of assets and a national presence of branches and agencies. The Skipton Group 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 Board is the chief operating decision maker and reviews the Group's operating results 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 and the UK through Skipton International Limited (SIL). The division also includes the Group's special purpose vehicles (SPVs), Darrowby No. 1 plc and Darrowby No. 2 plc, formed to acquire funds from wholesale markets, 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.

Our objectives and strategic priorities

The Building Society is at the heart of our business and is the key member of the Mortgages and Savings division. The Society is complemented by its group structure, within which subsidiary companies operate in activities generally related to financial services.

Core Strategy

Our strategy remains largely unaltered from previous years as we believe it to be the basis for a sustainable future. Our success is based on our long term strategy of delivering value to our members through our products and services. We are committed to mutuality because we believe that this is in the best long term interests of our members. Whilst there are drawbacks in the ability to raise external capital, our mutual status does provide us with the advantage that we do not need to maximise our profits to pay shareholders; instead, we focus on supporting our members, generating sufficient profit to maintain a strong balance sheet and take longer term decisions to invest in the future development of the business.

Our primary purpose remains to provide a secure home for our customers' savings which allows the Society to lend to borrowers and enable homeownership. Our core retail members continue to be those people who are moving 'to and through retirement' and we aim to fully understand their financial needs and provide a suite of products to help them towards a worry free retirement. In order to achieve our vision of 'Building a Better Society' we have adopted strategic plans that focus on defined medium term objectives. Our plans are focussed on the following four objectives:

1. Our Customers

Our strategy aims to put the customer at the heart of our business, provide a compelling and differentiated proposition that resonates with our target customers and make them want to become and remain Skipton customers. In order to achieve this, we will continue to invest in developing a deep understanding of the needs of our target customers through research and feedback. We will use this insight to continually refine, develop and improve the products and services that we offer. SFS remains integral to the core Society business,

providing a high street presence through financial planning managers based in the Society branches.

2. Our People

Our plans and strategies are delivered by our people. Our customers want us to be highly engaged, high performing and have a customer-centric culture. To achieve this, we will continue to develop our leaders, identify talent and put development in place, monitor our employee engagement, develop our remuneration strategies and put actions in place where areas of improvement are identified. In particular, we will focus on further developing the skills that our customer-facing people already have in listening to the customer.

3. Our Processes

We will focus on getting things right first time and on quality to ensure a consistent customer experience, putting good customer outcomes as the priority. We will continue to train our people in efficient processes and encourage an environment where existing processes are challenged and improved.

4. Our Financial Strength

Financial strength is fundamental to us being here for our members over the long term. Growing our profits allows us to invest in our business in order to deliver value to our members through consistently good products and services. Therefore, a key strategic objective is to achieve a sufficient level of profitability to continue to be able to grow whilst at the same time building an increasingly strong Common Equity Tier 1 (CET 1) ratio.

Managing liquidity and capital remains important in the current regulatory and economic environment. We will continue to enhance and embed our credit risk models to ensure effective pricing, provisioning and use of capital, and aim to achieve IRB status following submission of our waiver application during 2014. In addition to any capital benefit, this will provide us with better tools to understand the dynamics of our existing loan books, and improve pricing capability and arrears management strategies in an anticipated more competitive market.

The Society will continue to grow organically in the medium term but, as capital is generated through higher profits and dividends from subsidiaries, we will investigate possible inorganic growth where there is strategic value to our members.

We will continue to run off the legacy mortgage assets within Amber and NYM and seek to exploit opportunities to sell tranches of these assets where it makes commercial sense from a risk management / capital absorption / profitability perspective. SIL will also continue to grow in a controlled manner, in both the retail savings and residential mortgage markets in the Channel Islands, complemented by a small amount of buy–to-let lending on UK properties, and is expected to remain a significant contributor to the Mortgages and Savings division's performance.

Divisional Strategy

Our subsidiaries remain strategically important to the Society, and were important during the Global Financial Crisis when the core business' performance was poor, and the most significant contributor was Connells. Connells intends to grow its profits through further investment in its financial services capability and lettings opportunities. Likewise, HML will investigate new markets and opportunities as it seeks to grow revenues.

The remaining subsidiaries are less significant contributors to the Group's overall results and we will continue to manage these to deliver optimum performance whilst at the same time reviewing their continued relevance to the Group. During 2013 we disposed of Sterling International Brokers and Mutual One and we are working towards the closure of Bailey Computer Services in the first half of 2014. We shall continually review the relevance of our investments in subsidiary companies for the Group's future.

Key performance indicators (KPIs)

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

Financial KPIs

Key performance indicator	Why?	2013	2012 Restated*	2011	2010	2009
Group pre-tax profit from continuing operations	Provides the capital to enable the business to develop.	**£102.5m**	£35.4m	£22.2m	£35.0m	£18.0m
Group net interest margin (% of mean assets)	Demonstrates the ongoing earning potential of the business.	**1.01%**	0.61%	0.52%	0.37%	0.36%
Group cost income ratio	Managing costs is essential in ensuring that we increase efficiency across the business.	**79.32%**	83.88%	85.55%	89.50%	87.24%
Group impairment charge on loans and advances to customers	Indicates the level of delinquency within the loan portfolio.	**£21.5m**	£12.3m	£30.0m	£14.8m	£43.6m
Gross mortgage advances	Prudent controlled lending ensures the long term security of the business.	**£2,415.4m**	£1,483.7m	£1,699.7m	£492.8m	£407.0m
Group capital adequacy measures:	Maintaining a strong capital base ensures the Group remains financially strong.					
Core Tier 1 ratio		**12.32%**	11.08%	10.53%	11.06%	9.37%
Tier 1 ratio		**13.77%**	12.59%	12.02%	12.64%	10.77%
Tier 1 capital (before deductions)		**£1,026.2m**	£948.2m	£923.0m	£909.9m	£873.1m
Tier 1 capital (after deductions)		**£852.0m**	£752.0m	£726.3m	£719.0m	£690.9m
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		**18.61%**	21.10%	24.79%	27.75%	28.95%
Core liquidity buffer		**£1,186.8m**	£1,240.2m	£1,236.8m	£1,902.4m	£1,501.1m
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.	**84.63%**	83.07%	80.21%	82.37%	79.42%

* During the year, the Group has adopted IAS 19 (revised 2011), *Employee Benefits*, as detailed in notes 1a) and 41. If the revised standard had applied in 2012, Group net non-interest income would have been £1.0m lower than previously stated, with an equivalent increase in Other Comprehensive Income. The 2012 comparatives included in these financial statements have been restated accordingly, however the 2009 to 2011 comparatives included in the table above have not been restated as any restatement would not be material.

The Group's Financial KPIs are reviewed further on pages 17 to 27.

Non-Financial KPIs

Customer measures

Developing the relationship with our customers and ensuring we meet their needs is vital to our success. During 2013 we implemented a Customer Experience Measurement programme, in order to drive a deeper understanding of customer expectations and their experience of dealing with the Society. This explores both satisfaction with the overall relationship, and with specific interactions ('events'). The 'event' feedback is provided at an individual branch, online, and Skipton Direct team level to ensure that it is specific, actionable and highly targeted.

During 2013, we achieved a net satisfaction score of 86% in terms of the overall relationship with the Society. We also saw significant improvements in satisfaction at an 'event' level during the course of the year, achieving satisfaction levels of 93% for branch, 88% for Skipton Direct and 65% for online in the last quarter of the year (based on those giving a score of 6 or 7 out of 7).

The Society has also focussed on retaining customers and attracting new customers in the year in order to grow our customer base after almost four years of declining numbers. 2013 saw a substantial net increase in our customer numbers with net growth of 21,046 customers (2012: net loss of 13,566), over 7,000 of which were savers.

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 to the Society and its aims. We therefore measure employee engagement, through the use of employee surveys, which also provides 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 2013 improved to 83% (2012: 80%), which is above the Towers Watson financial services benchmark of 70-75%.

Employee diversity

The Society is committed to the principles of diversity. We aim to create an environment where the contributions of all our people are recognised and valued, to provide a working environment that promotes dignity and respect to all, is safe and accessible, free from unfair treatment, discrimination and harassment and gives fair access to learning, development, reward and promotion opportunities. We therefore have a range of policies and practices which support these aims and monitor their application.

The number of employees of each sex employed as at 31 December 2013 is outlined below:

	Male	Female	Total
Directors	9	3	**12**
Senior managers	77	28	**105**
Other employees	3,702	4,994	**8,696**
	3,788	**5,025**	**8,813**

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 41 to 46 and in notes 35 to 37.

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

Financial overview

The Group profit before tax in 2013 was £102.5m (2012: £35.4m), up £67.1m year-on-year, mainly driven by a continued improvement in the performance of the core Mortgages and Savings division, together with another strong performance from our estate agency subsidiary, Connells and the one-off benefit arising from the flotation of one of our New Zealand based businesses, Wynyard Group Limited. We have also written down the carrying value of a number of our subsidiaries by providing £16.6m (2012: £nil) against goodwill arising on consolidation, following a review of their current performance and future trading expectations.

We continued to focus on improving the performance of the core Mortgages and Savings division. A combination of increased mortgage lending, together with ongoing reduced funding costs since the introduction of the Funding for Lending Scheme (FLS) in 2012, resulted in the Group net interest margin increasing to 1.01% (2012: 0.61%). The improved net interest margin was also key to the significant improvement in the pre-tax profits of the Mortgages and Savings division which increased to £50.4m (2012: £4.5m), despite a year-on-year increase in the division’s charge for impairment losses on loans and advances to customers to £21.4m (2012: £12.1m) as, in particular, we reviewed the provisions held against our equity release mortgage portfolio.

Our estate agency business, Connells, once again delivered strong results reporting pre-tax profits of £50.2m (2012: £35.6m) as the UK housing market continued to improve and its number of house sales increased 23% year-on-year. Our Financial Advice division reported pre-tax profits of £3.9m (2012: loss of £0.9m) with no repeat of the provisions for compensation being required against past business cases in 2012, and a better than anticipated Stock Market performance during the year; whilst the Mortgage Services division produced a pre-tax profit of £0.9m in 2013 (2012: £0.8m), as it continued to rationalise and refine the business to better position it for success in an evolving market.

During the year, our New Zealand based software development company, Jade Software Corporation, first separated its risk management and intelligence business, Wynyard Group, which then raised capital through an Initial Public Offering on the New Zealand Stock Exchange, generating a profit for the Group of £24.8m.

Our capital and liquidity position allowed us to continue to increase our lending in a controlled and prudent manner and gross mortgage advances in 2013 were £2,415.4m (2012: £1,483.7m) and, despite allowing excess liquidity to fall further during the year, total assets increased by 5% to £14,486.7m (2012: £13,760.2m). The profits for the year resulted in our Core Tier 1 capital ratio increasing to 12.3% (2012: 11.1%).

Strategic Report and Business Review

Continued

Financial performance

Total Group pre-tax profits for 2013 were £102.5m (2012: £35.4m) as set out in the table below:

	2013 £m	2012 £m
Net interest income	**142.6**	84.2
Net non-interest income	**427.5**	401.1
Fair value gains on financial instruments	**3.9**	3.6
Share of profits from joint ventures and associates	**1.3**	1.6
Dividend income from equity share investments	**1.1**	-
Profit on disposal of subsidiary undertakings	**24.7**	-
Total income	**601.1**	490.5
Administrative expenses	**(455.3)**	(410.1)
Operating profit before impairment losses and provisions	**145.8**	80.4
Impairment losses on loans and advances to customers	**(21.5)**	(12.3)
Impairment losses on debt securities	**(1.2)**	(4.0)
Provisions for liabilities	**(20.6)**	(28.7)
Profit before tax	**102.5**	35.4
Taxation	**(26.2)**	(8.8)
Profit after tax	**76.3**	26.6

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 1.01% from 0.61% in 2012.

The interest margin benefitted, throughout the year, from higher than expected mortgage margins on new business, as the market slowly recovered during 2013. We have continued to offer competitive products to both existing and new borrowers.

We continued to focus on offering fair rates to our savers throughout the year. However, with the market demand for funding reduced as lenders took advantage of various government initiatives, our retail funding costs were significantly below expectations, despite us increasing balances during 2013.

Our successes in growing retail balances, together with access to the FLS meant that our wholesale funding requirements were low, and we had no requirement to carry out any other secured funding transactions. Similarly, our liquidity management throughout the year allowed us to steadily reduce our levels of liquidity, which reduced the negative impact on the interest margin.

Net non-interest income

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

The Group's other income for the year was up 7% to £427.5m (2012: £401.1m). Estate Agency income increased by £31.4m year-on-year driven largely by a 23% increase in the number of properties sold by Connells, together with 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 £2.0m. The Financial Advice division continued to improve revenue during the year but its income was impacted as we further invested in training employees to be able to operate compliantly and remain customer focussed in the changing regulatory climate. The decrease in revenue in the Investment Portfolio is a result of the disposal of Sterling International Brokers in February 2013 and Mutual One in August 2013.

Net non-interest income by division is set out below:

	2013 £m	2012 £m
Mortgages and Savings	**19.2**	17.7
Estate Agency	**281.9**	250.5
Mortgage Services	**58.6**	60.6
Financial Advice	**40.5**	44.5
Investment Portfolio	**33.0**	35.2
Inter-divisional adjustments*	**(5.7)**	(7.4)
	427.5	401.1

* 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 20 to 22.

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 £3.9m (2012: £3.6m) 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.

Profit on disposal of subsidiary undertakings

On 25 February 2013, the Group sold the business of Sterling International Brokers at its written down book value and as a result no profit or loss was recognised on sale.

On 19 July 2013, Wynyard Group, part of the Group's Investment Portfolio, raised funding by way of an Initial Public Offering on the New Zealand Stock Exchange which resulted in the Group's shareholding decreasing to 24.5%. Following the Group's reduction in its shareholding, Wynyard is accounted for as an associate under the equity method of accounting. This created a deemed disposal generating a profit to the Group (before tax and non-controlling interests) of £24.8m.

On 9 August 2013, the Group sold its entire holding in Mutual One Limited resulting in a loss on sale of £0.1m.

Administrative expenses

Total administrative expenses increased by 11% during 2013 to £455.3m (2012: £410.1m). Whilst all entities within the Group continue to focus on managing costs, inflationary pressures and an ever increasing need to invest further in regulatory compliance has produced upward pressure on expenditure. Additionally, the investments made by the Estate Agency division in its lettings capability and mortgage services headcount have increased the Group's cost footprint, although these are now beginning to generate revenue growth. Also included within Group administrative expenses is goodwill impairment of £16.6m (2012: £nil) and the cost of the Connells management incentive scheme of £7.7m (2012: £nil).

The Society continues to manage costs and improve efficiencies, where it can, but the above pressures, along with additional investment in our customer proposition, have resulted in its ratio of administrative expenses to mean assets increasing to 0.50% (2012: 0.44%). At a Group level, this management expense ratio is less comparable, given our many trading businesses, therefore we focus on the cost income ratio. Cost management across the Group, together with a rise in income, saw the Group cost income ratio improve in the year from 83.88% to 79.32%.

	2013 %	2012 %
Society management expense ratio	**0.50**	0.44
Group management expense ratio	**3.22**	2.96
Group cost income ratio*	**79.32**	83.88

* Administrative expenses as a percentage of total income before share of profits from joint ventures and associates, dividend income from equity share investments and profit on disposal of subsidiary undertakings.

Impairment losses on loans and advances to customers

The Group's impairment charge on loans and advances to customers was £21.5m (2012: £12.3m) and is broken down as follows:

	2013 £m	2012 £m
Residential mortgages	**7.5**	8.9
Equity release mortgages	**8.3**	0.5
Commercial and other loans	**5.7**	2.9
	21.5	12.3

The overall increase in the impairment loss charge is largely due to an £8.3m (2012: £0.5m) charge against the Society's equity release portfolio, acquired when we merged with Scarborough Building Society in 2009. Losses on this portfolio are a function of the interrelationship between long term house price rises and retail price inflation, and during the year, we have revised our assumptions of these metrics.

The performance of the Society's prime residential mortgage book remains good and arrears levels within the specialist residential mortgage portfolios held in Amber and NYM have also fallen. Consequently, the year-on-year charge for residential loan impairment has fallen.

Whilst the arrears levels within our commercial lending portfolio remain low, ongoing pressures on commercial property values led us to review the levels of provisions held against these loans and consequently increase the amount set aside for future losses.

Impairment losses on debt securities

The Society continues to run off its legacy treasury investments and only invests in high quality liquid assets. We continue to review the carrying value of this portfolio and during the year have provided £1.2m (2012: £4.0m) against 2 (2012: 1) treasury assets, where recovery in full of the principal amount appears doubtful. The quality of the remaining treasury portfolio remains good.

Strategic Report and Business Review

Continued

Provisions for liabilities

Provisions for liabilities amounted to £20.6m (2012: £28.7m) and relate to items such as claims against Connells' Survey and Valuation division, customer compensation within our Financial Advice division, MPPI claims in our Mortgages and Savings and Estate Agency divisions, provisions against the cost of surplus properties, and our share of the costs of the Financial Services Compensation Scheme (FSCS).

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 together with the second of three years' charges for anticipated losses on realisation of Icelandic banks' and Dunfermline Building Society's lending assets. The Financial Advice division is also subject to levies for particular market events such as the failure of Keydata. The total Group charge amounted to £7.7m (2012: £7.5m).

The remaining provisions made in the year amounted to £12.9m (2012: £21.2m). The table below provides a further breakdown of the total charge:

	2013 £m	2012 £m
FSCS levy	7.7	7.5
Provision for the costs of surplus properties	0.9	2.3
Commission clawbacks / rebates	5.4	6.2
Survey and valuation claims	3.1	8.4
Customer compensation	1.7	3.7
Other provisions	1.8	0.6
	20.6	28.7

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

Taxation

The Group's effective tax rate is 25.9% (2012: 26.0%) compared with the standard rate of UK Corporation tax of 23.25% (2012: 24.5%). The major impacts on the effective rate for the year are goodwill impairment and the costs of the Connells management incentive scheme which are not deductible for tax purposes, as well as the reversal of a deferred tax asset on losses previously recognised. However these are offset by non-taxable income, which mainly arises from the gain made on the Wynyard flotation (see note 17d), and the impact of lower tax rates in overseas jurisdictions.

The future reduction in the UK Corporation tax rate to 21% effective from 1 April 2014, and subsequently to 20% from 1 April 2015, results in a credit of £0.4m to the Income Statement and a charge of £1.8m to Other Comprehensive Income, giving an overall net charge of £1.4m in respect of the Group's net deferred tax asset.

Performance by business area

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

Business area	2013 £m	2012 £m
Mortgages and Savings	50.4	4.5
Estate Agency	50.2	35.6
Mortgage Services	0.9	0.8
Financial Advice	3.9	(0.9)
Investment Portfolio	20.5	(3.9)
Sundry, including inter-divisional adjustments*	(23.4)	(0.7)
Profit before tax	102.5	35.4

* Sundry, including inter-divisional adjustments relate primarily to the elimination of intra-divisional trading, the write down of goodwill arising on consolidation relating to subsidiary investments, and the cost of the Connells management incentive scheme.

Mortgages and Savings

The Mortgages and Savings division made a profit before tax of £50.4m, compared to a pre-tax profit of £4.5m in 2012, an improvement of £45.9m.

The key driver of the improvement has been an increase in net interest income to £140.8m, up from £81.9m in 2012 with net interest margin increasing by 41bps to 1.01% from 0.60% in 2012.

The improvement in net interest income has arisen from a reduction in the cost of acquiring retail savings during the course of 2013, reflecting market conditions driven largely by the introduction of the FLS in 2012, and strong retention of existing savings balances and customers due to competitive rates offered across our range of savings accounts.

In addition, we have increased gross mortgage lending by 63% during 2013, whilst maintaining new business margins through the ongoing development of strong relationships with our broker partners.

Net interest income has also benefitted from lower liquidity carrying costs during the year, reflecting the reduction in liquidity balances held in 2013 compared to the levels held in 2012. Liquidity levels remain prudent relative to both internal and regulatory requirements but have been reduced in line with the more stable funding environment seen during 2013.

Other income increased in the year to £19.2m (2012: £17.7m) and includes a one-off gain of £2.6m (2012: £nil) following the capital buy back exercise undertaken in December 2013. Excluding this, underlying other income is down 6% primarily due to a fall in income derived from investment product sales.

Costs have increased to £81.9m, up £7.0m on 2012, some of which are as a result of the volume growth seen during 2013, whilst productivity improvements have helped offset further investment in our customer proposition and increased regulatory costs.

Impairment charges on loans and advances to customers increased by £9.3m, reflecting an increase of £8.3m (2012: £0.5m) in the provision held against our equity release portfolio following a revision to our long term assumptions of house prices and inflation, and a £2.9m increase in the provisions charge against commercial loans compared to 2012. Provision charges on residential lending (excluding equity release) reduced to £7.5m (2012: £8.9m), due to declining arrears and delinquency.

Impairment charges in relation to debt securities have reduced by £2.8m to £1.2m, with impairment being taken on two treasury assets.

Other provisions for liabilities increased from £7.7m to £8.9m, and comprise principally the FSCS levy of £7.2m (2012: £6.1m), together with MPPI costs and provisions for the cost of closed branches or vacant investment properties.

The focus of Amber and NYM remains to manage the level of arrears in these portfolios through proactive collections processes which ensure good customer outcomes whilst, at the same time, managing down the mortgage assets. Collectively, these businesses made a profit before tax of £7.4m compared to a loss of £0.9m in 2012, driven by lower funding costs and reducing arrears and mortgage losses. Arrears balances reduced by 20% during 2013, whilst the aggregate mortgage balances continued to reduce, in 2013 by £138.6m to £1,592.5m, from £1,731.1m a year ago.

Our Channel Islands operation, SIL, made a profit before tax of £8.7m, up from £5.8m in 2012. SIL has continued to grow its mortgage book with mortgage assets in Guernsey and Jersey increasing by £67.8m in the year to £689.4m (2012: £621.6m). The quality of this book remains good. SIL also increased its savings balances by 8% to £783.5m (2012: £725.7m), which represent 113.6% of its loans (2012: 116.7%).

Estate Agency

The Estate Agency division's income was up 12.5% to £281.9m (2012: £250.5m) and it achieved a profit before tax of £50.2m in the year (2012: £35.6m), representing growth of 41%. 2013 has seen an upturn in activity in the housing market buoyed by new initiatives such as 'Help to Buy' and FLS which increased the appetite of banks and building societies to lend. Increased demand levels and a relative shortage in supply of new properties coming to the market inevitably led to house price growth, which was in evidence across most of the UK since the end of the Spring period. This combined with attractive mortgage rates fuelled higher demand from buyers towards the latter stages of the year.

Connells started the year with a similar sales pipeline to 2012, however through a range of initiatives the business managed to increase instruction volumes in 2013. This was a good achievement in a competitive marketplace and, together with the increased buyer demand, led to sales volumes being up 23% on 2012.

The Connells group has a diversified range of income streams, and continues to invest in its lettings, mortgage services and surveying businesses.

Connells Survey and Valuation made further investment in surveyor numbers, new technology and support infrastructure during 2013, and is well positioned to secure an increased market share. In previous years the Connells group has also invested in recruiting more mortgage consultants. In 2013 the returns on this investment were realised with a 38% increase in the number of mortgages the group arranged for its customers. This has been assisted by a greater availability of mortgage products and increased competition between lenders. Likewise, the Connells group continues to invest in its letting capability, and income in this part of its business increased by 20% during the year.

Connells owns a 4.9% (2012: 4.8%) shareholding in the property search provider Zoopla Group Limited, which was revalued during the year from its cost of £1.9m to an estimated fair value of £35.1m. This unrealised gain has been recognised within Other Comprehensive Income and not within profit before tax in the Income Statement.

The Connells group maintains a tight control of costs and remains well placed to capitalise on the current market opportunities arising from the improved market conditions.

Mortgage Services

HML, which celebrated its 25th year in 2013, remains the leader in the UK third party mortgage administration services market, with a market share in the UK of around 62% (2012: 66%) and total assets under management of £37.2bn (2012: £39.3bn).

The Mortgage Services division recorded an operating profit (before restructuring costs) of £2.2m in 2013 (2012: £1.2m). After the costs associated with rationalising and restructuring the business, in order to better position it for success in an evolving market, the division recorded a profit before tax of £0.9m compared to £0.8m in 2012. The continuation of a subdued market in the areas that it services, meant HML experienced further contraction in its portfolio of assets under administration. A combination of HML's high quality credit management and a continuation of low interest rates saw client arrears reduce during the year which, whilst benefitting the client, does impact adversely on HML's income.

HML is committed to value enhancement by working with existing clients and 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 also winning new clients. Finally, in August 2013, Fitch announced that HML's UK residential primary (prime and sub-prime) servicer ratings had been upgraded from RPS2+ to RPS1-. This makes HML's prime servicer rating the highest of any third party mortgage administration company in the UK and Ireland, and its sub-prime servicer rating the highest in Europe.

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 primary focus in 2013 has been the transition for each business into the new Retail Distribution Review (RDR) world. Whilst Pearson Jones and Torquil Clark have remained 'independent', SFS has adopted a 'restricted' approach under the new guidelines. Each advisory firm continues to provide high quality advice within their chosen markets and specifically through SFS, provide Skipton Building Society customers access to a complementary range of products and services.

The division reported a profit before tax of £3.9m (2012: loss of £0.9m) which was a much improved performance in 2013 with all three businesses trading profitably. It is pleasing that clients transitioned to the new propositions post-RDR and each business increased funds under management by offering clients long term, high quality advisory services. The performance of the division has also been helped by a better than anticipated Stock Market performance which has benefitted both the division and more importantly our clients. We have also benefitted from the release of provisions made in 2012 for the expected costs of customer compensation. Following the conclusion of thorough customer reviews the requirement for such provisions was far lower than our original estimates.

Investment Portfolio

The pre-tax profit for the Investment Portfolio was £20.5m which is £24.4m above the prior year (2012: loss of £3.9m) and largely driven by the flotation of Wynyard. Skipton Business Finance (provider of invoice discounting) and The Private Health Partnership (PHP) (specialising in private medical insurance and medical support) have delivered robust underlying profits. During the year, two businesses, Sterling International Brokers (money market brokers) and Mutual One (internal audit and compliance specialist), were sold. Sterling, which struggled in difficult trading conditions during the financial crisis, was sold in February 2013 at its written down book value, and in August 2013, the Group sold its entire holding in Mutual One, resulting in a loss of £0.1m.

In order to finance the rapid expansion of Jade's intelligence and investigations business, Wynyard, this business was floated on the New Zealand Stock Exchange in July 2013 and a one-off profit of £24.8m on the deemed disposal was recognised in the Group. Following the listing, the Group retains a 24.5% stake in Wynyard and our Jade shareholding remained unchanged at 56.8%.

Excluding the profit on flotation of Wynyard, the division suffered a pre-tax loss of £4.3m, which is £0.4m worse than the prior year. The increase in the losses was due to the Group's share of Wynyard's trading losses, losses at Jade as it seeks to re-establish itself and an impairment in the carrying value of one of PHP's subsidiaries, primarily due to the loss of a significant client.

Inter-divisional adjustments

Inter-divisional adjustments relate to the elimination of intra-divisional trading, adjustments made to the carrying value of subsidiaries and the costs of the management incentive scheme for the senior managers at Connells Limited.

During the year we reviewed the carrying value of subsidiaries and, following a revision to future cash flows and based on the Directors' assessment of recoverable amounts, provided £16.6m (2012: £nil) against the carrying value of consolidated goodwill held against businesses within the Mortgage Services, Estate Agency, Financial Advice and Investment Portfolio divisions.

In December 2012, a new management incentive scheme was introduced for members of Connells Limited's senior management. Senior managers purchased equity shares in that 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 dates. The maximum option length is nine years, and the fair value of the liability is being spread over the period to exercise. During the year the Group recognised a charge of £7.7m (2012: £nil).

Financial position

Loans and advances to customers

The Group has increased its lending during the year but continues to lend in a controlled and sustainable manner. Group gross mortgage advances in the year totalled £2,415.4m (2012: £1,483.7m).

An analysis of gross mortgage advances is shown below:

	2013 £m	2012 £m
Society	**2,264.3**	1,357.1
Amber Homeloans*	**0.2**	0.7
North Yorkshire Mortgages*	**-**	0.1
Skipton International	**150.9**	125.8
	2,415.4	1,483.7

* 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 2013 the Society's average indexed loan-to-value (LTV) for the residential mortgage book was 49.6% (2012: 53.0%). 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 78.7% (2012: 83.2%) and 78.5% (2012: 82.8%) respectively; nevertheless these ratios have fallen during the year.

SIL grew its mortgage book in the year with gross residential mortgage advances totalling £150.9m (2012: £125.8m), however, the average indexed LTV has reduced marginally to 59.5% (2012: 60.4%) demonstrating our focus on managing our credit risk exposures.

Overall, the Group's average indexed LTV for the residential mortgage book reduced to 52.9% (2012: 57.0%).

The Group's total new advances on buy-to-let products, included in the figures above, also increased in the year to £411.0m or 17.0% of the Group's gross mortgage lending (2012: £185.8m or 12.5%). The risks attached to buy-to-let lending are managed by prudent consideration of the level of equity in the property, where we generally only accept lower LTV ratios compared with our other residential lending, and the level of rental cover compared with the mortgage payments.

The Group's portfolio of commercial loans fell by 6.5% during the year to £409.8m as this closed portfolio continues to run off and the Group's portfolio of equity release loans, acquired in 2009 when the Society merged with the Scarborough Building Society, increased by £4.5m to £270.7m due to the roll-up of interest into the capital balances.

Overall, the Group's loans and advances have increased by 9% to £11,416.7m from £10,456.1m at the end of 2012 as set out in the table below:

	2013 £m	2012 £m
Residential mortgages (including buy-to-let)	**10,636.1**	9,642.1
Equity release mortgages	**270.7**	266.2
Commercial loans	**409.8**	438.2
Other lending:		
Debt factoring loans	**58.9**	48.2
Other loans	**41.2**	61.4
Gross balances	**11,416.7**	10,456.1
Impairment provisions	**(59.1)**	(72.8)
Fair value adjustment for hedged risk	**159.3**	210.2
	11,516.9	10,593.5

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 1,088 cases (2012: 1,262 cases), representing 1.04% (2012: 1.30%) 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	**2013**	2012
Society		
Number of cases	**434**	406
% of Society book	**0.49%**	0.50%
Impairment provision on residential mortgages (including equity release)	**£23.5m**	£14.9m
Amber Homeloans		
Number of cases	**446**	588
% of Amber book	**5.96%**	7.24%
Impairment provision on residential mortgages	**£19.1m**	£24.6m
North Yorkshire Mortgages		
Number of cases	**205**	267
% of NYM book	**4.64%**	5.53%
Impairment provision on residential mortgages	**£5.7m**	£8.1m
Skipton International		
Number of cases	**3**	1
% of SIL book	**0.09%**	0.03%
Impairment provision on residential mortgages	**£0.2m**	-
Total		
Number of cases	**1,088**	1,262
% of total book	**1.04%**	1.30%
Impairment provision on residential mortgages (note 16)	**£48.5m**	£47.6m

The specialist nature of Amber and NYM mortgages means these portfolios typically have higher levels of arrears than those in the Society. However, action continues to be taken to manage their arrears including ceasing new lending in Amber and NYM in March 2008 and implementing proactive collections processes, and forbearance processes where appropriate.

The Group also stopped offering commercial loans in November 2008 and the book continues to run off. The quality of the Society's commercial book remains strong with just 9 (2012: 9) 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 0.52% (2012: 0.42%) 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 £689.4m at the year end (2012: £621.6m); the quality of this book remains good with only 3 (2012: 1) 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 37a) 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 37a) 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 2013 the percentage of residential mortgage balances subject to forbearance, on this basis, is 3.3% (2012: 4.3%). For commercial balances the percentage is 8.2% (2012: 7.0%).

Liquidity

Whilst we have managed levels of liquidity down during the year from 21.1% to 18.6% of shares, deposits and liabilities, 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:

	2013	2012
Liquidity balance	**£2,381.1m**	£2,531.8m
As % of shares, deposits and liabilities	**18.61%**	21.10%
Core liquidity buffer*- eligible assets	**£1,186.8m**	£1,240.2m
Core liquidity buffer* as % of liquidity balance	**49.84%**	48.98%

* 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 99.0% (2012: 99.6%) of the Group's treasury investments are rated A3 or better (as shown below):

Rating	**2013 £m**	2012 £m
Aaa	**436.9**	1,933.2
Aa1	**1,366.7**	26.0
Aa2	**143.1**	106.7
Aa3	**131.6**	104.1
A1	**22.1**	-
A2	**149.7**	188.5
A3	**106.9**	164.5
Baa1	**18.8**	2.0
Baa2	**-**	1.1
Baa3	**-**	1.8
Ba1	**1.7**	1.7
Ca	**1.6**	2.2
Unrated:		
Other	**2.0**	-
	2,381.1	2,531.8

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. The move of a significant proportion of the Group's treasury investment portfolio from Aaa to Aa1 during the year is due to the downgrade of the UK Government's bond rating during the year. All treasury investments are monitored for impairment on a regular basis.

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 the Asset and Liability Committee). We remain aware of the economic uncertainties in Europe and have restricted our lending to entities in the Eurozone accordingly.

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 which are based on observable market data.

The Society regularly conducts an Individual Liquidity Adequacy Assessment (ILAA) in accordance with the Prudential Regulation Authority's (PRA) liquidity guidelines and the Board remains satisfied that the Group has sufficient liquid assets at its disposal in order 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 with less reliance on the wholesale markets.

Retail funding

The launch of the Government's FLS in August 2012 has resulted in reduced price competition for retail funding. However, as a mutual building society, our focus has always been on offering competitive products to retain savings as the prime source of a stable funding base.

At 31 December 2013, £10,260.1m (2012: £9,462.4m) of our funding comes from retail savings representing 84.6% (2012: 83.1%) of our total funding. In 2013, balances increased due to strong retention of existing savings balances and attraction of new customers as a result of the competitive rates offered across our savings range.

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 PRA's current liquidity regime, SIL has maintained a stable retail funding base and offshore deposits increased to £783.5m (2012: £725.7m). These balances are included in 'Amounts owed to other customers' within the Group Statement of Financial Position.

Wholesale funding

The remainder of the Group's funding comes from the wholesale markets. At 31 December 2013 our wholesale funding balances amounted to £1,748.3m (2012: £1,810.5m), a decrease of £62.2m during the year.

During the year, the Society has accessed the Government's FLS scheme and at 31 December 2013 had drawn down £460.0m (2012: £nil).

As a result of the strong retail inflows seen during the period, the Group's wholesale funding ratio decreased to 15.37% at 31 December 2013 (2012: 16.93%).

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

	2013 £m	2012 £m
Repo and other secured agreements	**879.7**	733.0
Deposits	**313.8**	346.6
Certificates of deposits	**8.0**	19.1
Medium term notes	**41.8**	41.0
Securitisation	**505.0**	670.8
	1,748.3	1,810.5

	2013 £m	2012 £m
Repayable on demand	**113.8**	82.8
In not more than three months	**755.4**	347.7
In more than three months but not more than one year	**113.5**	289.5
In more than one year but not more than five years	**763.0**	1,023.4
In more than five years	**2.6**	67.1
	1,748.3	1,810.5

The Society's long term credit ratings assigned by two major credit rating agencies, Fitch and Moody's, remain unchanged at BBB- and Ba1 respectively, however Moody's moved the Society to 'stable' outlook from negative in December 2013. Our securitisations through Darrowby No. 1 plc and Darrowby No. 2 plc remain AAA rated by both agencies.

Capital

The PRA regulates the Group which is required to manage its capital in accordance with the rules and guidance issued by the PRA and, until 31 December 2013, was under Basel II regulations. 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 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 2013 under Basel II:

	2013 £m	2012 £m
Tier 1		
Reserves	**922.3**	827.7
Permanent Interest Bearing Shares (note 1)	**90.0**	90.0
Pension fund deficit add back (note 2)	**23.4**	13.6
Deductions from Tier 1 capital (note 3)	**(174.2)**	(196.2)
Unrealised (gains) / losses on available-for-sale debt securities	**(20.5)**	2.3
Unrealised losses on cash flow hedges	**11.0**	14.6
Total Tier 1 capital	**852.0**	752.0
Tier 2		
Subordinated debt (note 1)	**82.7**	188.9
Collective impairment allowance	**24.0**	11.1
Net gain from change in fair value	**26.0**	-
Total Tier 2 capital	**132.7**	200.0
Total capital	**984.7**	952.0
Risk weighted assets		
Retail mortgages	**4,257.3**	4,037.4
Commercial loans	**405.7**	434.6
Treasury assets	**282.6**	274.6
Other assets	**453.5**	471.0
Operational risk	**771.4**	751.0
Market risk	**16.9**	4.4
	6,187.4	5,973.0
Core Tier 1 (note 4)	**12.32%**	11.08%
Tier 1 ratio (note 4)	**13.77%**	12.59%
Total capital (note 4)	**15.91%**	15.94%
Tier 1 to Total capital ratio	**86.52%**	78.99%

Notes

1. Under PRA 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 PRA 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.

The principal driver of the increase in Tier 1 capital during 2013 was the Group's retained profits, which are accumulated within the general reserve. As noted elsewhere, during the year the Group tendered and repurchased £16.7m of subordinated debt and called and repaid a further £75m at its first call date; consequently reducing the amount of Tier 2 capital the Group has in issue. However, the Group's overall capital resources increased by £32.7m during 2013 and the quality, as measured by Tier 1 capital as a proportion of total capital, has also increased.

For statutory purposes, under Basel II until 31 December 2013, we were required to calculate our capital ratios for both the Solo consolidation group and the UK consolidation group. The Solo consolidation group comprised principally the Group's UK based mortgage lending businesses whilst the UK consolidation group consisted of the entire Group except a number of entities, including Connells, whose activities are not closely aligned with the core business of financial services.

The table below sets out the capital resources of the Solo and the UK consolidation groups, together with the associated minimum regulatory capital resource requirements, as at 31 December 2013. We continue to operate above the Pillar 1 requirement.

	UK consolidation group		Solo consolidation group	
	2013	2012	**2013**	2012
Capital resources	**£909.6m**	£931.8m	**£828.2m**	£852.2m
Minimum Pillar 1 capital resource requirement	**£448.9m**	£436.8m	**£414.4m**	£401.5m
Capital ratio	**202.6%**	213.3%	**199.9%**	212.2%

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

CRD IV capital and leverage ratio

From 1 January 2014, the Basel II regulation upon which the above capital calculations are based was replaced by the CRD IV regulation. CRD IV introduces a number of changes to the capital framework which impact how our capital is calculated. The impact of CRD IV in some areas is taken immediately, however in some cases the impact is being phased in under transitional arrangements up to 2022. Under the new framework the key level at which we monitor our capital is at a prudential consolidation group level. The prudential group comprises the entire Group except a number of entities, including Connells, whose activities are not closely aligned with the core business of financial services.

The capital ratios for the prudential group on a CRD IV transitional basis and 'fully loaded' basis as at 1 January 2014 are set out below. The fully loaded position represents the CRD IV end-point definition applicable from 1 January 2022.

The key impacts of the CRD IV transitional rules on capital resources are:

- The full pension deficit is recognised under CRD IV; under Basel II an amount equivalent to five years of contributions was recognised;
- A proportion of the deferred tax asset is deducted from CET1 under CRD IV;
- A proportion of the additional Tier 1 and Tier 2 instruments become ineligible as capital under CRD IV pursuant to the grandfathering rules, i.e. are phased out.

The key impacts on capital resources of the CRD IV fully loaded rules are as above for the pension deficit and deferred tax, however all existing additional Tier 1 and Tier 2 instruments that become ineligible as capital are excluded in full.

	Prudential consolidation group	
	01.01.14 Transitional	**01.01.14 Fully loaded**
Common Equity Tier 1 ratio (%)	**14.14**	**14.23**
Tier 1 ratio (%)	**15.43**	**14.23**
Total capital ratio (%)	**17.14**	**15.67**

Leverage ratio on CRD IV basis

The CRD IV regulations also include the introduction of a new capital leverage ratio defined as the ratio of Tier 1 capital to total exposure. Total exposure is the Group's total assets, adjusted for certain items. The current minimum limit for the leverage ratio has been set by the Basel Committee at 3%.

In January 2014 the Basel Committee set out a revised definition of the leverage ratio. We have applied this definition to calculate a leverage ratio at a prudential group level, being the key consolidation level at which will be regulated under CRD IV. The leverage ratio calculated on this basis is 5.6% as at 1 January 2014.

In order to provide a basis for comparison with leverage ratios previously reported, at a full Group level the leverage ratio, based on earlier CRD IV end-point definitions, was 5.3% (2012: 4.8%).

Pension funds

The Group operates five funded defined benefit schemes as described in note 29, in addition to defined contribution stakeholder schemes into which eligible employees are automatically enrolled. The aggregate valuation of the five defined benefit schemes at 31 December 2013 resulted in a deficit of £53.3m (2012: £45.1m) using the methodology set out in IAS 19.

We continue to take steps to manage this deficit, and all the schemes are closed to new members and future accrual of benefit. Special contributions totalling £24.4m have been paid into the schemes in the last five years. We have also undertaken a number of other initiatives aimed at managing the funding deficit and associated long-tail risk including early retirement exercises and enhanced pension transfer exercises which resulted in £20.8m of the liability being extinguished in early 2011 and a further £3.1m in 2013.

Additionally, we have taken action to reduce the volatility of growth assets held by the schemes and the Trustees have increased the level of hedging in place to protect the schemes against inflation.

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.

Strategic Report and Business Review

Continued

Outlook

Recent economic signs within the UK are encouraging and point to a recovery slowly gathering momentum, and we expect this improvement to continue during 2014. We also expect the mortgage and retail markets within the UK to continue to be influenced, during 2014, by the impact that the FLS will continue to have on lenders' demand for funds and the existence of the two government backed mortgage assistance schemes.

The UK mortgage market is expected to continue growing as the larger banks increase their lending and take advantage of government initiatives. Competition has already begun to intensify with new lending margins reducing due to the demand for good quality customers with low LTVs. We will continue to ensure our lending is balanced and within our credit risk appetite. Our mortgage strategy will directly impact our net interest margin and we will continue to balance attracting new business at the right prices, at the right volume and at the right credit risk, and manage our overall portfolio carefully.

We will fund the growth in our mortgage assets primarily by increasing retail funding, carrying out regular securitisations and only utilising the FLS funding as a tactical option whilst it remains available. We expect competition for retail funding to remain subdued during most of 2014 but to then increase as FLS funding is no longer available for drawdown. We expect the UK savings market to show only modest growth as consumers continue to favour paying down debt. Key to our long term success is growing our member base and we will aim to maintain our overall proportion of funding from retail at current proportions of total funding.

We will continue to manage customers in arrears sensitively, applying forbearance where appropriate to deliver good outcomes for both the customer and the Group. We are confident that the quality of our lending, together with the improving economy will continue to drive down arrears levels in the immediate future.

There remains uncertainty around the housing market recovery and whether government schemes such as the 'Help to Buy' scheme will create a housing bubble. Housing transaction volumes increased in 2013 and Connells have an increased sales pipeline compared to this time last year, however the threat of increasing interest rates and government intervention designed to cool an emerging bubble may dampen the housing market with a consequent impact on Connells. However, whilst sales volumes may decrease, in the absence of a severe recession, we believe that the shortage of supply of housing in the UK will protect house prices from significant falls and Connells will continue to perform well.

The Group has improved its profits during 2013, and we are confident that we will continue to provide value to an increasing number of customers, whilst at the same time further improving the financial strength of the Group.

R J Twigg

R J Twigg
Group Finance Director
25 February 2014

Directors' Report

The Directors have pleasure in presenting their Annual Report and Accounts for the year ended 31 December 2013.

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 2013 and 2012 is set out in the Strategic Report and Business Review.

Business objectives

The business objectives of the Group are set out in the Strategic Report and Business Review on pages 14 to 28.

Business Review and future developments

The Chairman's Statement set out on pages 6 to 7, Group Chief Executive's Report set out on pages 8 to 10 and the Strategic Report and Business Review set out on pages 14 to 28 report on the performance of the business and its future objectives.

Profits and capital

Total Group profit before tax for the year ending 31 December 2013 was £102.5m (2012: £35.4m). The profit after tax transferred to the general reserve was £76.3m (2012: £26.6m).

Total Group reserves at 31 December 2013 were £926.3m (2012: £833.7m) including the available-for-sale reserve of £20.5m (2012: £(2.3)m) and the cash flow hedging reserve of £(11.0)m (2012: £(14.6)m).

Gross capital at 31 December 2013 was £1,147.7m (2012: £1,155.5m) including £124.4m (2012: £223.9m) of subordinated liabilities and £94.1m (2012: £96.1m) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings at 31 December 2013 was 8.97% (2012: 9.63%) and the free capital ratio was 7.11% (2012: 7.31%). The Annual Business Statement on page 149 gives an explanation of these ratios.

Mortgage arrears

Group mortgage balances at 31 December 2013 included 363 mortgage cases (2012: 406), either in possession or where payments were 12 months or more in arrears. The capital balances of these loans were £70.8m (2012: £74.7m). The total amount of arrears on these loans was £6.0m (2012: £6.1m).

Charitable donations

During the year the Group made charitable donations of £0.3m (2012: £0.2m) primarily through the Skipton Building Society Charitable Foundation. No contributions were made for political purposes (2012: £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 2013 for the Group was 13 days (2012: 15 days).

Principal risks and uncertainties

The principal risks and uncertainties are set out in the Risk Management Report on pages 41 to 46 and in notes 35 to 37.

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.

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

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

Property, plant and equipment

The Directors consider that the overall market value of the Group's freehold and leasehold properties, excluding the principal offices of the Society and HML, is in excess of the book value. In arriving at this view the Directors 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' Report
Continued

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 60, 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 responsible for preparing the Annual Report, Annual Business Statement, Directors' Report and the Annual Accounts in accordance with applicable laws and regulations.

The Building Societies Act 1986 (the Act) requires the Directors to prepare Group and Society annual accounts for each financial year. Under that law they are required to prepare the Group Annual Accounts in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the Society Annual Accounts on the same basis.

The Group and Society Annual Accounts are required by law and IFRSs as adopted by the EU to present fairly the financial position and the performance of the Group and the Society; the Building Societies Act 1986 states that references to IFRS accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing these Annual Accounts, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; 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 Conduct 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 Group.

A copy of these 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 Conduct Authority and Prudential Regulation 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 Strategic Report and 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 Strategic Report and Business Review on pages 14 to 28 and the Risk Management Report on pages 41 to 46. In addition notes 34 to 37 of the Annual Accounts include 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, which take into account potential changes in trading performance and funding retention, indicate 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 P J S Thompson (appointed Deputy Chairman 31 July 2013)
Mrs C Black (appointed 1 March 2013)
Ms M Cassoni
Mr I M Cornelius*
Mr D J Cutter* (Group Chief Executive)
Mr R D East
Mr M R Fleet*
Mr P R Hales
Mr C N Hutton (former Deputy Chairman, retired 30 July 2013)
Mr G E Picken
Ms H C Stevenson (appointed 1 March 2013)
Mr R J Twigg*

* Executive Directors

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

No Director had any interest in the shares of any Group undertaking at 31 December 2013.

Auditor

In accordance with Section 77 of the Building Societies Act 1986, a resolution for the re-appointment of KPMG Audit Plc as auditor 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 auditor is 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 auditor is aware of that information.

By Order of the Board

M H Ellis
Chairman
25 February 2014

Directors' Report on Corporate Governance

The Board is committed to complying with best practice in corporate governance. This report provides a framework of how the Society operates and is important in ensuring the Society carries on its business for the benefit of its current and future members.

The approach is based on the principles and provisions of the UK Corporate Governance Code (the Code) published by the Financial Reporting Council (FRC) in June 2010, which applies to listed companies, to the extent that they are relevant to a building society. A copy of the Code is available at www.frc.org.uk. In the interest of transparency, the Prudential Regulation Authority (PRA) also encourages building societies to explain in their Annual Report and Accounts whether, and to what extent, they adhere to the Code. An updated version of the Code (the New Code) was published in October 2012 and applies to financial years commencing on or after 1 October 2012.

This Report sets out how the Board operates. The Board's philosophy is to comply with the Code, and the guidance issued by the Building Societies Association on the Code to the extent that they are relevant to a building society; however the Society does not fully comply with all aspects of the Code, where the Board considers such aspects to be not relevant to it, or it is impracticable to do so.

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 either the FCA and / or the PRA.

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 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.

Each principal subsidiary of 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' own executive management. In addition, independent Non-Executive Directors also sit on the Boards of a number of subsidiaries and Mr Picken, a Society Non-Executive Director has been appointed to the Board of Connells Limited during 2013. These Boards are responsible for the prudent management of the business, within delegated authorities, to meet the strategic and operational objectives as defined in the corporate plan.

The Board's Principles of Governance, 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 role of 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':

- **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.

- **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.

- **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.

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

Board meetings

The Board meets at least 10 times per year and the Non-Executive Directors also meet, without Executive Directors present, at least once a year. The attendance record of each director at these meetings and at relevant Board committee meetings is set out on page 36. The Board also holds two strategy meetings each year, in June and December.

At each Board meeting, the Board receives a comprehensive management information pack covering financial and non-financial information (including operational, customer service and people metrics) with risk being an integral part of each reporting item. The relevant Executive Director or General Manager highlights appropriate matters including the performance of particular aspects of the business against targets.

The Board agenda also includes the following:

- Minutes of Board committee meetings held since the previous Board meeting and verbal updates from the chairmen of Board committees on the main issues discussed and matters agreed. This ensures that all Board members are aware of the key discussions and decisions made by the committees; and
- Items for decision and key matters which need to be debated, including any new business initiatives and any purchase or divestment of subsidiaries.

Board composition

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. At the date of this report the Board comprises 12 Directors; being four Executive Directors and eight independent Non-Executive Directors. Details of the Directors are set out on pages 12 to 13 of this report.

The Board considers all the Non-Executive Directors to be independent in accordance with the criteria set out in the Code.

The Chairman regularly reviews the size and composition of the Board and its committees and these are reviewed formally by the Nominations Committee at least annually. This ensures that there exists the required mix of skills and experience on the Board and that succession planning is adequately addressed.

Non-Executive Directors

In addition to their Board responsibilities, the Non-Executive Directors are also responsible for bringing independent judgement to the Board, and for constructively challenging the Executive team. The Non-Executive Directors meet, without the Executive directors present, at least annually to discuss relevant matters including succession planning and the overall performance of the Executive team.

The Board has appointed Mr Thompson (Deputy 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.

One of the criteria which the Board takes into consideration when recruiting a Non-Executive Director is his or her ability to have sufficient time to take on the position. In addition, throughout their term of office with the Society, Directors are required to inform the Board in advance of any other positions that they wish to take up so that the time commitment and any potential conflict of interest can be considered. The Society's letters of appointment of Non-Executive Directors give an indication of the time commitment required, although this will depend on Board committee memberships. The letters of appointment also identify the key responsibilities of the Non-Executive Directors 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.

Directors' Report on Corporate Governance

Continued

Copies of the letters of appointment of each of the Non-Executive Directors are available for inspection on request from the Group Secretary.

The Board is satisfied that all of the Non-Executive Directors are independent.

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 role profiles and terms of appointment.

The Chairman is responsible for leading the Board and for ensuring the Board acts effectively, promoting high standards of corporate governance. The Chairman is also responsible for 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 has overall responsibility for managing the Society and the subsidiaries. He leads the Executive team and is responsible for implementing the strategies and policies agreed by the Board, through a number of management and risk committees.

The Board elects its Chairman and Deputy Chairman annually at the Board meeting immediately following the Annual General Meeting (AGM).

Appointments to the Board

The **Nominations Committee** which comprises all the Society's Non-Executive Directors and is Chaired by the Society Chairman, leads the process for Board appointments and succession planning. The Committee, at least annually, reviews the structure, size and composition (including diversity) of the Board to ensure it contains the required balance of skills, knowledge and experience relevant to the activities of the Group.

The Nominations Committee also carries out an annual review of succession planning for Non-Executive Directors, the most recent review having been completed in January 2014. The succession plan ensures ongoing recruitment of Non-Executives to ensure that the Board continues to have the relevant skills and experience throughout any period of change in its composition.

During 2013, recruitment commenced for the replacement of Noel Hutton, Deputy Chairman and Non-Executive Director, ahead of his retirement on 30 July 2013. The Nominations Committee engaged Warren Partners, an independent external search agency, to assist in the candidate search and administration of the recruitment process. Warren Partners have no other connection with the Society. The Nominations Committee interviewed a number of candidates and consequently appointed Cheryl Black and Helen Stevenson to the Board, as Non-Executive Directors, following their approval as Approved Persons by the FCA.

Induction 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. Non-Executive Directors are encouraged to contact individual members of the Executive team to discuss any queries that they may have and to undertake subsidiary, branch and department visits on an ad hoc basis.

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.

Board diversity

The Board considers all aspects of diversity, including gender, when reviewing its composition although it has adopted the principle that all appointments should be made on merit. Accordingly, the Board has not set any measurable objectives for diversity.

At 31 December 2013, 25% of the Board were female, and 38% of the Society's Senior Leadership Team were female.

The Society takes into account diversity at all levels of recruitment and supports staff to take on various external interests, including voluntary roles such as school governorships and roles in other local voluntary organisations, to enable them to gain experience of Board roles.

Performance evaluation

The Board undertakes an annual evaluation of the performance and effectiveness of itself and its sub-committees, and the performance of individual Directors is also reviewed annually. At least every three years, this review is conducted by an external facilitator. The reviews address matters including the balance of skills on the Board, its diversity, how the Board and its committees work together as a unit and other factors relevant to its effectiveness.

In late 2013, the Board engaged Genius Methods, who have no other connection with the Society, to undertake an external performance evaluation of the Board and its sub-committees and the results were reviewed and discussed by the Board at its February 2014 meeting. The review found the Board to be effective, able to challenge and debate constructively and reach decisions competently. Areas for Board continuous improvement include: Committee structure, meeting attendance, succession planning, strategy process and Committee feedback. The Board will prioritise and agree a plan and timetable for addressing the recommendations raised in the review.

Individual Non-Executive Directors are evaluated on a one-to-one basis by the Chairman. Executive Directors are evaluated by the Group Chief Executive against agreed performance targets for their areas of responsibility and their own personal performance. The Chairman evaluates the Group Chief Executive's performance while the Deputy Chairman and Senior Independent Director lead the Board evaluation of the Chairman's performance, which also takes into account the views of Executive Directors.

Re-election policy

The Society's Rules require that Directors stand for election at the AGM following their appointment and for re-election every year thereafter. Generally, Non-Executive Directors are not expected to serve more than six years, although this may be extended to nine years in total. The Code recommends that all Directors of FTSE 350 Companies should stand for annual re-election. The Board agreed that all Directors should stand for annual re-election at the AGM from 2013 onwards.

Remuneration

Details relating to Directors' remuneration and contracts are contained in the Directors' Remuneration Report set out on pages 47 to 59.

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 pages 30 to 31.

The Directors consider that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, and provide the information necessary for members to assess the Group's performance, business model and strategy.

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 risk inherent in the Group are described in greater detail in the Risk Management Report on pages 41 to 46, together with an explanation of the framework adopted by the Group for managing 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 Chief Internal Auditor 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 2013 the Society maintained an adequate system of internal control that met the requirements of the UK Code.

Directors' Report on Corporate Governance

Continued

Board committees

The Board has delegated certain matters to Board committees in order that they can be considered in more detail by those Directors with the most relevant skills and expertise.

The committees are:

- The **Audit Committee** – details are contained in the Audit Committee Report on pages 38 to 40;
- The **Board Risk Committee** – details are contained in the Risk Management Report on pages 41 to 46;
- The **Remuneration Committee** and **Non-Executive Directors Remuneration Committee** – details are contained in the Directors' Remuneration Report on pages 47 to 59; and
- The **Nominations Committee** – details are contained in the section on 'Appointments to the Board' on page 34 of this Report.

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

Board and Committee membership attendance record

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

The Annual General Meeting (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 attend the AGM, unless their absence cannot be avoided, and are available for questions both during a 'question and answer' session within the meeting, and on an individual basis before and after the meeting.

All eligible members are encouraged to vote at the AGM, either in person or by voting proxy and the voting form includes a 'vote withheld' option. Members can vote by post, in any of the branches, online at skipton.co.uk/agm or at the AGM itself. 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 AGM magazine, the format of which is aimed at making it easily readable.

Copies of the full Annual Report and Accounts 2013 are also available on request in branches or by post.

	Board	Audit Committee	Nominations Committee	Remuneration Committee	Board Risk Committee
Mr M H Ellis	10/10	-	1/1	-	-
Mr P J S Thompson	10/10	6/6	1/1	10/10	-
Mrs C Black (appointed 1 March 2013)	7/8	2/2	1/1	-	-
Ms M Cassoni	10/10	6/6	1/1	-	-
Mr I M Cornelius	10/10	-	-	-	-
Mr D J Cutter	10/10	-	-	-	6/6
Mr R D East	10/10	-	1/1	10/10	6/6
Mr M R Fleet	10/10	-	-	-	-
Mr P R Hales	10/10	-	1/1	-	6/6
Mr C N Hutton (resigned 30 July 2013)	7/7	-	1/1	8/8	-
Mr G E Picken	10/10	6/6	1/1	-	6/6
Ms H C Stevenson (appointed 1 March 2013)	7/8	-	1/1	3/3	-
Mr R J Twigg	10/10	-	-	-	6/6

Relations with members and other investors

The Society's members comprise its investors (except deposit account holders) and non-corporate borrowers which is different to the shareholders of a listed company, whose owners may include institutional shareholders. The vast majority of the Society's customers are therefore its members and the Society encourages feedback from them on any aspect of the Society's activities and seeks to respond quickly to all enquiries received.

We conduct regular market research with members to evaluate their experience of dealing with the Society and how satisfied they are with their relationship with the Society. In total, we aim to carry out over 20,000 interviews with members each year to help us to understand how we can improve the service we provide to them. We also engage with members in numerous other ways, including our Customer Forum. This consists of face-to-face sessions with customers to get their feedback on our strategies and initiatives. Around eight customers attend each session along with four Society representatives. In addition to this, we now have over 5,000 members on our Customer Panel, which we use to gather feedback on a wide range of topics, including new product and proposition development.

The Society maintains a frequent dialogue with its providers of external capital and funding. As part of the annual results publication process, the Society conducts a series of meetings with institutional investors and analysts to provide a detailed briefing on its financial performance. The presentation materials are available on the Society's website. In addition, members of the Society's Executive and Treasury team hold regular meetings with external stakeholders throughout the year to provide updates on the Society's performance and respond to market queries.

M H Ellis
Chairman
25 February 2014

Audit Committee Report

Membership and attendees

The Audit Committee is appointed by the Board and comprises four Non-Executive Directors, currently:

Ms Cassoni, Non-Executive Director (Committee Chairman)
Mrs Black, Non-Executive Director
Mr Picken, Non-Executive Director
Mr Thompson, Non-Executive Director

The Committee met six times during 2013 and the attendance of its members is set out on page 36 in the Report on Corporate Governance. The Committee also held private discussions with the external auditors and the Chief Internal Auditor.

In addition to its members, the Chairman, Group Chief Executive, Group Finance Director, Chief Conduct Risk Officer and Secretary, Chief Financial Risk Officer, external audit representatives and the Chief Internal Auditor 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.

Role and responsibilities of the Committee

The responsibilities of the Committee are delegated by the Board and are set out it its written terms of reference. These are in line with the provisions of the Financial Reporting Council (FRC) Guidance on Audit Committees (the 'Smith Guidance') which was updated in September 2012 and is applicable to this year end. The Committee's primary responsibilities are:

- To monitor the integrity of the Group's financial statements, any formal announcements relating to the Group's financial performance and review significant reporting judgements;
- To provide advice, where requested by the Board, on whether the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for members to assess the Group's performance, business model and strategy;
- To monitor the relationship with the external auditors, including agreeing their remuneration and terms of engagement, monitoring their independence, objectivity and independence, ensuring that the policy to provide non-audit services is appropriately applied and to make recommendations to the Board on their appointment, re-appointment or removal;
- To review the effectiveness of the internal audit function and review its material findings;
- To keep under review the effectiveness of the Society's internal controls, including financial controls and risk management systems;
- To review the effectiveness of the Compliance Monitoring function and review its material findings; and
- To report to the Board how it has discharged its responsibilities.

The minutes of the Audit Committee are distributed to the Board and the Committee Chairman provides a verbal report 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.

Activities of the Committee during the year

The Committee has an annual schedule of work, developed from its terms of reference, with standing items that it considers at each meeting in addition to any specific matters upon which the Committee has decided to focus. The work of the Audit Committee falls under three main areas as follows:

a) Internal controls and risk

The Group recognises the importance of good systems of internal control in the achievement of its objectives and the safeguarding of its assets. Good internal controls also facilitate the effectiveness and efficiency of operations, help to ensure the reliability of internal and external reporting and assist in compliance with applicable laws and regulations.

The Group operates in a dynamic business environment and, as a result, the risks it faces change continually. Management are responsible for designing the internal control framework to ensure thorough and regular evaluation of the nature and extent of risk and the Group's ability to react accordingly. Management are also responsible for implementing the Board's policies on risk and control, noting that all employees are responsible for internal control as part of their individual objectives.

Further details of actual risk management practices are provided in the Risk Management Report on pages 41 to 46.

Through the Committee, the Group's internal audit function ('Audit Services') provides independent assurance to the Board on the effectiveness of the internal control framework. The information received and considered by the Committee during 2013 provided reasonable assurance that there were no material breaches of control and that, overall, the Society maintained an adequate internal control framework that met the principles of the Code.

Audit Services is supported by external advisers who are able to provide specialist service in connection with matters such as Treasury and Credit Risk. The Chief Internal Auditor reports to the Chairman of the Committee, and the

Committee is responsible for agreeing the annual budget of Audit Services, and ensuring that it retains adequate skills and resource levels that are sufficient to provide the level of assurance required.

The Audit Committee approves Audit Services' annual plan of work. This is prepared on a risk based approach by Audit Services reflecting input from management and the Committee.

The Committee reviews Audit Services reports and, through Audit Services, tracks management actions to completion; Audit Services then verifies these periodically after management have reported them as complete. Audit Services provides the Committee with reports on material findings and recommendations and updates on the progress made by management in addressing its findings.

The Committee also has oversight responsibility for the Group's Compliance Monitoring function which provides second line assurance on regulated activities across the Group. The outputs of the Compliance Monitoring function's monitoring activities are reported to the Committee, together with progress updates on management's implementation of the findings. The Compliance Monitoring function's annual plan of work is also approved by the Committee.

During the year, the main issues of internal control reviewed by the Committee were:

- the framework for the governance of conduct risk across the Group including its ongoing development and embedding;
- the sales process and associated controls within the Financial Advice division and Connells group to ensure fair customer outcomes are being delivered; and
- a number of specific areas of internal control were discussed including assessment of the adequacy of key processing controls across the Group to ensure these were robust and delivered a quality service to customers.

The Committee also reviews periodically the use of the confidential reporting channel in the Group. Awareness of 'whistle blowing' arrangements is maintained through internal communication and is covered as part of employees' induction and ongoing development.

As part of the external audit process, our external auditor provides us with internal control reports. During the year, KPMG did not highlight any material control weaknesses.

A review of the effectiveness of Audit Services was carried out during the year through a questionnaire completed by those in the business who had been audited, and the external auditors. In addition, a limited scope review was also conducted by an external consultancy firm. Having considered the results of the questionnaire, the external review and a number of other factors, including the quality of reporting to the Committee and impartiality of the internal auditors, the Committee concluded that Audit Services remained effective. An external body carries out a full evaluation of the effectiveness of the function at least every five years, with the next review scheduled for 2015.

b) Accounting, tax and financial reporting

The Committee considers the financial information published in the Group's annual and half year financial statements and considers the accounting policies adopted by the Group, presentation and disclosure of the financial information and, in particular, the key judgements made by management in preparing the financial statements.

The Directors are responsible for preparing the Annual Report and Accounts. At the request of the Board, the Committee considered whether the 2013 Annual Report was fair, balanced and understandable and whether it provided the necessary information for members to assess the Group's performance, business model and strategy. The Committee is satisfied that, taken as a whole, the 2013 Annual Report is fair, balanced and understandable and includes the necessary information as set out above. It has confirmed this to the Board, whose statement in this regard is set out on page 35.

The Committee pays particular attention to matters it considers to be important by virtue of their impact on the Group's results, and particularly those which involve a high level of complexity, judgement or estimation by management. The key areas of judgement that it considered in reviewing the 2013 financial statements were:

- The Committee reviewed the treatment of operational loss provisions, particularly within the Mortgage Services division, and satisfied itself that management's best estimate of their quantum to be recognised in the accounts, together with associated contingent liability and other disclosures, was appropriate.
- During the year, the Group first demerged Wynyard Group Limited from its New Zealand based subsidiary, Jade Software Corporation Limited, and subsequently raised capital by floating Wynyard on the New Zealand Stock Exchange. On flotation, the Group's shareholding was reduced to 24.5% and as a result control was lost. The Group recognised its remaining non-controlling interest in Wynyard as an associate at fair value in accordance with IAS 28, *Investments in Associates*, and determined its fair value to be the issue price of its shares on flotation. Consequently, the Group has realised a pre-tax profit of £24.8m. The Committee has reviewed the calculations prepared by management and is satisfied with the accuracy of these and the disclosures surrounding the transaction.

Audit Committee Report
Continued

- In late 2012, the Group granted options to senior management of Connells Limited which require the Group to purchase these options at certain future dates. The Committee has reviewed the accounting treatment adopted in accordance with IFRS 2, *Share-based Payment*, noting that the liability, spread over the vesting period to the date of exercise, is dependent on assumptions as to when the options will be exercised and the forecast profits and cash flows of Connells Limited. The Committee has reviewed management's assumptions and concurred with the treatment adopted.
- The Committee has considered the carrying value of the Group's investments in subsidiary undertakings, including the calculation of future put option liabilities and the level of consolidated goodwill and other intangible assets carried within the Statement of Financial Position. Based on management's assessment of future performance of the relevant business units, the Committee agreed with management's assessment of carrying value and the consequent provision of £16.6m against goodwill being made against a number of subsidiary investments.
- The Committee continues to monitor impairment provisions and has considered the impact of forbearance adopted in the mortgage portfolios on the level of provision made and the relevant disclosure in the accounts. The Committee is satisfied with the assumptions adopted and models used to calculate provisions over the retail mortgage books and commercial loan portfolio. The Committee has reviewed the carrying value of Treasury assets and considers this to be appropriate.
- The Committee has considered the carrying value of the equity release book acquired on the merger with Scarborough Building Society in 2009 and concluded that certain impairment assumptions (principally around inflation and forced sale discount) should be revised. Accordingly, an additional provision of £8.3m has been made in these accounts and the Committee has satisfied itself on the carrying value of these assets.
- The Committee has again reviewed the adoption of the going concern assumption for the interim and year end accounts, adopting the same, comprehensive approach for both reporting periods. This involves a rigorous consideration of our current and projected liquidity, capital and funding positions together with the potential risks which could impact these positions. Based on this review, the Committee concluded that the adoption of the going concern assumption to prepare the accounts remains appropriate.
- The Committee considered matters raised during the statutory external audit and has concluded that there were no adjustments required which were material to the financial statements.

c) External auditors

The Committee assesses the effectiveness of the external auditor annually, immediately after the completion of their year end audit, and this is reported to and discussed at the May Audit Committee meeting. This assessment is facilitated by Audit Services and is discussed, initially, without the presence of the auditors in the meeting. The Audit Committee considers that the relationship with the auditors is working well and is satisfied with their effectiveness and independence.

KPMG Audit plc, or its predecessor firm, has been the Society's auditor since the 1980's. The FRC revisions to the Code made in September 2012 now require FTSE 350 companies to put their external audit out to tender at least every 10 years. The Society last put the audit out to tender during 2005 and the Audit Committee has, therefore, agreed that it will put the appointment out to tender in the second half of 2014, with any new appointment being effective for the year ending 31 December 2015. Thereafter, the Committee will continue to assess the need for a competitive process on an annual basis as part of its review of the auditor's effectiveness.

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 undertook a number of non-audit related assignments for the Group during 2013. These were conducted in accordance with the framework and are 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.

The Audit Committee has also agreed a policy for the employment, by the Group, of former employees of the auditor which is designed to further maintain the auditor's independence.

Effectiveness of the Audit Committee

The effectiveness of the Committee is assessed as part of the annual Board and Committee effectiveness review, more detail of which is contained in the Report on Corporate Governance. The 2013 review, recently completed, concluded that the Committee operated effectively during the year.

Committee members are expected to undertake relevant training as part of their ongoing development and, periodically, the Committee as a whole receives training on current topics such as current sector challenges, regulatory developments, conduct risk issues and financial reporting hot topics.

M Cassoni
Chairman of the Audit Committee
25 February 2014

Risk Management Report

Risk overview

The management of the Group's business and the delivery of the Board's strategy involves the exposure of the Group to a number of potential risks. The Group aims to manage, appropriately, the risks that arise from its activities and the Board promotes a culture and philosophy that reflects an awareness and management of actual and potential risk exposures.

Governance structure

The Group has a formal structure for managing risks which is documented in detailed risk management policies.

The **Board Risk Committee** is responsible for considering and recommending the Group's risk appetite, capital adequacy and liquidity management policies 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 Board Risk Committee also has a number of sub-committees, which have day to day responsibility for risk management oversight, as follows:

- **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.

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 and Information Security 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 the Board approved risk appetite.
- Third line of defence, provided by 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.

Risk Management Report
Continued

The main drivers that impact the Group include:

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

The Mortgages and Savings division continues to operate in a low interest rate environment and, whilst various government initiatives, including the FLS introduced in 2012, have benefitted the business, the future withdrawal of these could increase margin pressures again. However, actions taken by the Society during and since the Global Financial Crisis have resulted in the Group achieving a higher interest margin and consequently the Group is now better placed to cope with such pressures.

Whilst arrears levels fell again in 2013, a general downturn in the economy, increasing interest rates or unemployment, would impact the Mortgages and Savings division through an increase in impairment by 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 by the general state of the economy, and 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 success of the Mortgage Services division is also dependent on the health of the UK mortgage market, and in particular, the emergence of new entrants or willingness of existing lenders to outsource their mortgage servicing. Since the start of the Global Financial Crisis, few new lenders of significance have entered the market, and existing lenders have reduced the size of their portfolios, both of which have adversely impacted HML's revenue.

The Financial Advice division is also exposed to the wider UK economy. Whilst the increase in the FTSE index, and the Stock Market generally, during 2012 and 2013 has restored some confidence, continuing global economic uncertainty may still impact the willingness of some customers to invest in longer term, more risky products.

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 and invoice discounting). The Society ceased new commercial lending in November 2008; and
- wholesale counterparties (including other financial institutions). Credit risk within our treasury portfolio 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 slowdown in the UK economy leading to higher unemployment, deterioration in household finances and falling house prices, all of which would be likely to result in increased arrears and mortgage losses. Whilst the economy is improving slowly, given the risks around the emergence of a housing bubble, particularly in the South East and London, the Group plans to maintain a cautious approach to new lending. In particular, the Group no longer lends to borrowers who self-certify their income or to those with impaired credit histories, nor does it undertake new commercial lending.

Whilst the wholesale markets are less volatile than during the Global Financial Crisis, the Group remains cautious and has reduced the number of counterparties to whom it lends, and the amounts it is willing to lend counterparties, to levels appropriate with the perceived risk of the counterparty.

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 retail credit management across the Group and the controls in place ensure lending is within the Board approved credit risk appetite. ALCO, through the Wholesale Credit Committee, similarly manages Treasury credit exposures.

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 and to Guernsey borrowers on properties in the UK.

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 despite increasing its mortgage lending volumes.

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, we ceased new lending in these portfolios in early 2008.

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

Commercial lending to customers and businesses

The Society has 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 manage these loans. 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.

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

Liquidity risk

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

Market background

Wholesale funding markets continue to be restricted, particularly to institutions such as the Society. 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. Liquidity regulation is changing towards the international Basel III measures, namely the Liquidity Coverage ratio and the Net Stable Funding ratio. The Society has already been measuring and monitoring these ratios, and is in a good position for when the regulations come into force in 2015 and 2018 respectively.

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 the Society's liquidity risk appetite and 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, the Board Risk Committee 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 reviewed and enhanced in line with the PRA's liquidity regime, as defined in BIPRU 12, and since June 2010 the Group has reported its liquidity position against Individual Liquidity Guidance (ILG) provided by the PRA 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 PRA, 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 by accessing the FLS. However, due to our credit ratings, the longer term unsecured wholesale markets remain largely unavailable for the Society. The Group's main source of funding is retail deposits which, at 31 December 2013, accounted for 84.6% (2012: 83.1%) 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 2013, the proportion of our treasury assets rated A3 or above was 99.0% (2012: 99.6%). 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.

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 PRA guidance.

Currency risk

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

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.

The Group also has equity investments in Jade Software Corporation Limited, Wynyard Group 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 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.

Equity risk

This is the risk of loss due to movements in equity markets. In prior years, the Group offered 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.

Following its flotation in July 2013, the Group holds a 24.5% stake in Wynyard Group Limited, which is listed on the New Zealand Stock Exchange. The equity risk of this investment is not hedged.

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 providing advice and efficient administration services.

The Mortgage Services division is responsible for the servicing of mortgage loans for third party lender clients. A failure in the operational processes within the division could give rise to clients suffering losses and seeking to claim compensation from the Group. The Mortgage Services division continues to invest and develop its processes and quality assurance arrangements in order to mitigate this risk.

As well as the core business providing advice on mortgages and general insurance, the Group owns 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 investment advice. Alert to the loss of customer trust experienced by Financial Services firms as a result of mis-selling 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. We are alert to the risk of cyber crime and have increased our general confidence and capability to mitigate this.

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
- Information Technology
- Change Management
- Legal and Regulatory
- Conduct
- People
- Financial Management and Management Information
- Premises
- Fraud
- Process
- Information Security
- 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 either has an established Compliance team, or utilises the Group's central resource, to monitor compliance with existing legislation and consider 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.

We will continue to work with the regulator, the Financial Conduct Authority (FCA), to ensure that we understand its expectations and comply with all its 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 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 manage the Group's exposure to pension obligation risk:

- The Board regularly reviews the Group's pension risk strategy.

- The Board and the pension scheme Trustees receive professional advice from different actuarial advisers.
- The pension scheme Trustees meet quarterly to monitor and make investment decisions, liaising with the principal employer in accordance with the scheme rules.
- The pension obligation position is updated every quarter and reported, along with key pension risk metrics, to the Board Risk Committee and the pension scheme Trustees.

The Group also performs stress testing on the pension scheme liabilities and assets as part of the pension risk metrics for the Board Risk Committee and also in its capital planning methodologies articulated in the Individual Capital Adequacy Assessment Process (ICAAP). Note 29 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 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 and the practical implications of the Mortgage Market Review which may be further impacted by European regulation. The Group has allocated resource to ensure continued compliance in these and other areas and we believe we are well placed to address current and evolving 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. In 2013 the Group re-adopted the Code of Practice on Taxation for Banks; this 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 reviewed by the PRA when setting the Group's Individual Capital Guidance (ICG) requirements.

The Group currently adopts the following approaches to calculate its 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 PRA for permission to use an Internal Ratings Based (IRB) approach for retail credit risk exposures in due course.

For the year ended 31 December 2013 we were required to determine our capital adequacy based upon the Basel II framework. However, from 1 January 2014 Basel II was replaced by CRD IV which introduced material changes to the way in which we calculate the capital we are required to hold and also changed the eligibility criteria for the capital instruments which count towards our capital requirements.

The Board Risk Committee and the Board monitor the Group's capital adequacy and we expect to continue to hold sufficient capital to satisfy our capital requirements under CRD IV in terms of both quantity and quality.

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 2013 Pillar 3 disclosures will be available from May 2014.

P R Hales
Chairman of Board Risk Committee
25 February 2014

Directors' Remuneration Report

Annual statement from the Chairman of the Remuneration Committee

I am pleased to present the Remuneration Committee's report which sets out details of the pay, bonuses and benefits for the Directors and Code Staff for the year ended 31 December 2013. We have always tried to make this report informative for our members and, this year, the Committee has adopted the majority of the requirements that now apply to UK listed companies, as we seek to maintain the highest standards of transparency and governance in relation to Directors' remuneration.

Accordingly, we have prepared this report, where possible, in line with the requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. We have presented the report in two sections:

- The Remuneration Policy part of the report on pages 48 to 53 explains how we will pay Directors in the future.
- The Annual Report on Remuneration part of the report on pages 54 to 59 explains how we put our policy into practice in 2013 and how we intend to apply it for 2014.

We are committed to best practice in corporate governance and will, therefore, ask our members to vote, on an advisory basis, on both the Directors' Remuneration Policy and the Directors' Remuneration Report at the forthcoming AGM. A summary of this report will be sent to members, together with the Summary Financial Statement, ahead of that meeting.

Remuneration in 2013

As noted elsewhere in these accounts, 2013 was a strong year for the business and Group pre-tax profit increased to £102.5m with the core Mortgages and Savings division pre-tax profit reaching £50.4m.

In recognition of this performance, the Directors agreed to make a discretionary bonus award to all Society employees below the level of the Senior Leadership Team and to introduce an annual bonus scheme for all these Society employees from 2014. The exceptional level of performance in 2013 was also reflected in the awards made for the existing Senior Leadership Team's bonus scheme.

Key decisions taken in 2013

The Committee's key deliberations and decisions made during the year were:

- We have introduced an annual bonus scheme for all Society employees below the level of the Senior Leadership Team which will give them a chance to participate in the success of the Society. It will operate under similar principles as the bonus for the senior executives and will be in place for the first time in 2014. As noted above, we decided to make a discretionary bonus payment for 2013 which amounted to an average of 4.8% of salary.
- Having considered the balance between short and medium term incentives and our aim to focus reward on the sustained generation of value for our members over a number of years, we decided to reduce the annual bonus opportunity and introduce a new medium term incentive arrangement (MTI) for senior executives, commencing in 2014. Although this increases the overall remuneration opportunities in the longer term, it supports the retention of key talent in the Society and alignment with members' interests in the longer term. Under the scheme, up to 50% of variable pay could be payable in the short term and up to 50% over the medium term. More details on the MTI scheme are set out in the policy section of the report.
- Following the FCA's guidance to the financial services industry, we undertook a review of the Group's bonus arrangements to confirm that they are designed appropriately. As a result of the review, changes were made to our remuneration principles to give greater clarity and direction.

Conclusion

On behalf of the Committee, I trust you will find the report useful and informative and look forward to your feedback on our Remuneration Policy. The Committee recommends that members vote both for the Directors' Remuneration Policy and the Directors' Remuneration Report at the forthcoming AGM.

Nimble Thompson
Chairman of the Remuneration Committee
25 February 2014

Directors' Remuneration Policy

Remuneration Policy for Executive Directors

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 and long term sustainability for our members.

Development of 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 are reviewed annually.

General principles of remuneration

- 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.
- Remuneration throughout the Skipton Group encourages a high level of stewardship and corporate governance.
- Remuneration policies, procedures and practices reflect sound, effective risk management and do not encourage risk taking which falls outside Board risk appetites or the scope of Board policies.
- 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.
- 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.
- 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.
- 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.
- 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.
- 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.
- Remuneration arrangements are cost effective and straightforward to understand, communicate and administer.

The table below shows the elements of remuneration for Executive Directors, the reasons for their inclusion and the way they operate with effect from 1 January 2014.

Element **How element supports our strategy**	**Operation**	**Maximum potential value**	**Performance conditions and assessment**
Basic salary • Supports the recruitment and retention of Executive Directors, reflecting their individual roles, skills and contribution.	Basic salary reflects the size of the role and responsibilities, individual performance (assessed annually) and the skills and experience of the individual. 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 Executive Directors competitively within this reference group.	Increases to base salary are determined annually by the Committee taking into account: • Individual performance; • The scope of the role; • Pay levels in comparable organisations; • Pay increases elsewhere within the Group.	None applicable, although we do take account of individual performance when considering base pay increases.
Pension • Supports recruitment and retention of Executive Directors at a cost that can be controlled by the Society.	Generally the Society contributes to a defined contribution pension scheme for the Executive Director. The contribution can instead be paid in cash (which is excluded from bonus calculations) if the Executive Director is likely to be affected by the limits for tax-approved pension saving.	20% of basic salary for Messrs Cutter and Twigg and 8% of basic salary for the other Executive Directors.	None applicable.
Benefits • To attract, retain and provide security for Executive Directors. • Provides a competitive level of benefits to assist Executive Directors to carry out their roles effectively.	A number of benefits are provided to Executive Directors, including a car or car allowance, private medical insurance, life insurance and disability benefits. The Committee reviews benefits from time to time and may make changes, for example to reflect market practice or the needs of the business.	The Society bears the cost of providing benefits, which may vary from year to year.	None applicable.
Short Term Incentive scheme (STI) • Supports the attraction and retention of Executive Directors. • Supports the development of a high performance culture. • Rewards performance within the context of achieving corporate goals and objectives as set out in the corporate plan.	Performance measures and targets are set on an annual basis and are measured over the financial year. Payment is normally made in cash shortly after performance has been assessed. The Committee has the ability to reduce or defer bonuses in certain circumstances, including: • capital falling below a certain level; • evidence of systemic conduct risk; and • evidence of control failures. If the total annual emoluments earned by an individual are greater than £500,000, or the STI is more than 33% of his or her total remuneration, 40% of the total STI earned is deferred over a three year period. Deferred remuneration is payable in three equal instalments over the three year period. The Committee may reduce or withdraw the payment of a deferred amount in certain circumstances, including failing to maintain a certain level of capital or the Society reporting a pre-tax loss.	The maximum incentive which may be earned for any year across the STI and the MTI is 100% of salary. The Committee determines the overall maximum and the split between the STI and the MTI from year to year. For 2014, the maximum STI opportunity will be 50% of salary for all Executive Directors. For each performance measure, the Committee determines a threshold, target and maximum level of performance. No bonus is payable for performance below the threshold level, with varying levels of payout for performance between threshold and maximum. On target performance generally attracts a bonus of 60% of the maximum.	The performance measures attached to the STI are currently: • Group profit; • Mortgages and Savings division profit; • Team KPIs, including People, Customers & Conduct, Process and Financial Strength dimensions; • Personal objectives. The measures are assessed independently. The weightings attached to the types of measure and the individual weightings attached to each individual measure may vary from year to year as determined by the Committee.

Element How element supports our strategy	Operation	Maximum potential value	Performance conditions and assessment
Medium Term Incentive scheme (MTI) • Encourages the right behaviours in respect of long term, sustainable performance that supports the achievement of strategic goals. • Provides a balance between long and short term rewards in the overall remuneration package for those senior executives eligible to participate.	Payments are based on performance (as determined by performance against agreed corporate plan targets) over rolling three year cycles. The corporate plan targets for each three year performance period are reviewed and agreed by the Board annually. The performance for each three year cycle is based on cumulative performance against the annual targets for the three year cycle. Payments are made over three years so that: • 50% of the incentive earned is paid immediately following completion of the three year performance period • 25% is deferred for one year • 25% is deferred for two years. The 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 MTI if it believes in extreme circumstances that the payments are not appropriate, for example due to failure to maintain certain capital levels, evidence of systemic conduct risk, or evidence of significant control failures or weaknesses.	As noted above an MTI scheme is being introduced in 2014, and the maximum incentive which may be earned for any year across the STI scheme and the MTI scheme is 100% of salary (50% STI plus 50% MTI). For each performance measure, the Committee determines a threshold, target and maximum level of performance. No bonus is payable for performance below the threshold level, with varying levels of payout for performance between threshold and maximum. On target performance generally attracts a bonus of 60% of the maximum.	50% of the award is based on Group profit and 50% of the award is based on Customer measures. The measures are assessed independently. Any payment from the MTI is subject to reduction, up to and including the whole payment, based on CET 1 capital levels at the end of each three year cycle. Any payment from the MTI is subject to satisfactory individual performance.

Notes to the table

Performance measures

The performance conditions attached to the STI and MTI schemes have been selected as they support the long-term, sustainable success of the Society. The Committee believes that the use of a range of financial and non-financial measures provides a balanced assessment of the overall performance of the Society.

The Committee considers the targets attached to the STI and MTI schemes to be commercially sensitive and will not therefore disclose these at the beginning of the financial years to which they relate. The Committee will, however, disclose the weightings that will be attached to each STI scheme performance measure at the beginning of the financial year to which they relate.

A summary of the targets set and the performance against the targets will be disclosed following the end of the relevant financial year. In setting the target and maximum payments the Committee considers both the market position and the risk appetite of the Society and sets these levels accordingly. The weightings for 2014 are outlined in the 'Statement of Implementation of Remuneration Policy in 2014' section of this report.

Changes from remuneration arrangements operated in 2013

The MTI scheme is a new arrangement, designed to align reward to the achievement of sustainable profit and member interests over a number of years. The scheme will commence in 2014, with the first payments due from the scheme in 2017 based on cumulative performance during the three year period ending on 31 December 2016.

Remuneration for other employees

All employees of the Society receive a basic salary and benefits consistent with market practice, and are eligible to participate in the Society's annual bonus and pension arrangements.

Members of the Executive Committee and other selected senior managers may be eligible to participate in the STI and / or MTI schemes on the same terms as the Executive Directors, subject to the discretion of the Group Chief Executive and the Committee. The award size for these individuals is typically lower than for the Executive Directors.

The Society has introduced a variable pay arrangement for all employees, so that everyone employed by the Society will have the opportunity to share in the Society's success. The scheme will operate for the first time in 2014, and a discretionary bonus payment will be made to all employees in respect of 2013 performance. The key principles underlying the scheme are aligned with those that apply for senior management.

Committee's discretion in relation to the STI and MTI schemes

As noted above, the Committee has the discretion to reduce or defer payments under the STI and MTI schemes in a number of circumstances. The Committee also has the discretion to cease or amend the operation of either arrangement where this is necessary to ensure the arrangements continue to meet the Committee's overriding remuneration principles. This might include, for example, amending the deferral arrangements to comply with changing regulation.

How the policy supports the Society's strategy

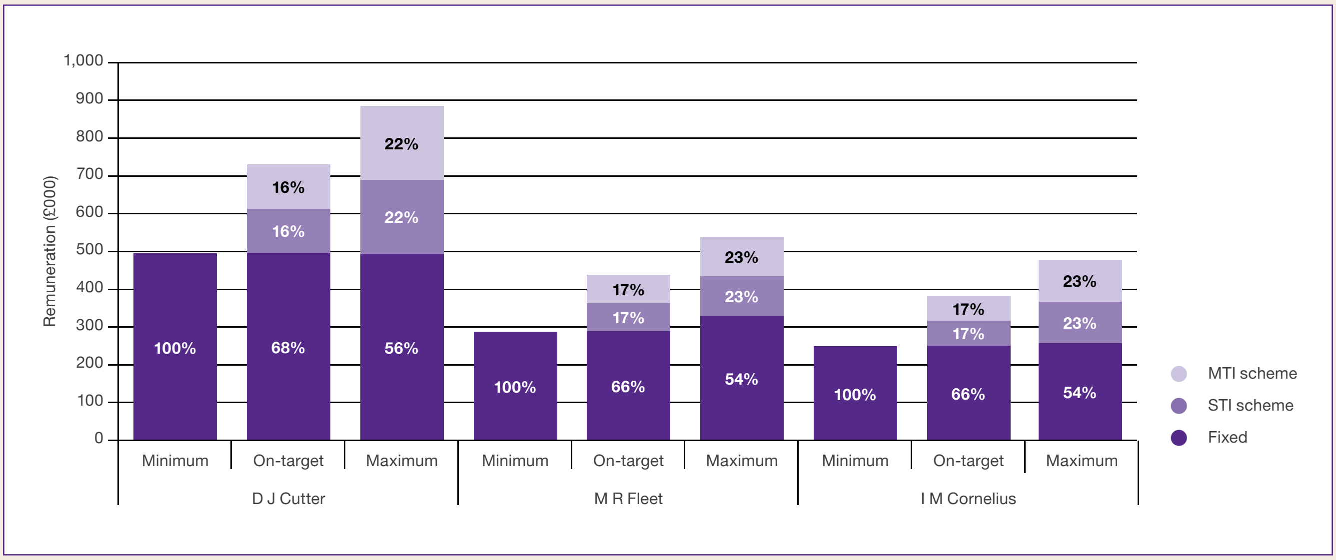
The table below shows how the variable elements of the remuneration policy support the Society's strategy.

	Generating profits for the Society…	...in a sustainable way...	…while delivering value to members and treating them fairly….	…and managing risks and processes while complying with regulation
Annual bonus features				
Group profit	●			
Mortgages and Savings division profit	●			
Team KPIs			●	●
Personal objectives		●		
Risk adjustment		●	●	●
Deferral of larger bonuses		●		●
Discretion to reduce / defer payments		●	●	●
Medium Term Incentive features				
Group profit	●			
Customer measures			●	
Multi-year measurement		●		
Risk adjustment		●	●	●
Deferral		●		●
Discretion to reduce / defer payments		●	●	●

Illustration of application of remuneration policy

The chart below illustrates the remuneration that would be paid to each of the Executive Directors under three different performance scenarios: (i) Minimum; (ii) On-target; and (iii) Maximum. The minimum scenario assumes that no payout is achieved from any variable elements of remuneration and on-target and maximum scenarios are as defined in the policy table on pages 49 to 50.

The elements of remuneration have been categorised into three components: (i) Fixed; (ii) Short Term Incentive; and (iii) Medium Term Incentive.



Mr Twigg's existing remuneration arrangements will continue until his transfer to Connells in April 2014 and he has therefore not been included in the table above.

Directors' Remuneration Report
Continued

Each element of remuneration is defined in the table below:

Element	Description
Fixed	Comprises basic salary, pension and benefits
STI scheme	Short Term Incentive scheme (including deferred elements)
MTI scheme^	Medium Term Incentive scheme

^ The first payments from the MTI scheme are dependent on achieving performance targets for the period between 2014 and 2016. The first 50% of the award will be made in 2017 with 25% deferred until 2018 and 25% deferred until 2019.

Policy on remuneration of Non-Executive Directors

The table below sets out the elements of Non-Executive Directors' remuneration and the policy on how each element is determined.

Element	Approach to determination
Base fees	Reviewed annually based on time commitment and responsibility required for Board and Board committee meetings. Review takes into account fees paid by comparable financial services organisations. Fees set by Non-Executive Directors' Remuneration Committee.
Additional fees	Additional fees are payable for additional responsibilities such as committee chairmanship or other duties.
Other items	Non-Executive Directors are not eligible to participate in any form of performance pay plans and do not receive pensions or other benefits.

The Remuneration Committee determines the Chairman's fee while the fees of the other Non-Executive Directors are determined by the Non-Executive Remuneration Committee.

Approach to recruitment remuneration

Overall, the Committee aims to recruit Executive Directors using remuneration packages that are market-competitive and consistent with the existing remuneration structure. In doing so, the Committee seeks to pay no more than necessary to attract talented individuals to join the Society.

Newly recruited Executive Directors are eligible to receive the same remuneration elements as existing Executive Directors as set out in the policy table above, namely:

- Salary – set at an appropriate level taking into account the experience and quality of the candidate.
- Pension and benefits – in line with our standard policy.
- Short Term Incentive scheme – in line with our standard policy.
- Medium Term Incentive scheme – in line with our standard policy.

The Committee does not expect to make special recruitment arrangements outside the standard policy, but may do so in exceptional circumstances in order to secure the appointment of the right candidate.

Non-Executive Directors will receive fees in line with the policy outlined above.

Directors' service contracts and notice periods

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.

Policy on termination payments

The Committee's overarching aim is to treat departing Executive Directors fairly, taking into account the circumstances of their departure, but always taking care to ensure that the interests of members are considered and that there are no rewards for failure.

Executive Directors are entitled to be paid their basic salary and contractual benefits (including pension contributions) during the notice period. The Society has the discretion to pay these as a lump sum benefit in lieu of notice.

The Rules of the STI scheme and the MTI scheme set out the treatment of awards for individuals who cease to be an employee or Director of the Society.

In the following circumstances, an individual will be treated as a 'good leaver' and will be eligible for a payment under the STI and MTI schemes:

- normal retirement;
- death;
- injury or disability; or
- any other circumstances which the Committee may in its discretion determine.

In exercising discretion on the treatment of an individual as a good leaver the Committee will consider the circumstances surrounding the departure. In particular, in exercising this discretion, the Committee may consider the performance of the individual.

Executive Directors who leave the Society for any other reason will not be eligible to receive a bonus or to be paid any deferred element of any bonus earned.

For the STI scheme, the Society will generally pay any bonus in full in respect of a completed bonus year. Good leavers will be considered for a bonus in respect of a partially completed bonus year. Such a bonus would be pro-rated to take account of the service completed during the year. The bonus would be paid at the usual time, after the end of the performance year taking account of the outcome of any performance conditions. Payment of any deferred element of the STI scheme for good leavers will be paid at the discretion of the Committee.

For the MTI scheme, deferred awards for completed performance periods and for part completed performance periods will be paid on the due date, except in the event of death, when the Committee may exercise its discretion and pay the deferred amount due immediately.

Consideration of remuneration for individuals elsewhere in the Society

The Committee is responsible for setting the remuneration of the Executive Directors and approves the policy for senior managers who have a material impact on the Society's risk profile (Code Staff). In addition, the Committee reviews recommendations from the Group Chief Executive for approval of the remuneration for other key executives.

Whilst the Committee does not consult employees on remuneration policy for Directors, it considers the level of salary increases across the Society when setting salary increases for Executive Directors.

Consideration of member views

The Committee does not consult with the Society's members on its executive remuneration policy, but takes into account any feedback given by members. The Committee has, for a number of years, invited members to vote on the annual remuneration report, and members have always voted in favour of it. When considering whether to adopt, on a voluntary basis, some of the changes to remuneration reporting that apply to UK listed companies, one of the factors that the Committee took into account was the opportunity to give members a chance to vote on the Society's Remuneration Policy. The Committee believes this will give members an opportunity to indicate their approval for the policy, and the outcome of the vote will influence the development of policy in future years.

Directors' Remuneration Report
Continued

Annual Report on Remuneration in 2013

Executive Directors' remuneration

The total remuneration for Executive Directors in 2013 is set out in the table below:

2013 Audited	**Salary**	**Benefits(1)**	**Current year annual performance pay(2)**	**Pension**	**Total**	**Prior years deferred performance pay now released(3)**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**
Mr D J Cutter	366	16	296	73	751	24
Mr I M Cornelius	215	12	158	17	402	-
Mr M R Fleet	235	65	170	19	489	-
Mr R J Twigg	280	12	206	56	554	-
	1,096	**105**	**830**	**165**	**2,196**	**24**

2012 Audited	Salary	Benefits(1)	Current year annual performance pay(2)	Pension	Total	Prior years deferred performance pay now released(3)
	£000	£000	£000	£000	£000	£000
Mr D J Cutter	352	16	181	68	617	-
Mr I M Cornelius (note 4)	123	7	62	10	202	-
Mr M R Fleet	230	26	110	18	384	-
Mr R J Twigg	275	12	126	54	467	-
	980	61	479	150	1,670	-

Notes

1. Benefits comprise the provision of a car or car allowance, and private medical insurance contributions. Mr Fleet's 2013 benefits include £44,717 in relation to relocation costs.
2. £332,172 of the 2013 annual performance pay has been deferred under the rules of the scheme (2012: £72,000).
3. 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.
4. 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.

Basic salary

In 2013, following an external benchmarking survey of executive remuneration in comparable financial services organisations, the Committee agreed to increase the basic salaries of the Executive Directors from 1 April 2013 as follows:

	2013	2012	**% increase**
Mr D J Cutter	**£370,000**	£352,000	**5.1%**
Mr I M Cornelius	**£216,500**	£210,000	**3.1%**
Mr M R Fleet	**£237,000**	£230,000	**3.0%**
Mr R J Twigg	**£281,500**	£275,000	**2.4%**

This compares with an average annual pay award in 2013 of 3.8% for all other Society employees.

Variable pay

The design and measures for the STI scheme in 2013 are the same as those described in the future policy section above. The measures, weightings and the resulting payments for 2013 were as follows:

Director	Target bonus opportunity (% of salary)	Maximum bonus opportunity (% of salary)	Weighting				Bonus awarded	
			Group profit	Mortgages & Savings profit	Team KPIs	Personal objectives	% of salary	£000
Mr D J Cutter	51%	85%	30%	30%	20%	20%	80%	296
Mr I M Cornelius	45%	75%	30%	30%	20%	20%	73%	158
Mr M R Fleet	45%	75%	30%	30%	20%	20%	72%	170
Mr R J Twigg	45%	75%	30%	30%	20%	20%	73%	206

The table below summarises the outcome against the various measures underlying the annual bonus arrangement:

Measure	Weight	Performance achieved				
		Below Threshold	Between Threshold and Target	Target	Between Target and Maximum	Maximum
Group profit	30%					
Mortgages and Savings division profit	30%					
Team KPIs	20%					
Personal objectives (average)	20%					

Directors' pension benefits

Mr Cutter and Mr Twigg are members of the Skipton Building Society Pension & Life Assurance Scheme (the Scheme), which is a defined benefit fund registered with HM Revenue and Customs under the Finance Act 2004. The Scheme was closed to future accrual of benefits on 31 December 2009 and no further member contributions have been made since that date. The value of their benefits in the Scheme is set out below.

Audited	**Normal Retirement Date**	**Members' contribution for the year ended 31 December 2013 £000**	**Accrued pension entitlement at 31 December 2012 £000 pa**	**Accrued pension entitlement at 31 December 2013 £000 pa**	**Value of remuneration for the year ended 31 December 2013 £000**
Mr D J Cutter	**1 January 2027**	**-**	**84**	**86**	**-**
Mr R J Twigg	**12 February 2030**	**-**	**69**	**70**	**-**

Audited	Normal Retirement Date	Members' contribution for the year ended 31 December 2012 £000	Accrued pension entitlement at 31 December 2011 £000 pa	Accrued pension entitlement at 31 December 2012 £000 pa	Value of remuneration for the year ended 31 December 2012 £000
Mr D J Cutter	1 January 2027	-	80	84	(2)
Mr R J Twigg	12 February 2030	-	65	69	(1)

Normal retirement date for members of the Scheme is when they reach the age of 65. The Scheme rules specify that this is the earliest date at which members are entitled to benefits from the Scheme:

- without consent (from the employer or the Trustee of the Scheme); and
- without actuarial reduction in the benefits;
- but disregarding any special provisions in the Scheme rules relating to a member's entitlement to early payment of their benefits on the grounds of ill health, redundancy or dismissal.

During the year the Directors' accrued pension entitlement was revalued in line with the Scheme rules. The value of remuneration shown above is calculated using a modified version of HM Revenue and Customs' tax rules for pension savings, as laid out in the regulations. The additional value earned by the Directors during the year due to their membership of the Scheme is included in the total remuneration for each Director.

Non-Executive Directors' remuneration

Non-Executive Directors' fees (excluding those of the Chairman) are reviewed annually by the Non-Executive Remuneration Committee, in line with the policy outlined above. The Non-Executive Directors' Remuneration Committee makes recommendations concerning Non-Executive Directors' remuneration to the Board.

The Non-Executive Remuneration Committee increased the Non-Executive Directors' basic annual fee from £42,000 to £44,000 from 1 August 2013, and the Deputy Chairman's fee to £50,000, having reviewed comparable data from similar organisations. The fees payable to the Chairmen of Board committees were also increased from that date: Audit Committee and Board Risk Committee to £12,000 per annum each and Remuneration Committee to £8,000.

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.

Audited		**2013**			2012	
	Fees £000	**Committee Fees £000**	**Total £000**	Fees £000	Committee Fees £000	Total £000
Mr M H Ellis (Chairman)	**155**	**-**	**155**	155	-	155
Mr P J S Thompson (Deputy Chairman) (note 1)	**45**	**3**	**48**	41	-	41
Mr C N Hutton (note 2)	**28**	**2**	**30**	48	4	52
Mrs C Black (note 3)	**36**	**-**	**36**	-	-	-
Ms M Cassoni (note 4)	**43**	**10**	**53**	18	1	19
Mr R D East	**43**	**-**	**43**	41	-	41
Mr P R Hales (note 5)	**43**	**10**	**53**	41	8	49
Ms A B E Kinney (note 6)	**-**	**-**	**-**	34	7	41
Mr G E Picken (note 7)	**52**	**-**	**52**	41	-	41
Ms H C Stevenson (note 8)	**36**	**-**	**36**	-	-	-
	481	**25**	**506**	419	20	439

Notes

1. Mr Thompson was appointed Deputy Chairman and Chairman of the Remuneration Committee on 31 July 2013.
2. Mr Hutton retired as a Director, Deputy Chairman and Chairman of the Remuneration Committee on 30 July 2013.
3. Mrs Black was appointed a Director on 1 March 2013.
4. Ms Cassoni was appointed a Director on 31 July 2012, and was appointed Chairman of the Audit Committee on 31 October 2012.
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 of the Society on 17 January 2012, and on 19 June 2013 was appointed a Director of Connells Limited, for which he receives an annual fee of £25,000.
8. Ms Stevenson was appointed a Director on 1 March 2013.

Code Staff

The Remuneration 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 in Tier 3 with banks and building societies with total assets less than £15bn. Those Group subsidiaries which fall within the scope of the Code are excluded from the disclosure below. During the year the Society had 35 (2012: 31) 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 (50%) is given to the achievement of non-financial objectives.

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 2013.

2013	**Number of beneficiaries**	**Fixed remuneration £000**	**Current year annual performance pay[1] £000**	**Total £000**	**Prior years deferred performance pay now released £000**
Senior management (including Executive Directors)	8	2,090	1,174	3,264	24
Other Code Staff	27	2,331	529	2,860	-
	35	4,421	1,703	6,124	24

2012	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay[1] £000	Total £000	Prior years deferred performance pay now released £000
Senior management (including Executive Directors)	8	1,867	696	2,563	-
Other Code Staff	23	2,035	371	2,406	-
	31	3,902	1,067	4,969	-

Notes

1. £332,172 of the 2013 performance pay is deferred over three years (2012: £72,000).

History of Group Chief Executive's remuneration

The table below shows the total remuneration of the Group Chief Executive over the last five years, together with the bonus awarded to the Group Chief Executive as a percentage of his maximum possible bonus.

Year	Total remuneration	Bonus as % of maximum
2013	£751,000	94%
2012	£617,000	60%
2011	£482,000	18%
2010	£463,000	25%
2009	£380,000	0%

Statement of implementation of Remuneration Policy in 2014

From 2014, an MTI scheme is to be introduced to align reward to the achievement of sustainable profit and member interests over a number of years. The performance period for the 2014 scheme is the three year period ending 31 December 2016, with the first payments from the scheme to be made in March 2017.

The introduction of the MTI scheme increases the variable pay of each participant by introducing a medium term award which is a third of the value of the 2013 STI scheme. In order to create the desired balance in overall variable pay between the short and medium term, the Remuneration Committee determined that some value should transfer from the STI scheme to the MTI scheme to achieve an equal balance between the two elements of variable pay. The proposals for each Executive Director are shown in the table below.

Director	Short Term Incentive		Medium Term Incentive	
	Target	Maximum	Target	Maximum
Mr D J Cutter	30%	50%	30%	50%
Mr I M Cornelius	30%	50%	30%	50%
Mr M R Fleet	30%	50%	30%	50%

The introduction of the MTI scheme impacts current remuneration packages in two ways:

- An overall increase in remuneration opportunity in the longer term – the maximum increases from 85% to 100% of base salary for the Group Chief Executive and from 75% to 100% for the other Executive Directors. This increases total remuneration in line with the market and supports longer term objectives focussed on growth and increased value for our members.
- A reduction in potential payments for the next three years due to the transition of value between short and medium term schemes – maximum reduces from 85% to 50% for the Group Chief Executive and from 75% to 50% for the other Executive Directors.

As a result and to reflect external benchmarking the Committee agreed to adjust the Executive Directors' base salaries.

Accordingly, Mr Cutter's salary was increased by 8.1% and the other Executive Directors' salaries increased by 4% on 1 January 2014, with the exception of Mr Twigg who will be joining the Connells group in April 2014.

From 1 January 2014 the Executive Directors' salaries are therefore as follows:

Director	1 April 2013	1 January 2014
Mr D J Cutter	£370,000	£400,000
Mr I M Cornelius	£216,500	£225,160
Mr M R Fleet	£237,000	£246,480
Mr R J Twigg	£281,500	£281,500

The operation of the Short Term Incentive scheme is expected to remain as outlined in the policy table with the following weighting of measures:

Element	Weight
Group profit	30%
Mortgages and Savings division profit	30%
Team KPIs	20%
Personal objectives	20%

The Committee and its advisers

The Remuneration Committee is responsible for determining, on behalf of the Board, the Group's Remuneration Policy, reviewing its adequacy, effectiveness and compliance with regulatory requirements. 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; and
- agrees the design and overall targets for any short or longer 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 requirements set out by the PRA and FCA. These principles, which are reviewed annually, set appropriate standards with regard to remuneration governance, risk management, variable pay structures (and the link to performance) and Code Staff remuneration. The overarching principles are set out in the policy section of this report. 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 2013. In discharging its duties, the Committee reviews and takes into account independently produced data in relation to similar financial services organisations. Remuneration consultants advising the Committee are independent from the Group.

The Committee currently comprises three Non-Executive Directors, Messrs Thompson (Chairman) and East and Ms Stevenson. The Chairman, Group Chief Executive, Chief Conduct Risk Officer and Secretary and Chief Human Resources Officer regularly attend meetings by invitation and external advisers are invited to attend meetings as and when appropriate. The external advisers providing support to the Committee in 2013 were Mercer Limited and PricewaterhouseCoopers LLP. Mercer is a long standing adviser to the Committee and provided consultancy on the design of the MTI scheme. Consultants from PricewaterhouseCoopers were introduced to support the Committee on some aspects of implementing the Remuneration Code which was done in conjunction with a BSA working group in 2012. The appointment of advisers is carried out on a competitive tender basis and neither Mercer nor PricewaterhouseCoopers are connected with the Society.

The Committee intends to review its advisers in 2014.

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

Statement of voting at 2013 AGM

At the 2013 AGM the Directors' Remuneration Report was subject to an advisory vote of members, the results of which were as follows.

Year	Vote	Votes		
		For	Against	Withheld
2013	Advisory vote on 2012 remuneration report	66,531 (87.44%)	9,556	1,751

Nimble Thompson
Chairman of the Remuneration Committee
25 February 2014

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 2013 set out on pages 61 to 148. 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 30, 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 2013 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

25 February 2014

Income Statements

For the year ended 31 December 2013

	Notes	**Group 2013 £m**	Group 2012 Restated* £m	**Society 2013 £m**	Society 2012 Restated* £m
Interest receivable and similar income	2	**393.4**	381.2	**365.3**	374.3
Interest payable and similar charges	3	**(250.8)**	(297.0)	**(252.5)**	(309.1)
Net interest receivable		**142.6**	84.2	**112.8**	65.2
Fees and commissions receivable	4	**425.9**	399.4	**23.5**	20.8
Fees and commissions payable	5	**(5.0)**	(7.4)	**(2.0)**	(2.7)
Fair value gains on financial instruments		**3.9**	3.6	**3.7**	3.5
Income from shares in subsidiary undertakings		**-**	-	**30.9**	40.5
Profit on disposal of subsidiary undertakings	17b), 17d)	**24.7**	-	**-**	-
Dividend income from equity share investments		**1.1**	-	**-**	-
Share of profits from joint ventures and associates	17c), 17d)	**1.3**	1.6	**-**	-
Other income	6	**6.6**	9.1	**3.3**	3.9
Total income		**601.1**	490.5	**172.2**	131.2
Administrative expenses	7	**(455.3)**	(410.1)	**(68.6)**	(59.9)
Operating profit before impairment losses and provisions		**145.8**	80.4	**103.6**	71.3
Impairment losses on loans and advances to customers	16	**(21.5)**	(12.3)	**(17.4)**	(9.8)
Impairment losses on debt securities	13	**(1.2)**	(4.0)	**(1.2)**	(4.0)
Provisions for liabilities	27	**(20.6)**	(28.7)	**(9.3)**	(9.7)
Provisions against investments in subsidiary undertakings	17a)	**-**	-	**(1.3)**	(5.4)
Profit before tax		**102.5**	35.4	**74.4**	42.4
Tax expense	11	**(26.2)**	(8.8)	**(11.1)**	(2.6)
Profit for the financial year		**76.3**	26.6	**63.3**	39.8
Profit for the financial year attributable to:					
Members of Skipton Building Society		**75.2**	27.6	**63.3**	39.8
Non-controlling interests		**1.1**	(1.0)	**-**	-
		76.3	26.6	**63.3**	39.8

* During the year, the Group and Society have adopted IAS 19 (revised 2011), *Employee Benefits*, as detailed in notes 1a) and 41. If the revised standard had applied in 2012, other income would have been £1.0m and £0.4m lower than previously stated for Group and Society respectively, with an equivalent increase in Other Comprehensive Income through the Statement of Other Comprehensive Income. The 2012 comparatives included in these financial statements have been restated accordingly.

Segmental performance of the Group is shown in note 39.

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

The notes on pages 68 to 148 form part of these Accounts.

Statements of Comprehensive Income

For the year ended 31 December 2013

	Notes	**Group 2013 £m**	Group 2012 Restated* £m	**Society 2013 £m**	Society 2012 Restated* £m
Profit for the financial year		**76.3**	26.6	**63.3**	39.8
Other comprehensive income:					
Items that will not be reclassified to profit or loss:					
Remeasurement losses on defined benefit obligations	29	**(9.2)**	(4.5)	**(4.5)**	(1.6)
Income tax on items that will not be reclassified to profit or loss	32	**0.7**	0.7	**0.3**	-
		(8.5)	(3.8)	**(4.2)**	(1.6)
Items that may be reclassified subsequently to profit or loss:					
Available-for-sale investments: valuation gains / (losses) taken to equity	32	**28.8**	(4.5)	**(2.4)**	(5.6)
Available-for-sale investments: realised losses / (gains) reclassified to Income Statement	32	**0.7**	(6.6)	**0.7**	(6.6)
Cash flow hedges: gains taken to equity	32	**5.2**	6.4	**5.2**	6.4
Exchange differences on translation of foreign operations	32	**(0.5)**	0.1	**-**	-
Income tax on items that may be reclassified to profit or loss	32	**(8.3)**	0.8	**(1.2)**	1.0
		25.9	(3.8)	**2.3**	(4.8)
Other comprehensive income / (expense) for the year, net of tax		**17.4**	(7.6)	**(1.9)**	(6.4)
Total comprehensive income for the year		**93.7**	19.0	**61.4**	33.4
Total comprehensive income attributable to:					
Members of Skipton Building Society		**92.6**	20.0	**61.4**	33.4
Non-controlling interests		**1.1**	(1.0)	**-**	-
		93.7	19.0	**61.4**	33.4

* During the year, the Group and Society have adopted IAS 19 (revised 2011), *Employee Benefits*, as detailed in notes 1a) and 41. If the revised standard had applied in 2012, other income would have been £1.0m and £0.4m lower than previously stated for Group and Society respectively, with an equivalent increase in Other Comprehensive Income through the Statement of Other Comprehensive Income. The 2012 comparatives included in these financial statements have been restated accordingly.

The notes on pages 68 to 148 form part of these Accounts.

Statements of Financial Position

As at 31 December 2013

	Notes	**Group 2013 £m**	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Assets					
Cash in hand and balances with the Bank of England		**859.4**	1,014.8	**859.4**	1,014.6
Loans and advances to credit institutions	12	**326.2**	383.1	**195.5**	232.0
Debt securities	13	**1,195.5**	1,133.9	**1,717.1**	1,694.1
Derivative financial instruments	14	**148.8**	202.7	**151.7**	207.9
Loans and advances to customers	15	**11,516.9**	10,593.5	**9,205.2**	8,221.7
Current tax asset		**-**	-	**-**	0.8
Deferred tax asset	28	**18.9**	28.8	**9.7**	16.8
Investments in group undertakings	17a)	**-**	-	**1,845.7**	1,980.5
Investments in joint ventures	17c)	**4.2**	3.1	**-**	-
Investments in associates	17d)	**13.4**	-	**-**	-
Equity share investments	17e)	**37.1**	3.1	**-**	-
Property, plant and equipment	18	**81.6**	81.4	**30.2**	31.2
Investment property	19	**6.7**	11.6	**27.1**	32.6
Intangible assets	20	**174.2**	196.2	**1.5**	1.5
Other assets	21	**103.8**	108.0	**10.5**	11.9
Total assets		**14,486.7**	13,760.2	**14,053.6**	13,445.6
Liabilities					
Shares	22	**10,260.1**	9,462.4	**10,260.1**	9,462.4
Amounts owed to credit institutions	23	**1,046.3**	907.6	**1,149.4**	969.0
Amounts owed to other customers	24	**930.8**	897.7	**1,268.9**	1,541.9
Debt securities in issue	25	**554.7**	730.9	**49.7**	60.1
Derivative financial instruments	14	**287.6**	370.8	**251.6**	304.9
Current tax liability		**9.3**	3.7	**2.7**	-
Other liabilities	26	**95.7**	83.0	**8.3**	7.4
Accruals and deferred income		**42.8**	40.2	**8.9**	7.1
Provisions for liabilities	27	**44.5**	54.5	**14.5**	16.6
Deferred tax liability	28	**13.9**	8.8	**3.5**	4.2
Retirement benefit obligations	29	**53.3**	45.1	**24.2**	20.1
Subordinated liabilities	30	**124.4**	223.9	**124.4**	223.9
Subscribed capital	31	**94.1**	96.1	**94.1**	96.1
Total liabilities		**13,557.5**	12,924.7	**13,260.3**	12,713.7
Members' interests					
General reserve		**911.6**	844.9	**809.9**	750.8
Available-for-sale reserve		**20.5**	(2.3)	**(5.6)**	(4.3)
Cash flow hedging reserve		**(11.0)**	(14.6)	**(11.0)**	(14.6)
Translation reserve		**5.2**	5.7	**-**	-
Attributable to members of Skipton Building Society		**926.3**	833.7	**793.3**	731.9
Non-controlling interests		**2.9**	1.8	**-**	-
Total members' interests		**929.2**	835.5	**793.3**	731.9
Total members' interests and liabilities		**14,486.7**	13,760.2	**14,053.6**	13,445.6

These Accounts were approved by the Board of Directors on 25 February 2014 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 68 to 148 form part of these Accounts.

Statements of Changes in Members' Interests

For the year ended 31 December 2013

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 2013	**844.9**	**(2.3)**	**(14.6)**	**5.7**	**833.7**	**1.8**	**835.5**
Profit for the financial year	75.2	-	-	-	**75.2**	1.1	**76.3**
Other comprehensive income							
Remeasurement losses on defined benefit obligations	(8.5)	-	-	-	**(8.5)**	-	**(8.5)**
Net gains from changes in fair value	-	22.3	3.6	-	**25.9**	-	**25.9**
Available-for-sale losses transferred to profit or loss on sale	-	0.5	-	-	**0.5**	-	**0.5**
Exchange differences on translation of foreign operations	-	-	-	(0.5)	**(0.5)**	-	**(0.5)**
Total other comprehensive income (note 32)	**(8.5)**	**22.8**	**3.6**	**(0.5)**	**17.4**	**-**	**17.4**
Total comprehensive income for the year	**66.7**	**22.8**	**3.6**	**(0.5)**	**92.6**	**1.1**	**93.7**
Balance at 31 December 2013	**911.6**	**20.5**	**(11.0)**	**5.2**	**926.3**	**2.9**	**929.2**
Balance at 1 January 2012	820.8	6.0	(19.0)	5.9	813.7	2.8	816.5
Profit for the financial year (restated*)	27.6	-	-	-	27.6	(1.0)	26.6
Other comprehensive income							
Remeasurement losses on defined benefit obligations (restated*)	(3.8)	-	-	-	(3.8)	-	(3.8)
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 32)	(3.5)	(8.3)	4.4	(0.2)	(7.6)	-	(7.6)
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

* The 2012 comparatives have been restated in line with accounting standards adopted in the year as described in notes 1a) and 41.

The notes on pages 68 to 148 form part of these Accounts.

Statements of Changes in Members' Interests

Continued

For the year ended 31 December 2013

Society	General reserve £m	Available-for-sale financial assets £m	Cash flow hedges £m	Total £m
Balance at 1 January 2013	**750.8**	**(4.3)**	**(14.6)**	**731.9**
Profit for the financial year	63.3	-	-	**63.3**
Other comprehensive income				
Remeasurement losses on defined benefit obligations	(4.2)	-	-	**(4.2)**
Net (losses) / gains from changes in fair value	-	(1.8)	3.6	**1.8**
Available-for-sale losses transferred to profit or loss on sale	-	0.5	-	**0.5**
Total other comprehensive income (note 32)	**(4.2)**	**(1.3)**	**3.6**	**(1.9)**
Total comprehensive income for the year	**59.1**	**(1.3)**	**3.6**	**61.4**
Balance at 31 December 2013	**809.9**	**(5.6)**	**(11.0)**	**793.3**

Balance at 1 January 2012	712.6	4.9	(19.0)	698.5
Profit for the financial year (restated*)	39.8	-	-	39.8
Other comprehensive income				
Remeasurement losses on defined benefit obligations (restated*)	(1.6)	-	-	(1.6)
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 32)	(1.6)	(9.2)	4.4	(6.4)
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

* The 2012 comparatives have been restated in line with accounting standards adopted in the year as described in notes 1a) and 41.

The notes on pages 68 to 148 form part of these Accounts.

Statements of Cash Flows

For the year ended 31 December 2013

	Notes	**Group 2013 £m**	Group 2012 Restated* £m	**Society 2013 £m**	Society 2012 Restated* £m
Cash flows from operating activities					
Profit before tax		**102.5**	35.4	**74.4**	42.4
Adjustments for:					
Impairment losses on debt securities	13	**1.2**	4.0	**1.2**	4.0
Impairment losses on loans and advances to customers	16	**21.5**	12.3	**17.4**	9.8
Loans and advances written off, net of recoveries	16	**(35.2)**	(27.6)	**(23.4)**	(11.7)
Provisions against investments in subsidiary undertakings	17a)	**-**	-	**1.3**	5.4
Depreciation and amortisation	18,19,20	**18.3**	19.2	**3.4**	3.7
Impairment of investment property	19	**1.2**	1.3	**1.2**	1.3
Impairment of goodwill	20	**16.6**	-	**-**	-
Dividends receivable from group undertakings		**-**	-	**(30.9)**	(40.5)
Dividends receivable from equity share investments		**(1.1)**	-	**-**	-
Interest on subscribed capital and subordinated liabilities	3	**21.1**	23.9	**21.1**	23.9
Net profit on sale of property, plant and equipment, investment properties and intangible assets	6	**(0.2)**	(0.2)	**(0.3)**	(0.2)
Share of profits from joint ventures and associates	17c), 17d)	**(1.3)**	(1.6)	**-**	-
Profit on disposal of subsidiary undertakings	17b), 17d)	**(24.7)**	-	**-**	-
Other non-cash movements		**4.7**	(8.9)	**5.4**	(5.4)
		124.6	57.8	**70.8**	32.7
Changes in operating assets and liabilities:					
Movement in prepayments and accrued income		**1.0**	3.1	**0.4**	5.7
Movement in accruals and deferred income		**(23.4)**	(5.2)	**(24.9)**	(3.9)
Movement in provisions for liabilities		**(10.0)**	20.3	**(2.1)**	6.1
Movement in fair value of derivatives		**(29.3)**	10.0	**2.9**	4.0
Movement in fair value adjustments for hedged risk		**13.0**	10.9	**9.8**	8.5
Fair value movements in debt securities		**20.7**	(11.4)	**18.5**	(10.2)
Movement in loans and advances to customers		**(964.3)**	(365.2)	**(1,028.7)**	(437.6)
Movement in shares		**848.9**	183.6	**848.9**	183.6
Net movement in amounts owed to credit institutions and other customers		**174.8**	6.9	**(91.2)**	123.4
Net movement in debt securities in issue		**(175.7)**	(358.2)	**(10.2)**	(708.1)
Net movement in loans and advances to credit institutions		**24.5**	51.4	**29.3**	51.4
Net movement in other assets		**7.3**	(7.7)	**5.1**	(1.7)
Net movement in other liabilities		**12.8**	6.3	**5.0**	(1.1)
Income taxes paid		**(20.2)**	(4.9)	**(7.1)**	(1.8)
Net cash flows from operating activities		**4.7**	(402.3)	**(173.5)**	(749.0)

* The 2012 comparatives have been restated in line with accounting standards adopted in the year as described in notes 1a) and 41.

Statements of Cash Flows

Continued

For the year ended 31 December 2013

	Notes	**Group 2013 £m**	Group 2012 Restated* £m	**Society 2013 £m**	Society 2012 Restated* £m
Net cash flows from operating activities		**4.7**	(402.3)	**(173.5)**	(749.0)
Cash flows from investing activities					
Purchase of debt securities	13	**(767.1)**	(2,280.5)	**(737.2)**	(2,176.4)
Proceeds from disposal of debt securities	13	**683.6**	3,031.3	**694.5**	2,995.8
Purchase of property, plant and equipment and investment property	18,19	**(11.6)**	(12.0)	**(1.2)**	(1.8)
Purchase of intangible assets	20	**(7.4)**	(7.8)	**(0.6)**	(0.3)
Proceeds from disposal of property, plant and equipment, investment property and intangible assets		**5.2**	1.6	**4.0**	0.8
Dividends received from group undertakings		**-**	-	**30.9**	40.5
Dividends received from equity share investments		**1.1**	-	**-**	-
Dividends received from joint ventures		**1.1**	1.0	**-**	-
Dividends paid to non-controlling interests	26	**(1.9)**	(1.3)	**-**	-
Purchase of subsidiary undertakings		**-**	(0.2)	**-**	-
Further investment in subsidiary undertakings	17a)	**(0.2)**	-	**(1.3)**	-
Investment in joint ventures and equity share investments	17c), 17e)	**(0.8)**	(3.1)	**-**	-
Purchase of other business units	17a)	**(0.7)**	-	**-**	-
Cash received from sale of subsidiary undertakings, net of cash disposed of		**(0.3)**	3.3	**-**	-
Cash received on flotation of subsidiary		**19.2**	-	**-**	-
Net cash flows from investing activities		**(79.8)**	732.3	**(10.9)**	858.6
Cash flows from financing activities					
Repurchase of subordinated liabilities	30	**(91.7)**	-	**(91.7)**	(12.5)
Decrease in loans to subsidiary undertakings	17a)	**-**	-	**134.8**	180.6
Interest paid on subordinated liabilities		**(12.8)**	(15.6)	**(12.8)**	(15.6)
Interest paid on subscribed capital		**(8.3)**	(8.3)	**(8.3)**	(8.3)
Net cash flows from financing activities		**(112.8)**	(23.9)	**22.0**	144.2
Net (decrease) / increase in cash and cash equivalents		**(187.9)**	306.1	**(162.4)**	253.8
Cash and cash equivalents at 1 January		**1,176.2**	870.1	**1,025.0**	771.2
Cash and cash equivalents at 31 December		**988.3**	1,176.2	**862.6**	1,025.0

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

	Notes	**Group 2013 £m**	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Cash in hand and balances with the Bank of England		**859.4**	1,014.8	**859.4**	1,014.6
Mandatory reserve deposit with the Bank of England		**(18.4)**	(11.1)	**(18.4)**	(11.1)
		841.0	1,003.7	**841.0**	1,003.5
Loans and advances to credit institutions	12	**147.3**	172.5	**21.6**	21.5
Cash and cash equivalents as at 31 December		**988.3**	1,176.2	**862.6**	1,025.0

* The 2012 comparatives have been restated in line with accounting standards adopted in the year as described in notes 1a) and 41.

The notes on pages 68 to 148 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 30 of the Directors' Report) and in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and effective at 31 December 2013; 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, and derivatives and certain other liabilities at fair value through profit or loss.

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

The Directors have adopted IAS 19 (revised 2011), *Employee Benefits*, IFRS 13, *Fair Value Measurement*, and Annual Improvements to IFRS (2009 – 2011), as well as amendments to IAS 1, *Presentation of items of Other Comprehensive Income*, IAS 12, *Deferred Tax – Recovery of Underlying Assets*, and IFRS 7, *Financial Instruments – Disclosures*.

The Directors have not adopted IFRS 10, *Consolidated Financial Statements*, IFRS 11, *Joint Arrangements*, and IFRS 12, *Disclosure of Interest in Other Entities*, which although endorsed by the EU are currently not effective.

Note 41 to the Accounts sets out details of the impact of newly adopted standards together with the impact 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 2013.

b) Basis of consolidation

Subsidiary undertakings

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

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

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 future purchase of remaining non-controlling interests. Under this accounting policy the Group consolidates 100% of the results of such 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 have taken 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 results 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

1. Accounting policies *(continued)*

excess of the non-controlling interests in the subsidiary undertaking's equity are allocated against the interests of the Group unless the non-controlling entity has a binding obligation and is able to make an additional investment to cover those losses.

Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, as well as any related non-controlling interest and other components of equity. Any resulting gain or loss is recognised in the Income Statement.

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 within 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 share investments

An equity share investment is an investment in the share capital of a company where the Group does not have significant influence.

Equity share investments 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 loans and advances to customers by the transfer of the beneficial interest in such 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 beneficial interest in these loans to the SPVs are not treated as sales by the Society. The Society continues to recognise these assets within its own Statement of Financial Position after the transfer because it retains the risks and rewards of the portfolio. In the accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the SPVs.

c) Intangible assets

Goodwill

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

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash generating units expected to benefit from the synergies of combination. The impairment test compares the carrying value of goodwill to its associated value in use. The value in use calculations are carried out by discounting the future cash flows of the cash generating unit (see note 20). Future cash flows are ordinarily based upon the corporate plans of the cash generating units for the next five years and assumed growth thereafter for the subsequent 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 to the Statement of Financial Position.

1. Accounting policies *(continued)*

Goodwill arising on acquisitions before the transition to IFRS on 1 January 2005 has been retained at its previous UK GAAP amount and is reviewed for impairment at least annually, as above. Goodwill written off to reserves under UK GAAP prior to 1 January 2004 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 as incurred.

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 10 years. Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

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 to the Group against the carrying value of the asset.

Research and development

Expenditure on research activities is expensed to the Income Statement in the period it is incurred.

Development expenditure is capitalised and recognised as an intangible asset only if the expenditure can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable and the Group intends to, and has sufficient resources to, complete development and use or sell the asset. If these criteria are not met, the expenditure is recognised in the Income Statement as it is incurred. Subsequent to initial recognition, capitalised development expenditure is measured at cost less accumulated amortisation and is subject to impairment testing at each reporting date or when there is indication of impairment.

d) Financial assets

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

Available-for-sale

Available-for-sale assets are non-derivative financial assets that are not classified as loans and receivables, at fair value through profit or loss or held to maturity. 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. When the assets are derecognised, the gain or loss accumulated in equity is reclassified to the Income Statement.

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

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

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 and all other liquidity balances are classified as loans and receivables, and are measured at amortised cost using the effective interest method. The effective interest method implies an interest rate which exactly discounts the forecast cash flows of an asset over its expected life back to its carrying value.

1. Accounting policies *(continued)*

In accordance with the effective interest method, directly attributable 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 used to secure debt securities issued by the Group's special purpose vehicles, Darrowby No. 1 plc and Darrowby No. 2 plc, which are each consolidated into the Group Accounts. The beneficial interest in the underlying loans has been transferred to these 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 (for example 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 within 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.

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 hedged item or the amount in the cash flow hedging 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 risks of the host instrument and where the hybrid instrument is not measured at fair value, the embedded derivative is separated from the host instrument and measured at fair value 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.

1. Accounting policies *(continued)*

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 expenses 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 'Fair value gains on financial instruments' caption in the Income Statement.

Held to maturity

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

e) Financial liabilities

Borrowings, 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. Borrowings are subsequently measured at amortised cost using the effective interest method. Derivative liabilities, the fair value of the put option obligation and the fair value of the liability of the management incentive scheme are measured at fair value through profit or 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.

Where financial liabilities are hedged, the Group elects to use the fair value option for those hedged financial liabilities. This designation has been adopted to reduce the volatility that would otherwise exist given that the underlying liabilities in question are economically hedged by derivatives which are also held at fair value through profit or loss.

f) Impairment of financial assets

Impairment of loans and advances secured on residential property or land

Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession or where fraud or negligence has been identified. Objective evidence of impairment may include indications that the borrower or group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, or the debt being renegotiated to reduce the burden on the borrower. The key drivers influencing the objective evidence predominantly relate to affordability issues driven by unemployment and 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, 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 within 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 loss to decrease, the decrease in impairment loss is recognised through the Income Statement.

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

Impairment of other loans and advances

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

1. Accounting policies *(continued)*

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 loss 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 repayments and amortisation, and the current fair value, less any impairment loss on that asset previously recognised in the Income Statement.

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

g) Derecognition of financial assets and liabilities

Financial assets are derecognised when the contractual rights to receive cash flows have expired or where substantially all the risks and rewards of ownership have been transferred. The Society has not derecognised the loans securing its securitisation issues because substantially all the risks and rewards are retained by the Society as detailed in note 1b). Financial liabilities are derecognised only when the obligation is discharged, cancelled or has expired.

h) Foreign currency transactions

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

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

The Income Statements of subsidiary undertakings with non-Sterling functional currencies are translated into Sterling at the monthly average rates for the period, and assets and liabilities are translated at the closing rate of exchange at the reporting date (other than certain non-monetary items that are held at their translated historical cost). 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, except to the extent that the translation difference is allocated to the non-controlling interest.

Where a foreign operation is disposed of in its entirety, or partially disposed of such that control is lost, the cumulative amount of translation differences recognised as a separate component of equity is reclassified to the Income Statement as part of the gain or loss on disposal.

i) Taxation

The income tax expense or credit on the profits or losses 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 or receivable on the taxable income or expenditure for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the Statement of Financial Position liability method, which recognises temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor income and

1. Accounting policies *(continued)*

expenditure, and differences relating to investments in subsidiary undertakings, associates and joint arrangements to the extent that it is probable they will not reverse in the foreseeable future. Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which temporary differences reverse, based on tax rates and laws enacted or substantively enacted at the reporting date.

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

j) Leases

Where the Group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. The asset is recorded within 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 under 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.

k) Employee benefits

Defined contribution pension arrangements

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

Defined benefit schemes

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

Included within 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.

Net interest income on the defined benefit obligations comprises interest income on plan assets, less the interest cost on the scheme liabilities, and interest on the effect of the asset ceiling. Net interest income and other expenses relating to the defined benefit pension schemes are recognised in the Income Statement.

Remeasurements of the retirement benefit obligations, which comprise actuarial gains or losses (arising from the differences between previous actuarial assumptions and actual experience), the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest) are recognised in the Statement of Comprehensive Income.

Past and current service costs are recognised immediately in the Income Statement. When a plan is curtailed, the resulting gain or loss on settlement is also recognised immediately in the Income Statement. The Group recognises gains or losses on the settlement of a retirement benefit obligation when the settlement occurs.

1. Accounting policies *(continued)*

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

l) Fees and commissions

Other than those accounted for using 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 and land and auction income are recognised on the date contracts are exchanged. Property management income is recognised when the cash is received, which reflects the point at which income is earned and contractual obligations have been fulfilled. 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. Mortgage Services income is recognised on an accruals basis over the period of services rendered.

The recognition of fees and commissions receivable from the sale of third party Regulated Financial Services products is dependent on the market in which the adviser operates and therefore the nature of the advice provided. Revenue is recognised either when the right to consideration has been obtained through fulfilment of performance obligations, or when the provision of advice can be demonstrated by the signing of the initial suitability letter by the customer which demonstrates acceptance of the advice provided. A provision for future clawbacks is made for repayment in the event of early termination by the customer. Ongoing commission income received monthly over the life of a policy is recognised on an accruals basis over the period of the service 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.

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

m) Government grants

Grants received which related to expenditure on property, plant and equipment or intangible assets are netted against the cost of the underlying asset 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 in the Income Statement.

n) Property, plant and equipment

Property, plant and equipment is 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 to their 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	Five to 10 years
Short leasehold buildings	Period of lease
Equipment, fixtures and fittings	Two 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. Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted where appropriate. 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.

Subsequent expenditure on items of property, plant and equipment is capitalised only if the subsequent expenditure increases the item's revenue generating capabilities and it is probable that future economic benefits associated with the expenditure will flow to the Group.

Any gain or loss on disposal of an item of property, plant and equipment is recognised in the Income Statement.

1. Accounting policies *(continued)*

o) Segmental reporting

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

Each segment is determined according to distinguishable operating components of the Group that are regularly reviewed 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 39.

p) 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.

q) Investment properties

Properties held by the Group which 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.

Rental income from investment property is recognised over the term of the lease and is included in other income.

Any gain or loss on disposal of investment property is recognised in the Income Statement.

r) Financial guarantee contracts

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

s) Sale and repurchase agreements

Investments and other securities may be lent or sold subject to a commitment to repurchase them (a ‘repo’). Such securities are retained within 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 within the Statement of Financial Position as appropriate.

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

t) Client money

A number of Group companies hold or receive money on behalf of their clients in the course of normal business. These amounts are not represented within the Statement of Financial Position as substantially all the risks and rewards relating to the client money remain with the clients themselves. Such Group companies are subject to client money regulation, and all client money is held in accordance with these regulations as required by the FCA. Client money held by the Group as at 31 December 2013 amounted to £19.4m (2012: £24.4m), and for Society amounted to £nil (2012: £nil).

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 evaluated continually and are based on historical experience and other factors, including

1. Accounting policies *(continued)*

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 loans and advances to customers would result in a £0.8m (2012: £1.7m) increase in the Group's interest income and a £0.7m (2012: £1.1m) increase in the Society's interest income.

During the year a charge of £1.9m (2012: £1.2m credit) for the Group and a charge of £1.9m (2012: £2.4m charge) for the Society were recognised through interest income, following a reassessment of the expected lives of loans and advances to customers.

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 assess key assumptions such as the probability of an account going into possession, the time period over which an account will exhibit objective evidence of an impairment loss (the 'emergence period'), and the eventual loss incurred in the event of forced sale or write-off.

A critical estimate in calculating the eventual loss incurred in the event of sale is the future level of UK house prices which we have assumed increased by 3.7% across our portfolios in 2013 and will increase by 3% in each of 2014 and 2015. Based upon the loss provisioning model used by the Group, a 10% fall in house prices compared to the assumptions used (e.g. from 3% to (7%) in 2014) would increase the year end residential impairment provision by £4.8m (2012: £5.6m). Other sensitivities include the emergence period, where an increase of three months would increase the loan impairment provision by £2.1m (2012: £3.9m), and the loss given default, where a 10% increase equates to a £3.4m (2012: £4.0m) increase in the loan impairment provision.

In respect of commercial loan exposures these are individually reviewed on a monthly basis and suitably qualified commercial underwriters 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 a reduction in the aggregate put option obligation by £1.5m (2012: £1.4m). A 10% increase in the aggregate market value of these businesses would increase the put option liability by £1.5m (2012: £1.3m).

Management incentive scheme

During 2012, senior management of Connells Limited purchased equity shares in that company and at the same time the Group issued options to these shareholders which require the Group to purchase these options at some future dates. In accordance with IFRS 2, *Share-based Payment*, the Group recognises the increase in the fair value of the liability, spread over the vesting period to the date of exercise. The fair value of this liability is dependent on the following assumptions: an estimate of when

1. Accounting policies *(continued)*

the options will be exercised by the non-controlling shareholders, and the forecast profits and cash flows of Connells Limited over the period to exercise.

A 10% increase in the pre-tax profits of Connells Limited above the amounts forecasted would result in an increase to the fair value of the liability of £1.6m (2012: £nil), with a corresponding increase to the Income Statement charge for the year. In addition, the fair value of the liability at 31 December 2013 is based on the assumption that management will exercise their options at the earliest available opportunity under the terms of the scheme; if however management were to exercise their options at the latest opportunity then the fair value of the liability and corresponding charge to the Income Statement would reduce by £1.2m (2012: £nil) as at 31 December 2013.

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 cash flows, discount rates and growth rates. These assumptions are reviewed on a regular basis by senior management.

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

The discount rate used to discount the future expected cash flows is based on the cost of capital assigned to each cost generating unit (see note 20) 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 2013, to the extent that discount rates were to increase by 10%, e.g. from 10% to 11%, the impairment charge would increase by £nil (2012: £0.3m). In addition, a reduction in the long term growth rate assumption from 2.5% to 0% would increase the impairment charge by £nil (2012: £0.3m).

Fair value of financial instruments

Fair values are determined by the three tier valuation hierarchy as defined within IFRS 13 and Amendments to IFRS 7, *Financial Instruments: Disclosures,* as described in note 38.

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 cash flow 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.

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

The schemes expose the Group to actuarial risks such as investment risk, interest rate risk, mortality risk and longevity risk. In conjunction with its actuaries the Group makes key financial assumptions which are used in the actuarial valuation of the defined benefit pension obligation and, therefore, changes to these assumptions have an impact on the pension obligation shown within the Statement of Financial Position and amounts reported in the Income Statement. These assumptions include the inflation and discount rates, life expectancy, commutation allowances and the rate of salary growth; see note 29 for further details on these assumptions.

A decrease in corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to scheme liabilities. This would impact the Statement of Financial Position adversely and may give rise to increased charges in future years' Income Statements. This effect would be partially offset by an increase in the value of the schemes' bond holdings and caps on inflationary increases also exist to protect the schemes against high levels of inflation.

Approximate sensitivities of the principal assumptions are set out in the table below which shows the increase or reduction in the pension obligations that would result. Each sensitivity considers one change in isolation.

1. Accounting policies *(continued)*

Assumption	Change in assumption	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Discount rate	+/-0.25% pa	**-/+10.8**	-/+9.3	**-/+5.3**	-/+5.1
Rate of inflation	+/-0.5% pa	**+/-10.3**	+/-9.7	**+/-4.4**	+/-4.3
Rate of salary growth	+/-0.5% pa	**-**	-	**-**	-
Commutation allowance	+/-10% pa	**+/-1.6**	+/-1.5	**+/-0.7**	+/-0.7
Life expectancy	+ 1 year	**+4.7**	+4.1	**+2.3**	+2.1

The average duration of the defined benefit obligation as at 31 December 2013 is 20 years (2012: 20 years).

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 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 FCA guidance, the Society provides for an estimate of the management expense levy for those scheme years triggered by the reporting date, and in 2013 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 £1.8m (2012: £1.9m) and vice versa.

Other provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, it is probable that the Group will be required to settle that obligation, and the amount can be estimated reliably. 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 other provisions made within the Group cover provisions for the cost of surplus properties, commission reclaims and rebates, customer claims and customer compensation.

Included in the Group's customer compensation provision is a gross provision of £3.8m (2012: £11.6m) which represents the Directors' best estimate of the expenditure required to settle liabilities arising from past business events. The provision has fallen considerably since 2012 as reviews of past business written have revealed a lower incidence of customer detriment and, consequently, compensation required to be paid than previously estimated. The past business reviews are now largely complete and the degree of uncertainty surrounding their ultimate quantum is, likewise, reduced.

The provisions are calculated gross of professional indemnity insurance, for which a receivable of £2.2m (2012: £8.5m) has been included within other assets. The Directors believe that the insurance asset meets the 'virtually certain' test in accordance with the accounting standard and that recoveries will continue to be made under the terms of the insurance policies in place.

2. Interest receivable and similar income

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
On financial assets not at fair value through profit or loss:				
On loans fully secured on residential property	**427.5**	402.3	**340.8**	312.8
On other loans:				
To subsidiary undertakings	**-**	-	**62.4**	86.6
Other	**11.4**	13.6	**8.8**	11.2
On debt securities	**23.1**	38.7	**22.8**	38.0
On other liquid assets	**4.8**	7.4	**3.9**	6.5
	466.8	462.0	**438.7**	455.1
On financial assets at fair value through profit or loss:				
Net expense on derivative financial instruments	**(73.4)**	(80.8)	**(73.4)**	(80.8)
	393.4	381.2	**365.3**	374.3

Included within interest receivable and similar income on debt securities is income from fixed income securities in the Group of £14.8m (2012: £16.5m) and in the Society of £14.6m (2012: £15.7m). Also included within interest receivable and similar income on debt securities is income from available-for-sale assets in the Group of £18.9m (2012: £32.5m) and in the Society of £18.6m (2012: £31.7m).

Included within interest receivable and similar income is interest accrued on impaired financial assets in the Group of £6.6m (2012: £8.0m) and in the Society of £1.4m (2012: £1.5m).

3. Interest payable and similar charges

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
On financial liabilities not at fair value through profit or loss:				
On shares	**217.7**	240.1	**217.7**	240.1
On subscribed capital	**8.3**	8.3	**8.3**	8.3
On deposits and other borrowings:				
Subordinated liabilities	**12.8**	15.6	**12.8**	15.6
Subsidiary undertakings	**-**	-	**53.0**	70.4
Wholesale and other funding	**30.5**	53.0	**2.7**	18.8
Other	**0.1**	0.2	**-**	-
	269.4	317.2	**294.5**	353.2
On financial liabilities at fair value through profit or loss:				
Net income on derivative financial instruments	**(18.6)**	(20.2)	**(42.0)**	(44.1)
	250.8	297.0	**252.5**	309.1

4. Fees and commissions receivable

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Mortgage origination related fees	**29.7**	20.7	**10.8**	6.6
General insurance fees	**33.8**	32.4	**3.5**	5.4
Commissions earned on property sales	**125.0**	104.2	**-**	-
Commissions earned on property lettings	**27.8**	23.1	**-**	-
Survey and valuation services	**43.0**	36.6	**-**	-
Mortgage servicing fees	**51.9**	54.5	**-**	-
Financial advice fees	**48.5**	52.3	**-**	-
Other fees and commissions	**66.2**	75.6	**9.2**	8.8
	425.9	399.4	**23.5**	20.8

5. Fees and commissions payable

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Mortgage origination related fees	**0.4**	0.3	**0.4**	0.3
Other fees and commissions	**4.6**	7.1	**1.6**	2.4
	5.0	7.4	**2.0**	2.7

6. Other income

	Group 2013 £m	Group 2012 Restated* £m	Society 2013 £m	Society 2012 Restated* £m
Property rents receivable	**1.2**	2.0	**1.8**	2.0
Net interest on defined pension obligations (note 29)	**(2.1)**	(2.0)	**(0.9)**	(0.9)
Government grants	**0.1**	0.4	**-**	-
Net profit on sale of property, plant and equipment, investment properties and intangible assets	**0.2**	0.2	**0.3**	0.2
Profit on repurchase of subordinated liabilities	**2.6**	-	**2.6**	-
Other	**4.6**	8.5	**(0.5)**	2.6
	6.6	9.1	**3.3**	3.9

* The 2012 comparatives have been restated as described in notes 1a) and 41.

Other income earned on financial assets held at fair value through profit or loss amounted to £0.1m (2012: £2.0m) for both Group and Society.

7. Administrative expenses

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Employee costs:				
Wages and salaries	**250.7**	229.4	**41.6**	37.1
Social security costs	**24.7**	21.8	**4.0**	3.4
Pension costs:				
Defined contribution arrangements (note 29)	**7.0**	6.7	**2.5**	2.4
Defined benefit schemes service costs (note 29)	**0.5**	-	**0.5**	-
Settlement gain (note 29)	**(0.1)**	-	**(0.1)**	-
	282.8	257.9	**48.5**	42.9
Other administrative expenses	**172.5**	152.2	**42.1**	40.6
Central administrative costs recharged to Group undertakings	**-**	-	**(22.0)**	(23.6)
	455.3	410.1	**68.6**	59.9
Other administrative expenses comprise:				
Depreciation and amortisation (notes 18, 19 and 20)	**18.3**	19.2	**3.4**	3.7
Impairment of goodwill (note 20)	**16.6**	-	**-**	-
Impairment of investment property (note 19)	**1.2**	1.3	**1.2**	1.3
Amounts payable under operating leases	**18.1**	21.1	**5.0**	6.9
Other property and establishment costs	**18.0**	17.5	**5.5**	5.6
Postage and communications	**14.3**	14.8	**4.6**	4.9
IT costs	**12.0**	10.1	**7.7**	6.2
Marketing and advertising	**14.2**	11.5	**2.8**	1.9
Insurance	**6.4**	6.2	**2.0**	1.9
Legal, professional and consultancy	**12.7**	17.7	**6.6**	5.4
Training, recruitment and other employee related costs	**10.3**	12.0	**3.0**	2.3
Costs of management incentive scheme (note 26)	**7.7**	-	**-**	-
Other	**22.7**	20.8	**0.3**	0.5
	172.5	152.2	**42.1**	40.6

Settlement gains of £0.1m (2012: £nil) were realised in the Group upon completion of an enhanced pension transfer exercise. The costs of £0.5m (2012: £nil) for providing these enhancements are included in pension costs above. Further details are provided in note 29.

The remuneration of the external auditors, which is included within legal, professional and consultancy costs above, is set out below (excluding VAT):

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
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**	0.1	**-**	-
Audit-related assurance services	**0.1**	0.1	**0.1**	0.1
Other assurance services	**0.3**	0.4	**-**	-
	1.2	1.3	**0.3**	0.3

8. Employee numbers

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

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Principal office and administration centres	**816**	786	**816**	786
Society branch offices	**672**	642	**672**	642
Subsidiary undertakings	**7,212**	7,010	**-**	-
	8,700	8,438	**1,488**	1,428

9. Directors' emoluments

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

Total Directors' emoluments amounted to £2.7m (2012: £2.1m).

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:

	2013 £m	2012 £m
Salary, benefits and annual performance pay	**2.5**	1.9
Employer pension contributions	**0.2**	0.2
	2.7	2.1

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:

	2013 £m	2012 £m
Mortgage loans outstanding at 31 December	**0.3**	0.1
Savings balances at 31 December	**1.2**	1.2

Interest receivable and payable on the above accounts during the year was as follows:

	2013 £000	2012 £000
Interest receivable	**7**	6
Interest payable	**26**	32

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

10. Related party transactions *(continued)*

Directors' loans and transactions

At 31 December 2013 there were outstanding mortgage loans granted in the ordinary course of business amounting in aggregate to £0.3m (2012: £0.1m) to three (2012: 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 £10.5m (2012: £11.7m) and £4.2m (2012: £3.7m) respectively to pension schemes, which are classified as related parties.

Related party transactions

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

	2013 £m	2012 £m
Rendering and receiving of services	**7.9**	6.7
Recharges of central costs	**22.0**	23.6
Interest receivable	**62.4**	86.6
Interest payable	**(53.0)**	(70.4)
Other income	**2.9**	3.1
Collateral transferred to securitisation vehicles	**-**	595.2
Purchase of debt securities	**-**	(71.0)
Repayment of debt securities	**95.9**	122.6
Repayment of subordinated debt	**-**	(12.5)

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 2013 the Society owed subsidiary undertakings £1,224.7m (2012: £1,431.3m) and was owed £1,715.2m (2012: £1,850.0m) 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:

	2013 £m	2012 £m
Services provided to the Group	**3.2**	1.3
Services provided by the Group	**4.5**	2.0

At 31 December 2013 the Group owed joint ventures and associates £0.1m (2012: £nil) and was owed £0.5m (2012: £0.3m) by joint ventures and associates.

There are no provisions in respect of sales of goods and services or in respect of outstanding loans to or from related parties at 31 December 2013 (2012: £nil).

11. Taxation expense

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Current tax	**19.2**	10.0	**6.2**	3.0
Deferred tax (note 28)	**7.0**	(1.2)	**4.9**	(0.4)
	26.2	8.8	**11.1**	2.6

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 2013 £m	Group 2012 restated* £m	**Society 2013 £m**	Society 2012 restated* £m
Profit before tax from continuing operations	**102.5**	35.4	**74.4**	42.4
Less share of profits of joint ventures and associates, net of tax	**(1.3)**	(1.6)	**-**	-
	101.2	33.8	**74.4**	42.4
Tax calculated at UK standard rate of 23.25% (2012: 24.5%)	**23.5**	8.3	**17.3**	10.4
Effects of:				
Expenses not deductible for tax purposes	**7.0**	1.8	**0.9**	1.8
Adjustment to tax expense in respect of prior periods	**-**	(0.4)	**0.4**	-
Reversal of deferred tax asset previously recognised	**3.1**	-	**-**	-
Non-taxable income	**(6.0)**	(0.3)	**(7.2)**	(9.9)
Corporation tax rate change	**(0.4)**	0.5	**(0.3)**	0.3
Effect of lower tax rates in other jurisdictions	**(1.2)**	(0.8)	**-**	-
Other	**0.2**	(0.3)	**-**	-
Tax expense	**26.2**	8.8	**11.1**	2.6

* The 2012 comparatives have been restated in line with accounting standards adopted in the year as described in notes 1a) and 41.

The effective tax rate for the Group for the year ended 31 December 2013 is 25.9% (2012: 26.0%). The major impacts on the effective rate for the year are goodwill impairment and costs of the Connells management incentive scheme which are not deductible for tax purposes, as well as the reversal of a deferred tax asset on losses previously recognised; offset by non-taxable income, which mainly arises from the gain made on the Wynyard flotation (see note 17d)), and the impact of lower tax rates in overseas jurisdictions.

The effective tax rate for the Society for the year ended 31 December 2013 is 14.9% (2012: 6.1%). The major impacts on the effective rate are the non-taxable dividend income received of £30.9m (2012: £40.5m) and the non-tax deductible £1.3m (2012: £5.4m) written-off investments during the year.

The future reduction in the UK Corporation tax rate to 21% effective from 1 April 2014, and subsequently to 20% from 1 April 2015, results in a credit of £0.4m to the Income Statement and a charge of £1.8m to Other Comprehensive Income, giving an overall net charge of £1.4m in respect of the Group's net deferred tax asset.

12. Loans and advances to credit institutions

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Repayable on demand	**224.3**	330.2	**152.5**	209.1
In not more than three months	**78.5**	30.0	**19.6**	-
In more than one year	**23.4**	22.9	**23.4**	22.9
	326.2	383.1	**195.5**	232.0
Amounts included within cash and cash equivalents	**147.3**	172.5	**21.6**	21.5

At 31 December 2013 £154.3m (2012: £210.5m) of cash has been pledged by the Group and £154.5m (2012: £210.5m) of cash has been pledged by the Society against derivative contracts.

At 31 December 2013, Group and Society loans and advances to credit institutions include £19.6m (2012: £nil) in reverse repurchase agreements with external counterparties. Under these agreements both the Group and Society hold £20.0m (2012: £nil) of debt securities. These debt securities have not been recognised as the external counterparties have retained substantially all the risks and rewards of ownership. The Group is permitted to sell or repledge the debt securities in question but has not done so during the year.

13. Debt securities

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Gilts	**478.8**	278.7	**478.8**	278.7
Treasury bills	**-**	23.2	**-**	23.2
Certificates of deposit	**62.6**	55.1	**62.6**	-
Fixed rate bonds	**170.6**	255.8	**170.6**	255.8
Floating rate notes	**203.7**	204.5	**193.7**	192.3
Residential mortgage backed securities	**261.2**	295.2	**792.8**	922.7
Commercial mortgage backed securities	**18.6**	21.4	**18.6**	21.4
	1,195.5	1,133.9	**1,717.1**	1,694.1
Debt securities have remaining maturities as follows:				
In not more than one year	**186.4**	202.2	**181.5**	134.8
In more than one year	**1,009.1**	931.7	**1,535.6**	1,559.3
	1,195.5	1,133.9	**1,717.1**	1,694.1
Transferable debt securities comprise:				
Listed on a recognised investment exchange	**1,129.2**	1,068.8	**1,650.8**	1,694.1
Unlisted	**66.3**	65.1	**66.3**	-
	1,195.5	1,133.9	**1,717.1**	1,694.1
Market value of listed transferable debt securities	**1,130.8**	1,069.9	**1,656.0**	1,695.2
Carrying value of securities pledged as collateral under sale and repurchase agreements	**505.6**	417.8	**804.2**	849.0

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 (excluding accrued interest) of £505.6m (2012: £417.8m) have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group has retained substantially all the risks and rewards of ownership.

13. Debt securities *(continued)*

Included in the Society's residential mortgage backed securities are £460.6m (2012: £556.5m) and £71.0m (2012: £71.0m) 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 £6.2m (2012: £59.7m) of securities, included in the table above, 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 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
At 1 January	**1,133.9**	1,877.3	**1,694.1**	2,507.3
Additions	**767.1**	2,280.5	**737.2**	2,176.4
Disposals	**(683.6)**	(3,031.3)	**(694.5)**	(2,995.8)
Impairment losses	**(1.2)**	(4.0)	**(1.2)**	(4.0)
Changes in fair value	**(20.7)**	11.4	**(18.5)**	10.2
At 31 December	**1,195.5**	1,133.9	**1,717.1**	1,694.1

Pursuant to the amendments to IAS 39, *Financial Instruments: Recognition and Measurement*, and IFRS 7, *Financial Instruments: Disclosures*, the Group has reclassified certain available-for-sale investment securities to the loans and receivables 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% (2012: 0.90%).

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

	Group and Society	
	2013 £m	2012 £m
Carrying value of reclassified assets	**139.3**	173.3
Fair value of reclassified assets	**140.9**	168.1

If these assets had not been reclassified, the fair value gain arising in the Statement of Comprehensive Income would have been £10.1m (2012: £20.6m).

14. Derivative financial instruments

	Group		Society	
	Positive market value 2013 £m	**Negative market value 2013 £m**	**Positive market value 2013 £m**	**Negative market value 2013 £m**
Derivatives designated as fair value hedges:				
Interest rate swaps	51.1	74.5	51.1	74.6
Index swaps	-	106.3	-	106.3
Currency swaps	6.5	-	6.5	-
	57.6	**180.8**	**57.6**	**180.9**
Derivatives designated as cash flow hedges:				
Interest rate swaps	3.3	4.1	3.4	5.3
Basis swaps	-	1.0	-	1.0
	3.3	**5.1**	**3.4**	**6.3**
Other derivatives held at fair value:				
Interest rate swaps	44.2	58.4	47.0	21.1
Index swaps	43.4	0.3	43.4	0.3
Investment products - embedded derivatives	0.3	43.0	0.3	43.0
	87.9	**101.7**	**90.7**	**64.4**
	148.8	**287.6**	**151.7**	**251.6**

	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	135.8	77.4	135.9
Index swaps	-	114.6	-	114.6
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:				
Interest rate swaps	77.9	79.7	83.1	13.7
Quanto swaps	-	0.1	-	0.1
Index swaps	21.5	14.7	21.5	14.7
Investment products - embedded derivatives	14.3	20.9	14.3	20.9
	113.7	115.4	118.9	49.4
	202.7	370.8	207.9	304.9

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.

15. Loans and advances to customers

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Loans fully secured on residential property	**10,858.3**	9,860.7	**8,646.3**	7,580.5
Other loans:				
Loans fully secured on land	**400.3**	433.2	**400.3**	433.2
Other loans	**99.0**	89.4	**0.5**	2.4
Fair value adjustment for hedged risk	**159.3**	210.2	**158.1**	205.6
	11,516.9	10,593.5	**9,205.2**	8,221.7
The remaining maturity of loans and advances to customers from the reporting date is as follows:				
On call and at short notice	**66.0**	55.8	**6.7**	6.7
In not more than three months	**21.1**	15.8	**7.6**	8.3
In more than three months but not more than one year	**56.9**	79.7	**30.7**	52.6
In more than one year but not more than five years	**617.7**	571.0	**406.7**	372.6
In more than five years	**10,814.3**	9,944.0	**8,786.9**	7,820.9
	11,576.0	10,666.3	**9,238.6**	8,261.1
Less: Impairment (note 16)	**(59.1)**	(72.8)	**(33.4)**	(39.4)
	11,516.9	10,593.5	**9,205.2**	8,221.7

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

At 31 December 2013, loans and advances to customers include £1,048.6m (2012: £1,334.9m) for both the Group and Society which have been used in secured funding arrangements, resulting in the beneficial interest in these loans being transferred to Darrowby No. 1 plc (£659.4m; 2012: £829.1m), and Darrowby No. 2 plc (£389.2m; 2012: £505.8m) which are special purpose vehicles consolidated into the Group Accounts. The carrying value of these loans at the date the beneficial interest was transferred was £1,746.0m (2012: £1,746.0m). These loans secure £724.0m (2012: £947.8m) of funding for the Group.

All the assets pledged are retained within the Society's Statement of Financial Position as the Society retains substantially all 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 2013				
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**
Amounts written off during the year, net of recoveries				
Individual impairment	**(14.8)**	**(1.0)**	**(19.3)**	**(35.1)**
Collective impairment	**(0.1)**	**-**	**-**	**(0.1)**
	(14.9)	**(1.0)**	**(19.3)**	**(35.2)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	**7.2**	**1.4**	**0.1**	**8.7**
Collective impairment	**8.9**	**4.1**	**-**	**13.0**
	16.1	**5.5**	**0.1**	**21.7**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	**(0.3)**	**-**	**0.1**	**(0.2)**
Charge for the year	**15.8**	**5.5**	**0.2**	**21.5**
At 31 December 2013				
Individual impairment	**29.9**	**4.1**	**1.1**	**35.1**
Collective impairment	**18.6**	**5.4**	**-**	**24.0**
	48.5	**9.5**	**1.1**	**59.1**

Group				
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, net of recoveries				
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

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 2013				
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**
Amounts written off during the year, net of recoveries				
Individual impairment	**(3.1)**	**(1.0)**	**(19.2)**	**(23.3)**
Collective impairment	**(0.1)**	**-**	**-**	**(0.1)**
	(3.2)	**(1.0)**	**(19.2)**	**(23.4)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	**2.6**	**1.4**	**0.1**	**4.1**
Collective impairment	**9.5**	**4.1**	**-**	**13.6**
	12.1	**5.5**	**0.1**	**17.7**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	**(0.3)**	**-**	**-**	**(0.3)**
Charge for the year	**11.8**	**5.5**	**0.1**	**17.4**
At 31 December 2013				
Individual impairment	**7.7**	**4.1**	**0.4**	**12.2**
Collective impairment	**15.8**	**5.4**	**-**	**21.2**
	23.5	**9.5**	**0.4**	**33.4**

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, net of recoveries				
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

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

Further analysis of the impairment provision within our residential and commercial books is provided in note 37.

Included in the charge to the Income Statement is the impact of the change in the impairment charge due to the time value of money. For the Group this amounted to £0.5m (2012: £1.0m); for the Society it amounted to £0.2m (2012: £0.4m).

17. Investments in Group undertakings

a) Subsidiary undertakings

Investments in subsidiary undertakings are recorded at cost, which includes an estimate of the remaining liability to purchase non-controlling shareholdings at a future date where applicable.

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

Society	**Shares in subsidiary undertakings**		**Loans to subsidiary undertakings**		**Total**	
	2013 £m	2012 £m	**2013 £m**	2012 £m	**2013 £m**	2012 £m
Cost						
At 1 January	**186.9**	186.9	**1,850.0**	2,030.6	**2,036.9**	2,217.5
Additions	**1.3**	-	**12.7**	24.9	**14.0**	24.9
Repayments	**-**	-	**(147.5)**	(205.5)	**(147.5)**	(205.5)
At 31 December	**188.2**	186.9	**1,715.2**	1,850.0	**1,903.4**	2,036.9
Provisions						
At 1 January	**56.4**	51.0	**-**	-	**56.4**	51.0
Provided in the year	**1.3**	5.4	**-**	-	**1.3**	5.4
At 31 December	**57.7**	56.4	**-**	-	**57.7**	56.4
Net book value at 31 December	**130.5**	130.5	**1,715.2**	1,850.0	**1,845.7**	1,980.5

The Society reviews the carrying value of its investments in subsidiary undertakings at each reporting date. During the year, the Society invested a further £1.3m (2012: £nil) in the intermediate holding company Skipton Group Holdings Limited (SGHL). During the year, the Society also provided £1.3m against the carrying value of its investment in SGHL (2012: £5.4m provided against Amber Homeloans Limited).

17. Investments in Group undertakings *(continued)*

At 31 December 2013, the Group held a controlling interest in the following principal trading subsidiary undertakings:

		Percentage of ownership interest	
Name of subsidiary undertaking	**Principal business activity**	**2013**	2012
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**	99.6
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
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	**100.0**	100.0
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
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 that require the Group 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 is 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 dependent primarily 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 of the liability is expensed in the Income Statement.

At 31 December 2013 the total financial liability for the options detailed above was £13.5m (2012: £12.0m).

In 2012 members of Connells Limited senior management purchased equity shares in that company for £1.3m, which reduced the Group's shareholding from 100% to 99.6%. At the same time options were issued that require SGHL to purchase this shareholding at some future dates, with further details provided in note 26. At 31 December 2013 the total financial liability for these options was £8.9m (2012: £1.3m).

The remaining subsidiary undertakings are 100% owned except for Jade Software Corporation Limited where the Group holds a 56.8% interest (2012: 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.

17. Investments in Group undertakings *(continued)*

All the above bodies are incorporated, registered and operate in the United Kingdom except for Skipton International Limited, which is incorporated and registered in Guernsey, and operates in Guernsey, Jersey and the UK; 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.

All the above subsidiary undertakings have prepared accounts to 31 December 2013 and their audited results have been included in the Group Accounts.

On 16 September 2013, Connells Limited acquired a further 12.5% shareholding in Just Wills Group Limited for £nil, increasing its share to 87.5%, and on 18 December 2013 acquired a further 12.5% shareholding in that company for £0.2m, increasing its holding to 100%.

On 29 November 2013, Sequence (UK) Limited, a subsidiary of Connells Limited, acquired the trade and assets of The Knight Partnership, together with 100% of the share capital of Knight Partnership Lettings Limited, for consideration of £0.7m. The fair value of the net assets acquired was £0.6m and the transaction generated £0.1m of goodwill.

The Group made no further increases to its shareholdings in existing subsidiary undertakings (2012: £nil) during the year. However, the reassessment of the expected future payments under the put option agreements resulted in a further £3.3m (2012: £1.4m) of goodwill being recognised.

b) Disposals

On 25 February 2013, the Group sold the business and certain assets of Sterling International Brokers Limited for £nil, and that company then ceased trading. There is no material impact on these financial statements as in 2012 the Group recognised total charges amounting to £3.4m to write down the assets to their estimated recoverable amount.

On 9 August 2013, the Group sold its entire holding in Mutual One Limited for £0.1m, generating a loss on disposal of £0.1m. During the period of ownership in the year, Mutual One Limited's contribution to the Group's profit before taxation was £nil (2012: £(0.1)m loss).

c) Joint ventures

At 31 December 2013, the Group held interests in the following companies:

Name of investment	Principal business activity	Percentage of ownership interest 2013	2012
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	**47.2**	46.5
Home Telecom Limited	Telecommunications services	**49.2**	49.2

The joint ventures above are incorporated in England and Wales.

On 19 June 2013, Connells Limited acquired an additional 0.7% of the share capital of Vibrant Energy Matters Limited for £nil, increasing its holding to 47.2%.

	Group 2013 £m	Group 2012 £m
Share of joint ventures'		
Gross assets	**5.8**	5.5
Gross liabilities	**(1.6)**	(2.4)
At 31 December	**4.2**	3.1
Share of joint ventures'		
Income	**24.5**	21.1
Expense	**(21.6)**	(19.0)
Taxation	**(0.7)**	(0.5)
Share of joint ventures' profit after tax	**2.2**	1.6

Joint ventures are recognised within the Group's financial statements using the equity accounting method.

17. Investments in Group undertakings *(continued)*

d) Associates

At 31 December 2013, the Group held an interest in the following company:

Name of investment	Principal business activity	Percentage of ownership interest	
		2013	2012
Wynyard Group Limited	Provider of software development services	**24.5**	-

Wynyard Group Limited is incorporated in New Zealand.

On 30 March 2013, Jade Software Corporation Limited sold its intelligence and investigations business to Wynyard Group Limited, a separate Group entity.

On 19 July 2013, Wynyard Group Limited raised capital through seeking a listing on the New Zealand Stock Exchange. On flotation, the Group's shareholding was reduced to 24.5% and as a result control was lost. The Group now recognises its investment in Wynyard Group Limited as an associate as the Directors believe that the Group has retained 'significant influence' by virtue of its shareholding being above 20% and being the single largest shareholder.

On loss of control, therefore, the Group ceased consolidating Wynyard Group Limited as a subsidiary undertaking and derecognised the assets (including goodwill), liabilities and non-controlling interests of Wynyard Group Limited, including any components of Other Comprehensive Income attributable to it. The Group recognised its remaining non-controlling interest in Wynyard as an associate at fair value in accordance with IAS 28, *Investments in Associates*, and determined its fair value to be the issue price of its shares on flotation. Consequently, the Group recognised a profit of £24.8m (2012: £nil) through the Income Statement.

As at 31 December 2013 the market value of the Group's holding in Wynyard Group Limited was £14.5m (2012: £nil), which is based on a quoted share price and is therefore regarded as a Level 1 valuation technique as described in note 38b).

	Group 2013 £m	Group 2012 £m
Share of associate's		
Gross assets	**14.2**	-
Gross liabilities	**(0.8)**	-
At 31 December	**13.4**	-
Share of associate's		
Income	**1.4**	-
Expense	**(2.3)**	-
Taxation	**-**	-
Share of associate's loss after tax	**(0.9)**	-

The associate is recognised within the Group's financial statements using the equity accounting method.

e) Equity share investments

At 31 December 2013, the Group held interests in the following companies:

Name of investment	Principal business activity	Percentage of ownership interest	
		2013	2012
Zoopla Group Limited	Property search provider	**4.9**	4.8
Hearthstone Investments Limited	Property fund management	**21.0**	22.7

Both of the above investments are unlisted companies and are held as available-for-sale financial assets. As at 31 December 2012, the Group's shareholding in Zoopla was 4.8%. Following the purchase of additional shares on 25 November 2013 for £0.8m, the Group's holding at 31 December 2013 amounted to 4.9%.

17. Investments in Group undertakings *(continued)*

The Group's shareholding in Hearthstone was 22.7% at 31 December 2012, and following a number of rights issues during the year to which the Group did not subscribe, this holding stands at 21.0% at 31 December 2013. Despite holding a greater than 20% shareholding, the Directors do not consider that the Group has significant influence in Hearthstone and therefore account for the Group's holding as an equity share investment rather than as an associate.

	Group 2013 £m	Group 2012 £m
At 1 January	**3.1**	-
Acquisitions	**0.8**	3.1
Gain recognised in Other Comprehensive Income	**33.2**	-
At 31 December	**37.1**	3.1

The Directors consider that the fair value of the Group's holding in Zoopla is £35.1m at 31 December 2013 (2012: £1.1m), which is based on the value of recent share transactions in November 2013. Note 38d) to the accounts provides further details. This has resulted in an unrealised gain of £33.2m (2012: £nil) being recognised in Other Comprehensive Income. The Group's holding in Hearthstone, where the fair value cannot be reliably measured, continues to be held at cost, which values Hearthstone at £2.0m at 31 December 2013 (2012: £2.0m).

18. Property, plant and equipment

Group	**2013**			2012		
	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	83.6	100.4	**184.0**	90.0	97.9	187.9
Additions	3.5	7.8	**11.3**	1.9	10.1	12.0
Disposals	(1.6)	(7.4)	**(9.0)**	(0.1)	(7.6)	(7.7)
Disposal of subsidiary undertakings	-	(0.8)	**(0.8)**	-	-	-
Items reclassified in the year	7.8	(7.8)	**-**	-	-	-
Transfer from / (to) investment property	0.2	-	**0.2**	(8.2)	-	(8.2)
At 31 December	**93.5**	**92.2**	**185.7**	83.6	100.4	184.0
Depreciation						
At 1 January	22.2	80.4	**102.6**	20.9	80.8	101.7
Charge for the year	3.9	5.7	**9.6**	2.7	6.5	9.2
Disposals	(1.2)	(6.7)	**(7.9)**	-	(6.9)	(6.9)
Disposal of subsidiary undertakings	-	(0.3)	**(0.3)**	-	-	-
Items reclassified in the year	3.9	(3.9)	**-**	-	-	-
Transfer from / (to) investment property	0.1	-	**0.1**	(1.4)	-	(1.4)
At 31 December	**28.9**	**75.2**	**104.1**	22.2	80.4	102.6
Net book value at 1 January	61.4	20.0	**81.4**	69.1	17.1	86.2
Net book value at 31 December	**64.6**	**17.0**	**81.6**	61.4	20.0	81.4

18. Property, plant and equipment *(continued)*

Society	**2013**			2012		
	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	40.1	29.3	**69.4**	48.4	29.3	77.7
Additions	0.6	0.3	**0.9**	-	1.8	1.8
Disposals	(0.1)	(0.3)	**(0.4)**	-	(1.8)	(1.8)
Items reclassified in the year	2.0	(2.0)	**-**	-	-	-
Transfer from / (to) investment property	0.2	-	**0.2**	(8.3)	-	(8.3)
At 31 December	**42.8**	**27.3**	**70.1**	40.1	29.3	69.4
Depreciation						
At 1 January	11.7	26.5	**38.2**	11.4	27.8	39.2
Charge for the year	1.5	0.4	**1.9**	1.7	0.5	2.2
Disposals	-	(0.3)	**(0.3)**	-	(1.8)	(1.8)
Items reclassified in the year	0.2	(0.2)	**-**	-	-	-
Transfer from / (to) investment property	0.1	-	**0.1**	(1.4)	-	(1.4)
At 31 December	**13.5**	**26.4**	**39.9**	11.7	26.5	38.2
Net book value at 1 January	28.4	2.8	**31.2**	37.0	1.5	38.5
Net book value at 31 December	**29.3**	**0.9**	**30.2**	28.4	2.8	31.2

The net book value of land and buildings comprises:

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Freehold	**56.2**	57.1	**25.3**	25.3
Long leasehold	**2.8**	2.7	**1.0**	1.9
Short leasehold	**5.6**	1.6	**3.0**	1.2
	64.6	61.4	**29.3**	28.4

19. Investment property

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Cost				
At 1 January	**17.6**	10.1	**40.2**	32.6
Additions	**0.3**	-	**0.3**	-
Disposals	**(7.0)**	(0.7)	**(7.0)**	(0.7)
Transfer (to) / from property, plant and equipment	**(0.2)**	8.2	**(0.2)**	8.3
At 31 December	**10.7**	17.6	**33.3**	40.2
Depreciation				
At 1 January	**6.0**	3.3	**7.6**	4.5
Charge for the year	**0.3**	0.1	**0.9**	0.5
Impairment	**1.2**	1.3	**1.2**	1.3
Disposals	**(3.4)**	(0.1)	**(3.4)**	(0.1)
Transfer (to) / from property, plant and equipment	**(0.1)**	1.4	**(0.1)**	1.4
At 31 December	**4.0**	6.0	**6.2**	7.6
Net book value at 1 January	**11.6**	6.8	**32.6**	28.1
Net book value at 31 December	**6.7**	11.6	**27.1**	32.6

All investment property relates to property purchased by the Group or Society and is either unoccupied by the Group or Society, or relates to branches where part of the property is subsequently sub-leased. £20.6m (2012: £21.1m) of investment property in the Society is occupied by Group companies and is therefore classed as property, plant and equipment within the Group.

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

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Market value of investment property	**9.0**	15.6	**29.2**	36.1

The estimated market value of the investment properties has been determined by an appropriately qualified internal valuer in accordance with RICS Appraisal and Valuation Standards and is an indication of fair value. This fair value measurement is categorised as a Level 3 fair value measurement, based on the inputs to the valuation technique used as described in note 38b).

The fair value of the majority of investment properties is estimated using the market valuation approach which uses prices and other relevant information generated by market transactions involving comparable properties. Where comparable transactions may not be available, the Group may also consider a discounted cash flow technique which considers the present value of the net cash flows to be generated from the property, taking into account expected rental growth, void periods and rent-free periods. The expected net cash flows are discounted using risk-adjusted discount rates.

Certain properties are purpose built facilities, for which comparable market transactions are unavailable, and the discounted cash flows do not reflect the value in use to the Group. Therefore, the cost method is considered more appropriate, and reflects the amount that currently would be required to replace the service capacity of such properties.

20. Intangible assets

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Software, databases and customer contracts	**18.0**	23.6	**1.5**	1.5
Goodwill	**156.2**	172.6	**-**	-
	174.2	196.2	**1.5**	1.5

Software, databases and customer contracts	**Group 2013 £m**	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Cost				
At 1 January	**81.0**	73.5	**13.4**	13.1
Acquisition of subsidiary undertakings	**0.2**	-	**-**	-
Acquisition of business assets	**0.7**	-	**-**	-
Additions	**7.4**	7.8	**0.6**	0.3
Disposals	**(2.6)**	(0.3)	**-**	-
Disposal of subsidiary undertakings	**(6.6)**	-	**-**	-
At 31 December	**80.1**	81.0	**14.0**	13.4
Amortisation and impairment				
At 1 January	**57.4**	47.8	**11.9**	10.9
Charge for the year	**8.4**	9.9	**0.6**	1.0
Disposals	**(2.3)**	(0.3)	**-**	-
Disposal of subsidiary undertakings	**(1.4)**	-	**-**	-
At 31 December	**62.1**	57.4	**12.5**	11.9
Net book value at 1 January	**23.6**	25.7	**1.5**	2.2
Net book value at 31 December	**18.0**	23.6	**1.5**	1.5

20. Intangible assets *(continued)*

Goodwill	**Group 2013 £m**	Group 2012 £m
Cost, less amortisation to 1 January 2004		
At 1 January	**189.0**	187.5
Acquisitions of subsidiary undertakings and business units	**0.1**	0.2
Additions and revaluations of put options	**3.3**	1.4
Amounts written off	**(1.5)**	(0.1)
Disposal of subsidiary undertakings	**(8.0)**	-
At 31 December	**182.9**	189.0
Impairment losses		
At 1 January	**16.4**	16.5
Provisions for impairment losses in the year	**16.6**	-
Amounts written off	**(1.5)**	(0.1)
Disposal of subsidiary undertakings	**(4.8)**	-
At 31 December	**26.7**	16.4
Net book value at 1 January	**172.6**	171.0
Net book value at 31 December	**156.2**	172.6

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating unit (operating segment) that is expected to benefit from that business combination. The carrying value of goodwill has been allocated as follows:

Operating segment	**Group 2013**		
	Cost of goodwill £m	**Accumulated impairment £m**	**Carrying value £m**
Mortgage Services	**2.9**	**2.9**	**-**
Estate Agency	**129.6**	**2.2**	**127.4**
Financial Advice	**30.3**	**13.5**	**16.8**
Investment Portfolio	**20.1**	**8.1**	**12.0**
Total goodwill	**182.9**	**26.7**	**156.2**

Operating segment	Group 2012		
	Cost of goodwill £m	Accumulated 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
Total goodwill	189.0	16.4	172.6

20. Intangible assets *(continued)*

Following a revision in future cash flows and based upon the Directors' assessment of recoverable amounts, £2.9m (2012: £nil), £0.4m (2012: £nil), £10.4m (2012: £nil) and £2.9m (2012: £nil) of impairment has been recognised during the year against the Mortgage Services division, the Estate Agency division, the Financial Advice division and the Investment Portfolio respectively.

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 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 corporate plans for the next five years, which take into account the risks inherent in each of the businesses, and cash flows are extrapolated for subsequent years (up to an additional 10 years) based on a long term growth rate of 2.5% (2012: 2.5%) or specific where circumstances dictate.

The corporate plans 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 41 to 46.

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 2013 %**	Group 2012 %
Mortgage Services	**11**	10
Estate Agency	**16**	14
Financial Advice	**13-14**	11-12
Investment Portfolio	**11-14**	12-15

21. Other assets

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Trade receivables	**32.4**	34.8	**0.2**	0.8
Prepayments	**15.5**	16.4	**8.1**	9.2
Accrued income	**11.9**	12.7	**-**	-
Other	**44.0**	44.1	**2.2**	1.9
	103.8	108.0	**10.5**	11.9

Included within Group other assets above are £34.1m (2012: £31.0m) of undrawn advances to debt factoring clients.

The ageing of the Group's trade receivables, gross of provision for impairment, at the reporting date was as follows:

	Group 2013		Group 2012	
	£m	%	£m	%
Neither past due nor individually impaired	**18.7**	**52.7**	18.7	47.9
Past due but not individually impaired:				
Up to 30 days	**9.0**	**25.4**	11.2	28.7
30 to 120 days	**3.8**	**10.7**	4.1	10.5
Over 120 days	**0.9**	**2.5**	0.8	2.1
	32.4	**91.3**	34.8	89.2
Individually impaired	**3.1**	**8.7**	4.2	10.8
	35.5	**100.0**	39.0	100.0

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

	Group 2013 £m	Group 2012 £m
At 1 January	**(4.2)**	(4.4)
Provisions made during the year	**(1.4)**	(1.6)
Receivables written off during the year	**1.7**	1.6
Provisions no longer required	**0.8**	0.2
At 31 December	**(3.1)**	(4.2)

The Society has £0.2m (2012: £0.8m) of trade receivables, £nil (2012: £0.7m) of which are neither past due nor impaired. £0.2m (2012: £0.1m) are past due but not individually impaired.

22. Shares

	Group and Society 2013 £m	Group and Society 2012 £m
Held by individuals	**10,150.3**	9,329.1
Other shares	**95.8**	90.4
Fair value adjustment for hedged risk	**14.0**	42.9
	10,260.1	9,462.4
Shares are repayable from the reporting date in the ordinary course of business as follows:		
On demand	**3,820.6**	3,103.1
In not more than three months	**3,698.9**	3,745.9
In more than three months but not more than one year	**1,343.1**	1,400.9
In more than one year but not more than five years	**1,275.2**	1,153.0
In more than five years	**122.3**	59.5
	10,260.1	9,462.4

The Group and Society comparatives for the maturity of shares have been restated to reflect a more detailed analysis being undertaken during the year on this maturity split. The revised presentation more accurately reflects the maturity profile.

23. Amounts owed to credit institutions

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Amounts owed to subsidiary undertakings	**-**	-	**103.1**	61.4
Other	**1,046.3**	907.6	**1,046.3**	907.6
	1,046.3	907.6	**1,149.4**	969.0
Amounts owed to credit institutions are repayable from the reporting date in the ordinary course of business as follows:				
Repayable on demand	**53.3**	43.6	**156.4**	105.0
In not more than three months	**670.2**	278.2	**670.2**	278.2
In more than three months but not more than one year	**23.1**	205.5	**23.1**	205.5
In more than one year but not more than five years	**297.1**	313.2	**297.1**	313.2
In more than five years	**2.6**	67.1	**2.6**	67.1
	1,046.3	907.6	**1,149.4**	969.0

Amounts owed to credit institutions by the Group includes an amount of £219.0m (2012: £277.0m) 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.

At 31 December 2013 £43.4m (2012: £30.6m) of cash has been received by the Group against derivative contracts.

24. Amounts owed to other customers

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Amounts owed to subsidiary undertakings	-	-	1,121.6	1,369.9
Other	930.6	897.1	147.3	171.8
Fair value adjustment for hedged risk	0.2	0.6	-	0.2
	930.8	897.7	1,268.9	1,541.9
Amounts owed to other customers are repayable from the reporting date in the ordinary course of business as follows:				
Repayable on demand	195.7	197.9	84.4	74.2
In not more than three months	298.9	215.2	85.3	69.5
In more than three months but not more than one year	352.0	407.4	39.6	63.3
In more than one year but not more than five years	82.8	77.2	1,059.6	1,334.9
In more than five years	1.4	-	-	-
	930.8	897.7	1,268.9	1,541.9

The comparative figures for amounts owed to subsidiary undertakings for the Society have been restated to present £1,334.9m within amounts repayable in more than one year but not more than five years, rather than within repayable on demand. This amount represents amounts owed to the Society's securitisation vehicles and this revised presentation is considered to more accurately reflect their maturity profile.

25. Debt securities in issue

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Certificates of deposit	8.0	19.1	8.0	19.1
Other debt securities	546.8	711.8	41.8	41.0
Fair value adjustment for hedged risk	(0.1)	-	(0.1)	-
	554.7	730.9	49.7	60.1
Debt securities in issue are repayable from the reporting date in the ordinary course of business as follows:				
In not more than one year	50.8	20.7	49.6	19.1
In more than one year	503.9	710.2	0.1	41.0
	554.7	730.9	49.7	60.1

Group debt securities in issue include £505.0m (2012: £670.8m) 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 (2012: 1) floating rate note issued to the capital markets totalling £41.6m (2012: £40.8m).

26. Other liabilities

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Trade payables	**6.0**	6.3	**0.5**	0.2
Tax deducted at source from interest paid	**3.3**	2.9	**3.3**	2.9
Fair value of put option obligation	**13.5**	12.0	**-**	-
Fair value of liability of management incentive scheme	**8.9**	1.3	**-**	-
Debt factoring liabilities	**34.1**	31.0	**-**	-
Other	**29.9**	29.5	**4.5**	4.3
	95.7	83.0	**8.3**	7.4

The debt factoring liabilities of £34.1m (2012: £31.0m) represent undrawn advances to debt factoring clients.

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

	Group 2013 £m	Group 2012 £m
At 1 January	**12.0**	11.6
Unwind of the discount factor	**1.5**	1.5
Revaluation of market value and future exercise dates	**1.9**	0.2
Dividends paid to non-controlling shareholders	**(1.9)**	(1.3)
At 31 December	**13.5**	12.0

Management incentive scheme

In December 2012, five members of Connells Limited senior management purchased equity shares in that 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 dates. Four of the five options remain outstanding at the year end, with the maximum option length being nine 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 is subsequently remeasured at each reporting date with any changes in fair value recognised in the Income Statement for the year.

The movement in the fair value of the liability of the management incentive scheme is summarised below:

	Group 2013 £m	Group 2012 £m
At 1 January	**1.3**	-
Share options issued in the year	**-**	1.3
Movement in fair value of the scheme recognised in the Income Statement	**7.7**	-
Share options forfeited in the year	**(0.1)**	-
At 31 December	**8.9**	1.3

27. Provisions for liabilities

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Provision for the costs of surplus properties	**5.3**	7.9	**0.8**	3.4
Financial Services Compensation Scheme (FSCS)	**12.3**	12.9	**12.0**	12.2
Commission clawbacks / rebates	**5.7**	5.9	**-**	-
Survey and valuation claims	**11.4**	12.1	**-**	-
Customer compensation	**6.4**	13.5	**1.7**	1.0
Other provisions	**3.4**	2.2	**-**	-
	44.5	54.5	**14.5**	16.6

Movements in provisions during the year were as follows:

Group 2013	**Provision for the costs of surplus properties £m**	**FSCS £m**	**Commission clawbacks / rebates £m**	**Survey and valuation claims £m**	**Customer compensation £m**	**Other provisions £m**	**Total £m**
At 1 January	**7.9**	**12.9**	**5.9**	**12.1**	**13.5**	**2.2**	**54.5**
Reclassified to other liabilities and accruals	**-**	**-**	**(0.5)**	**-**	**-**	**-**	**(0.5)**
Charge / (credit) for the year (gross)	**0.9**	**7.7**	**5.4**	**3.1**	**(3.7)**	**1.8**	**15.2**
Utilised during the year	**(3.5)**	**(8.3)**	**(5.1)**	**(3.8)**	**(3.4)**	**(0.6)**	**(24.7)**
At 31 December	**5.3**	**12.3**	**5.7**	**11.4**	**6.4**	**3.4**	**44.5**

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

Group 2013	**Provision for the costs of surplus properties £m**	**FSCS £m**	**Commission clawbacks / rebates £m**	**Survey and valuation claims £m**	**Customer compensation £m**	**Other provisions £m**	**Total £m**
Charge / (credit) for the year (gross)	**0.9**	**7.7**	**5.4**	**3.1**	**(3.7)**	**1.8**	**15.2**
PI recoverability asset released during the year	**-**	**-**	**-**	**-**	**5.4**	**-**	**5.4**
Net charge to Income Statement	**0.9**	**7.7**	**5.4**	**3.1**	**1.7**	**1.8**	**20.6**

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

27. Provisions for liabilities *(continued)*

Group 2012	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks / rebates £m	Survey and valuation claims £m	Customer compensation £m	Other provisions £m	Total £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	7.5	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

Group 2012	Provision for the costs of surplus properties £m	FSCS £m	Commission clawbacks / rebates £m	Survey and valuation claims £m	Customer compensation £m	Other provisions £m	Total £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

Society **2013**	**Provision for the cost of surplus properties** **£m**	**FSCS** **£m**	**Customer compensation** **£m**	**Total** **£m**
At 1 January	**3.4**	**12.2**	**1.0**	**16.6**
Charge for the year	**0.7**	**7.2**	**1.4**	**9.3**
Utilised during the year	**(3.3)**	**(7.4)**	**(0.7)**	**(11.4)**
At 31 December	**0.8**	**12.0**	**1.7**	**14.5**

Society 2012	Provision for the cost of surplus properties £m	FSCS £m	Customer compensation £m	Total £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

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 33b).

The Society FSCS provision reflects market participation up to the reporting date. Following the payment of the 2012/2013 scheme year levy in August 2013, the £12.0m provision at the year end relates to the estimated Management Expense Levy for scheme year 2013/2014 and the estimated Management Expense Levy and Capital Levy for scheme year 2014/2015. The Society's provision does not include management expense levies for any further scheme years, nor compensation levies which may arise from any ultimate payout on future claims made under the scheme.

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 aim 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 provisions for the potential claims on payment protection insurance sold by the Group. The Group has experienced a fall in complaint levels during 2013 and despite uphold rates remaining low, a number of cases are being referred to the Financial Ombudsman Service (FOS), with each MPPI referral incurring a £900 fee.

Additionally, within the Financial Advice division, we have undertaken a number of reviews of advisory processes where, predominantly, initial enquiries indicated documentation issues in a number of cases.

The provision made at 31 December 2013 represents management's best estimate of the costs that will arise from these reviews, including the costs of remediation. The liability included within the provision of £3.8m (2012: £11.6m) is calculated gross of professional indemnity insurance for which a receivable of £2.2m (2012: £8.5m) has been included within other assets.

The amounts of the gross provision and the associated professional indemnity insurance recovery have fallen considerably during 2013 as the review has concluded that the amount of remediation likely to be required is significantly less than previously estimated. Management believe that the insurance asset meets the 'virtually certain' test in accordance with the accounting standard and that recoveries will continue to be made under the terms of the insurance policies in place.

Other provisions

Other provisions include amounts for the cost of estimated compensation payments which arise from past operational issues within the Mortgage Services division. The provision made at 31 December 2013 was £1.8m (2012: £1.7m) and represents management's best estimate of the costs that will arise from such issues.

28. Deferred tax

Deferred taxes are calculated on timing differences under the Statement of Financial Position liability method, using the enacted tax rate that is expected to apply when these differences reverse, generally 20% (2012: 23%).

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

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
At 1 January	20.0	20.6	12.6	14.3
Income Statement (charge) / credit (note 11)	(7.0)	1.2	(4.9)	0.4
Items taken directly to Other Comprehensive Income	(8.2)	(1.8)	(1.5)	(2.1)
Disposal of subsidiaries	0.2	-	-	-
At 31 December	5.0	20.0	6.2	12.6

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

Deferred tax assets	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Fixed asset temporary differences	0.9	1.4	-	-
Pension benefits	11.3	10.7	4.9	4.7
Provisions for loan impairment	0.8	1.9	0.5	0.2
Corporation tax losses	0.2	6.8	-	4.9
Derivatives and loans	4.3	7.0	4.3	7.0
Other	1.4	1.0	-	-
	18.9	28.8	9.7	16.8

Deferred tax liabilities	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Fixed asset temporary differences	2.5	2.2	2.1	1.8
Derivatives and loans	2.7	4.3	1.4	2.4
Available-for-sale financial assets	7.2	-	-	-
Other	1.5	2.3	-	-
	13.9	8.8	3.5	4.2
Net deferred tax asset	5.0	20.0	6.2	12.6

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

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Fixed asset temporary differences	0.9	(0.5)	0.3	(0.4)
Provisions	(0.4)	(0.1)	(0.3)	0.1
Unwind of merger fair value adjustments	-	(0.3)	-	-
Utilisation of tax losses	4.9	-	4.9	-
Other	1.6	(0.3)	-	(0.1)
	7.0	(1.2)	4.9	(0.4)

Unrecognised deferred tax relating to trading losses carried forward at 31 December 2013 is £3.4m (2012: £0.3m).

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. Pensions

Defined contribution schemes

The amount charged to the Income Statement in respect of contributions to the Group's defined contribution and stakeholder pension arrangements is the contribution payable in the year. The total pension cost charged to the Income Statement amounted to Group: £7.0m (2012: £6.7m) and Society: £2.5m (2012: £2.4m).

On 1 July 2013 the Society implemented new legislation which requires the automatic enrolment of eligible employees into a pension arrangement. The legislation is being enacted by size of employer and other Group companies will implement its requirements during 2014 and 2015.

Defined benefit schemes

The Group sponsors five funded defined benefit arrangements:

- The Skipton Building Society Pension & Life Assurance Scheme (the Skipton Scheme)
- The Scarborough Building Society Group Pension and Death Benefits Scheme (the Scarborough 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)

These are separate trustee administered funds holding the pension scheme assets to meet long term liabilities for current and past employees as follows:

- Skipton Scheme – 798 members
- Scarborough Scheme - 177 members
- Connells Scheme - 537 members
- Sequence 1997 Scheme - 820 members
- Sequence Staff Scheme - 225 members

The level of retirement benefit in each scheme is principally based on salary and is linked to changes in inflation up to retirement. For all schemes the level of retirement benefit is based on salary earned in the last years of employment prior to leaving active service (this is known as Career Average Revalued Earnings (CARE)) as follows:

- Skipton Scheme – the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service or, for members employed by Skipton Financial Services Limited, the annual average salary earned in the last five years of employment prior to leaving active service;

- Scarborough Scheme – the highest (prior to 2003) or the average (post 2003) annual salary earned in the last three years of employment prior to leaving active service;

- Connells Scheme – the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service;

- Sequence 1997 Scheme – the annual average salary earned in the last three years of employment prior to leaving active service;

- Sequence Staff Scheme – the greater of the annual average salary earned in the last three years and the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service.

The schemes are all now closed to new members and to the future accrual of benefits, with the exception of the Scarborough Scheme where active members retain a link to salary (capped at 5% per annum). The Scarborough Scheme closed to future accrual of benefits, subject to the exception noted above, 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 schemes are subject to the funding legislation outlined in the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, and Guidance Notes adopted by the Financial Reporting Council, sets out the framework for funding defined benefit occupational pension schemes in the UK.

The Trustee of each scheme is required to act in the best interest of the scheme's beneficiaries. The appointment of the Trustee is determined by the schemes' trust documentation.

29. Pensions *(continued)*

Full actuarial valuations were carried out as at the dates set out below in accordance with the scheme funding requirements of the Pensions Act 2004 and the funding of each scheme is agreed between the Group and the Trustee in line with those requirements. This legislation requires the deficit to be calculated using prudent, as opposed to best estimate, actuarial assumptions. The most recent actuarial valuations for each of the schemes showed the following:

Scheme	Valuation date	Deficit £m	Recovery Period	Annual Contribution £m
Skipton	1 April 2011	(0.5)	7 years 2 months	0.5
Scarborough	31 December 2010	(5.4)	6 years 5 months	0.7
Connells	30 April 2011	(9.7)	7 years	1.2
Sequence 1997	5 April 2011	(3.8)	7 years	0.4
Sequence Staff	1 April 2013	(5.1)	7 years	0.6

Scheme expenses and levies to the Pension Protection Fund are payable by the Group as and when they are due and are accounted for within the Group's administrative expenses.

For the purposes of IAS 19, the actuarial valuations, which were carried out by a qualified independent actuary, have been updated on an approximate basis to 31 December 2013. There have been no changes in the valuation methodology adopted for this year's disclosures compared to the previous year's disclosures.

The aggregate costs of the five schemes are recognised in accordance with IAS 19. Whilst the Society is the principal employer for the Skipton and Scarborough schemes, current and former employees of other Group companies are also members of these schemes and the Society makes recharges to these subsidiaries in relation to deficit contributions under an internal agreement based on the proportion of active members who were employees at the time of closure to future accrual. These companies are no longer participating employers in the schemes and account for the pension scheme on the basis of the deficit contributions paid by that company. The Society accounts for the difference between the aggregate IAS 19 costs of the scheme and the aggregate contributions paid by the other entities.

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

	Group and Society	
	2013 %	2012 %
Retail price inflation (RPI)	**3.50**	2.90
Consumer price inflation (CPI)	**2.50**	2.00
Discount rate	**4.55**	4.60
Increases to pension payment:		
RPI or 5% per annum if less	**3.30**	2.80
RPI or 5% per annum if less, min 3% per annum	**3.80**	3.55
RPI or 2.5% per annum if less	**2.40**	2.40
CPI or 5% per annum if less	**2.50**	2.00
CPI or 5% per annum if less, min 3% per annum	**3.40**	3.30
CPI or 2.5% per annum if less	**2.40**	1.90
Rate of increase deferred pensions (CPI or 5% per annum if less)	**2.50**	2.00
Allowance for commutation of pension for cash at retirement	**100% of post A day maximum**	100% of post A day maximum

All the schemes' deferred pensions now accrue inflationary increases based on CPI rather than RPI, unless the scheme rules specifically refer to RPI.

The most significant non-financial assumption is the assumed rate of longevity. For the year ended 31 December 2013, 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 2013 improvements with a 1% per annum long term rate of convergence. The tables adopted imply the following life expectancy:

29. Pensions *(continued)*

	Life expectancy at age 65 (years) 2013	2012
Male retiring in the current year	**23.5**	23.6
Female retiring in the current year	**24.8**	24.6
Male retiring in 15 years' time	**24.5**	24.6
Female retiring in 15 years' time	**25.9**	25.8

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

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Fair value of plan assets	**162.2**	157.9	**81.6**	81.2
Present value of defined benefit obligations	**(215.5)**	(203.0)	**(105.8)**	(101.3)
Net pension liability	**(53.3)**	(45.1)	**(24.2)**	(20.1)

The present value of scheme liabilities is measured by discounting the best estimate of future cash flows to be paid out by the schemes using the projected unit credit method. The value calculated in this way is reflected in the net liability within the Statement of Financial Position as shown above.

The projected unit credit method is a valuation method in which each potential cash flow from the schemes (e.g. annual pension payment, or potential lump sum payment on death) is multiplied by an assumed probability of payment and discounted between the valuation date and the time the payment is needed.

All remeasurements are recognised in the year in which they occur in the Statement of Other Comprehensive Income. As all remeasurements and assets are recognised, the deficits shown above are those recognised within the Statement of Financial Position.

IAS 19 allows an employer to recognise a surplus as an asset to the extent that it is able to recover a surplus either through reduced contributions in the future or through refunds from the scheme, even if the refunds may only be available at some distant time in the future, such as after the last benefit has been paid. None of the schemes are in surplus as at 31 December 2013.

The Group has reviewed the guidance provided by IFRIC 14 and has concluded that it is not necessary to make any adjustments to the IAS 19 figures in respect of an asset ceiling or minimum funding requirement as at 31 December 2013. As the schemes remain in deficit, the asset ceiling has no impact and so a reconciliation is not required.

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

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
At 1 January	**203.0**	192.1	**101.3**	97.0
Current service cost	**-**	-	**-**	-
Past service cost	**0.5**	-	**0.5**	-
Interest expense	**9.2**	9.1	**4.5**	4.6
Contributions by employees	**-**	-	**-**	-
Remeasurement (gains) / losses arising from changes in:				
Scheme experience	**(0.7)**	(0.5)	**-**	(0.9)
Demographic assumptions	**(0.5)**	-	**(0.3)**	-
Financial assumptions	**12.7**	7.9	**5.9**	3.8
Actual benefit payments	**(5.6)**	(5.6)	**(3.5)**	(3.2)
Liabilities extinguished on settlements	**(3.1)**	-	**(2.6)**	-
At 31 December	**215.5**	203.0	**105.8**	101.3

29. Pensions *(continued)*

The Scarborough Scheme completed a flexible benefit offer during the year which was taken up by 16 deferred members. This offer provided enhanced transfer values to these deferred members. The value of the transfers paid has been reflected as a settlement. Transfer Values totalling £2.5m (2012: £nil) were paid out of the scheme and the liability extinguished was £2.6m (2012: £nil). This resulted in a settlement gain of £0.1m (2012: £nil) for the Group and the Society. Enhancements paid by the Group and Society of £0.5m (2012: £nil) are shown as a past service cost.

The Sequence Staff Scheme also completed a flexible benefits offer during the year which was taken up by seven deferred members. This offer provided transfer values to these deferred members or early retirement within the scheme. The value of the transfers paid and cash taken on early retirement has been reflected as a settlement. Transfer Values totalling £0.5m (2012: £nil) were paid out of the scheme and the liability extinguished was £0.5m (2012: £nil). This resulted in a settlement gain of £nil (2012: £nil). No enhancement was paid (2012: £nil).

There have been no other settlements, plan amendments or curtailments in the period.

The table below sets out the reconciliation of the fair value of scheme assets for the year:

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
At 1 January	**157.9**	148.5	**81.2**	78.1
Interest income (restated*)	**7.1**	7.1	**3.6**	3.7
Return on plan assets (excluding amounts included in interest income) (restated*)	**2.3**	2.9	**1.1**	1.3
Contributions by employer	**3.5**	5.0	**1.7**	1.3
Contributions by employees	**-**	-	**-**	-
Benefits paid	**(5.6)**	(5.6)	**(3.5)**	(3.2)
Expenses paid by the schemes	**-**	-	**-**	-
Assets distributed on settlements	**(3.0)**	-	**(2.5)**	-
At 31 December	**162.2**	157.9	**81.6**	81.2

* The 2012 comparatives have been restated in line with accounting standards adopted in the year as described in notes 1a) and 41.

The actual return on the scheme assets over the year ended 31 December 2013 was as follows:

- Group £9.4m (2012: £10.0m)
- Society £4.7m (2012: £5.0m)

29. Pensions *(continued)*

The table below sets out the fair value of the scheme assets by each major category:

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
UK equities	**-**	5.7	**-**	1.5
Diversified growth fund (note 1)	**127.4**	93.1	**63.4**	47.5
Property	**-**	1.4	**-**	0.6
Corporate bonds	**25.3**	32.0	**13.8**	16.0
Fixed interest bonds	**-**	0.7	**-**	0.7
Index linked bonds	**-**	23.9	**-**	14.7
Liability driven investments (note 2)	**8.7**	-	**4.1**	-
Cash	**0.8**	1.1	**0.3**	0.2
	162.2	157.9	**81.6**	81.2

Notes:

1. Diversified growth funds 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.
2. Liability Driven Investments (LDI) are investments in assets which are expected to behave in a similar manner to liabilities and therefore aim to provide a better match against liability movements than conventional bonds or gilts.

During the year the Trustee invested in an LDI fund which aims to cover 30% of the interest rate sensitivity and 60%-70% of the inflation sensitivity of the funded liabilities on the scheme funding basis. Such investments were made by the Skipton, Connells and Sequence 1997 schemes and the Trustee is currently considering LDI strategies for the Scarborough and Sequence Staff schemes.

None of the fair values of the assets shown above include any of the Group's own financial instruments or any property occupied by, or other assets used by, the Group. All of the schemes' assets have a quoted market price in an active market with the exception of the Trustee's bank account balance.

It is the policy of the Trustee and the Group to review the investment strategy at the time of each funding valuation. The Trustee's investment objectives and the processes undertaken to measure and manage the risks inherent in the scheme investment strategy are documented in the schemes' Statement of Investment Principles.

29. Pensions *(continued)*

The table below sets out the amounts which have been recognised within the Income Statement. The service costs, settlements for the year and administrative expenses are recognised in 'administrative expenses', whilst the net interest cost is recognised within 'other income'.

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Service cost:				
Current service cost	**-**	-	**-**	-
Past service cost	**0.5**	-	**0.5**	-
Gains on settlements	**(0.1)**	-	**(0.1)**	-
Administrative expenses	**-**	-	**-**	-
Net interest expense (restated*)	**2.1**	2.0	**0.9**	0.9
Total recognised in Income Statement	**2.5**	2.0	**1.3**	0.9

* The 2012 comparatives have been restated in line with accounting standards adopted in the year as described in notes 1a) and 41.

The table below sets out the remeasurements of retirement benefit obligations which have been recognised within the Statement of Comprehensive Income:

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Remeasurements of retirement benefit obligations:				
Actuarial gains / (losses) arising from:				
Experience adjustments	**0.7**	0.5	**-**	0.9
Demographic assumptions	**0.5**	-	**0.3**	-
Financial assumptions	**(12.7)**	(7.9)	**(5.9)**	(3.8)
Return on plan assets (excluding amounts included in net interest expense) (restated*)	**2.3**	2.9	**1.1**	1.3
Total amount recognised in Other Comprehensive Income	**(9.2)**	(4.5)	**(4.5)**	(1.6)

* The 2012 comparatives have been restated in line with accounting standards adopted in the year as described in notes 1a) and 41.

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 2014:

	Group 2014 £m	**Society 2014 £m**
Estimated employer contributions	**3.3**	**1.2**
Estimated employee contributions	**-**	**-**
Estimated total contributions	**3.3**	**1.2**

30. Subordinated liabilities

	Group and Society 2013 £m	Group and Society 2012 £m
Subordinated fixed rate notes 2014	**15.2**	15.2
Subordinated fixed rate notes 2015	**18.1**	20.1
Subordinated fixed rate notes 2017	**10.2**	10.2
Subordinated fixed rate notes 2018	**35.5**	52.7
Subordinated fixed rate notes 2018	**-**	75.4
Subordinated fixed rate notes 2019	**10.1**	10.1
Subordinated fixed rate notes 2022	**31.2**	31.2
	120.3	214.9
Unamortised discount on issue	**(0.3)**	(0.7)
Fair value adjustment for hedged risk	**4.4**	9.7
	124.4	223.9

During 2013, the Society undertook a tender offer for certain tranches of subordinated notes to retire capital that under new rules will cease to be eligible regulatory capital. Market conditions allowed the Society to buy back £14.7m of the fixed rate notes due in 2018 and £2.0m of the fixed rate notes due in 2015 which generated a profit of £2.6m, which is included in other income. In December 2013, the Society also repaid, at par, £75.0m of fixed rate notes repayable in 2018 by exercising its first call option.

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, £nil (2012: £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 PRA. The note holders' rights are subordinate to those of the depositors and other payables.

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.

31. Subscribed capital

	Group and Society 2013 £m	Group and Society 2012 £m
6.875% Permanent Interest Bearing Shares	**45.9**	44.5
8.500% Permanent Interest Bearing Shares	**16.0**	16.2
12.875% Permanent Interest Bearing Shares	**26.3**	26.3
	88.2	87.0
Fair value adjustment for hedged risk	**5.9**	9.1
	94.1	96.1

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.

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

	Group					
	2013			2012 Restated*		
	Before-tax amount £m	**Tax (expense) / benefit £m**	**Net-of-tax amount £m**	Before-tax amount £m	Tax benefit / (expense) £m	Net-of-tax amount £m
Available-for-sale financial assets	**29.5**	**(6.7)**	**22.8**	(11.1)	2.8	(8.3)
Cash flow hedges	**5.2**	**(1.6)**	**3.6**	6.4	(2.0)	4.4
Remeasurements of defined benefit obligation	**(9.2)**	**0.7**	**(8.5)**	(4.5)	0.7	(3.8)
Translation of foreign operations	**(0.5)**	**-**	**(0.5)**	0.1	-	0.1
Other comprehensive income	**25.0**	**(7.6)**	**17.4**	(9.1)	1.5	(7.6)

	Society					
	2013			2012 Restated*		
	Before-tax amount £m	**Tax (expense) / benefit £m**	**Net-of-tax amount £m**	Before-tax amount £m	Tax benefit / (expense) £m	Net-of-tax amount £m
Available-for-sale financial assets	**(1.7)**	**0.4**	**(1.3)**	(12.2)	3.0	(9.2)
Cash flow hedges	**5.2**	**(1.6)**	**3.6**	6.4	(2.0)	4.4
Remeasurements of defined benefit obligation	**(4.5)**	**0.3**	**(4.2)**	(1.6)	-	(1.6)
Other comprehensive income	**(1.0)**	**(0.9)**	**(1.9)**	(7.4)	1.0	(6.4)

* The 2012 comparatives have been restated in line with accounting standards adopted in the year as described in notes 1a) and 41.

33. 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 2013 or which rely on it for ongoing funding.

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 Capital Levy. The Management Expenses Levy covers the costs of running the scheme and the Capital 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's FSCS provision reflects market participation up to the reporting date. £8.7m (2012: £9.6m) of the provision relates to the estimated management expense levy for the scheme years 2013/2014 and 2014/2015. This amount was calculated on the basis of the Directors' estimate of the Society's current share of protected deposits taking into account the FCA's estimate of total management expense levies for each scheme year.

The Management Expenses Levy for scheme years 2013/2014 and 2014/2015 is calculated using a funding rate which is the higher of 12 months LIBOR + 100bps and the Government's own cost of borrowing, and is the rate that will be charged for the HM Treasury loans.

The FSCS now expects a capital shortfall of approximately £802m, which will be levied against UK retail deposit holders as a Capital Levy over a three year period starting in 2013/2014. For the scheme year 2014/2015, triggered by participation in the market at 31 December 2013, the Society has recognised a provision of £3.3m (2012: £2.6m) for the second of three annual tranches of the Capital Loan repayment. In common with the Management Expenses Levy, the Capital Loan repayment was calculated on the basis of the Directors' estimate of the Society's current share of UK protected deposits.

c) Within the Mortgage Services division, the Group is aware of certain issues related to a portfolio of CCA regulated loans, which HML administers on behalf of a client. The Group has made provision for the potential costs which may arise from these issues and this is included within provisions for liabilities in note 27. The provision made at 31 December 2013 represents management's best estimate of the liability arising although, given the technical complexities associated with administrating CCA regulated accounts, the extent of any ultimate liability is uncertain.

In addition, the client is performing a review of its CCA portfolio, and the Group is aware that there may be further liabilities depending on the findings of the review and the actions of the client. Given that the review is ongoing and the technical complexities associated with administering CCA regulated accounts, the Group is unable to quantify what, if any, liability may arise. However, based on the Group's internal consideration of the potential issues, in view of the respective responsibilities of HML and their client, and taking account of the availability of other mitigants, the Directors believe that any provision arising would not have a material impact on the annual accounts.

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

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Contracted but not provided for	**1.0**	0.7	**-**	-

33. Other financial commitments and contingent liabilities *(continued)*

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

Group	2013 Land and buildings £m	2013 Other £m	2012 Land and buildings £m	2012 Other £m
Amounts falling due:				
Within one year	**14.4**	**1.9**	15.9	0.9
Within two to five years inclusive	**38.5**	**3.8**	47.9	1.6
Over five years	**19.7**	**-**	26.7	-
	72.6	**5.7**	90.5	2.5

Society	2013 Land and buildings £m	2013 Other £m	2012 Land and buildings £m	2012 Other £m
Amounts falling due:				
Within one year	**4.3**	**1.3**	4.9	0.3
Within two to five years inclusive	**13.4**	**3.3**	17.5	0.9
Over five years	**9.4**	**-**	13.5	-
	27.1	**4.6**	35.9	1.2

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

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Amounts falling due:				
Within one year	**0.9**	0.8	**0.3**	0.3
Within two to five years inclusive	**1.9**	1.5	**0.8**	0.8
Over five years	**0.9**	0.7	**0.7**	0.5
	3.7	3.0	**1.8**	1.6

34. 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 used, 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.

34. Financial instruments *(continued)*

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 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 Group's exposure to changes in Bank Base Rate are also included within cash flow hedges. The weighted average maturity of interest rate swaps being cash flow hedged at 31 December 2013 was approximately 2.1 years (2012: 1.9 years); the amounts held in the cash flow hedging reserve will be recognised in the Income Statement over this period.

Ineffectiveness on those fair value and cash flow hedges for which hedge accounting has been achieved is an immaterial amount.

35. 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 short notice periods, actually remain with the Group beyond their contractual notice. 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. ALCO manages liquidity under delegated authority, within risk appetite limits established by the Board, and also monitors 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 and quality 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;

35. Liquidity risk *(continued)*

- the Group's Market & Liquidity Risk function conducts a series of daily, weekly and monthly stress tests that are designed to ensure that the Group's liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding; and
- under the Regulatory liquidity regime, introduced in 2010, the Group is required to hold highly liquid assets ('buffer liquidity' such as government and supranational debt securities and cash) in excess of the Regulator'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.

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. In practice, customer deposits, i.e. shares, amounts owed to credit institutions and amounts owed to other customers, are likely to be repaid later than on the earliest date on which repayment can be required.

Group	2013					
	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	859.4	-	-	-	-	**859.4**
Loans and advances to credit institutions	224.3	78.5	-	23.4	-	**326.2**
Debt securities	-	26.5	159.9	840.8	168.3	**1,195.5**
Derivative financial instruments	-	3.8	34.1	67.4	43.5	**148.8**
Loans and advances to customers	65.7	21.0	56.6	614.5	10,759.1	**11,516.9**
Equity share investments	-	-	-	-	37.1	**37.1**
Trade receivables	13.7	18.7	-	-	-	**32.4**
Total financial assets	**1,163.1**	**148.5**	**250.6**	**1,546.1**	**11,008.0**	**14,116.3**
Liabilities						
Shares	3,820.6	3,698.9	1,343.1	1,275.2	122.3	**10,260.1**
Amounts owed to credit institutions	53.3	670.2	23.1	297.1	2.6	**1,046.3**
Amounts owed to other customers	195.7	298.9	352.0	82.8	1.4	**930.8**
Debt securities in issue	-	2.2	48.6	503.9	-	**554.7**
Derivative financial instruments	-	1.7	26.2	127.2	132.5	**287.6**
Trade payables	-	6.0	-	-	-	**6.0**
Fair value of put option obligation	-	6.0	7.3	0.2	-	**13.5**
Fair value of liability of management incentive scheme	-	-	-	6.2	2.7	**8.9**
Subordinated liabilities	-	15.3	-	63.9	45.2	**124.4**
Subscribed capital	-	-	-	-	94.1	**94.1**
Total financial liabilities	**4,069.6**	**4,699.2**	**1,800.3**	**2,356.5**	**400.8**	**13,326.4**
Net liquidity gap	**(2,906.5)**	**(4,550.7)**	**(1,549.7)**	**(810.4)**	**10,607.2**	**789.9**

35. Liquidity risk *(continued)*

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
Equity share investments	-	-	-	-	3.1	3.1
Trade receivables	16.1	18.7	-	-	-	34.8
Total financial assets	1,416.5	141.7	230.1	1,231.3	10,346.3	13,365.9
Liabilities						
Shares	3,103.1	3,745.9	1,400.9	1,153.0	59.5	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
Trade payables	-	6.3	-	-	-	6.3
Fair value of put option obligation	-	2.2	7.4	2.4	-	12.0
Fair value of liability of management incentive scheme	-	-	-	-	1.3	1.3
Subordinated liabilities	-	-	77.2	94.0	52.7	223.9
Subscribed capital	-	-	-	-	96.1	96.1
Total financial liabilities	3,344.6	4,258.3	2,120.1	2,482.8	503.2	12,709.0
Net liquidity gap	(1,928.1)	(4,116.6)	(1,890.0)	(1,251.5)	9,843.1	656.9

In the table above, £53.5m of subscribed capital, previously included in 1-5 years and reported accordingly in 2012, has been represented as maturing in more than five years. This reclassification has been made to reflect the contractual maturity of these Permanent Interest Bearing Shares whose maturity had previously been assessed to be the 2017 call date. The comparative figures for shares have also been amended on a consistent basis with the revised presentation outlined in note 22.

35. Liquidity risk *(continued)*

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

Group			**2013**		
Liabilities	**0-3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Shares	**7,519.5**	**1,343.1**	**1,319.8**	**185.4**	**10,367.8**
Amounts owed to credit institutions, other customers and debt securities in issue	**1,229.3**	**564.0**	**794.8**	**4.0**	**2,592.1**
Derivative financial instruments	**20.2**	**42.9**	**91.9**	**315.2**	**470.2**
Trade payables	**6.0**	**-**	**-**	**-**	**6.0**
Fair value of put option obligation	**6.9**	**7.7**	**0.6**	**-**	**15.2**
Fair value of liability of management incentive scheme	**1.2**	**-**	**-**	**-**	**1.2**
Subordinated liabilities	**16.1**	**3.9**	**80.1**	**48.5**	**148.6**
Subscribed capital	**1.6**	**6.3**	**31.7**	**79.3**	**118.9**
	8,800.8	**1,967.9**	**2,318.9**	**632.4**	**13,720.0**

Group			2012		
Liabilities	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	6,849.1	1,401.2	1,211.6	90.7	9,552.6
Amounts owed to credit institutions, other 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
Trade payables	6.3	-	-	-	6.3
Fair value of put option obligation	2.7	7.7	3.6	-	14.0
Fair value of liability of management incentive scheme	1.3	-	-	-	1.3
Subordinated liabilities	3.0	12.2	100.7	186.5	302.4
Subscribed capital	1.6	6.3	31.7	79.3	118.9
	7,426.3	2,061.0	3,050.2	775.6	13,313.1

Society			**2013**		
Liabilities	**0-3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Shares	**7,519.5**	**1,343.1**	**1,319.8**	**185.4**	**10,367.8**
Amounts owed to credit institutions, other customers and debt securities in issue	**1,052.0**	**436.6**	**1,033.6**	**2.6**	**2,524.8**
Derivative financial instruments	**16.3**	**29.3**	**64.3**	**315.2**	**425.1**
Trade payables	**0.5**	**-**	**-**	**-**	**0.5**
Subordinated liabilities	**16.1**	**3.9**	**80.1**	**48.5**	**148.6**
Subscribed capital	**1.6**	**6.3**	**31.7**	**79.3**	**118.9**
	8,606.0	**1,819.2**	**2,529.5**	**631.0**	**13,585.7**

35. Liquidity risk *(continued)*

Society	2012				
Liabilities	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Shares	6,849.1	1,401.2	1,211.6	90.7	9,552.6
Amounts owed to credit institutions, other 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
Trade payables	0.2	-	-	-	0.2
Subordinated liabilities	3.0	12.2	100.7	186.5	302.4
Subscribed capital	1.6	6.3	31.7	79.3	118.9
	7,507.9	2,060.0	2,963.1	541.9	13,072.9

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

In the Group and Society tables above, the comparatives for subscribed capital have been represented on the same basis as that outlined under the liquidity analysis on page 122. As a result, the revised presentation above more accurately reflects the maturity profile of the associated contractual cash flows of subscribed capital. In addition, the Society and Group tables reflect a revised maturity profile of shares on a consistent basis with that outlined in note 22.

36. 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 Group's Market & Liquidity Risk 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 policy which is overseen by ALCO and approved by the Board. 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.

a) 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, in line with regulatory requirements. Results are compared to Board and Operational limits weekly and 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. These advanced interest rate risk measurement methodology outputs, which are compared to Board and Operational limits weekly and 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.

36. Market risk *(continued)*

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

	As at 31 December 2013 £m	Average 2013 £m	High 2013 £m	Low 2013 £m	As at 31 December 2012 £m
Static earnings-at-risk	**2.9**	**2.1**	**3.2**	**1.1**	1.4
Historical value-at-risk	**1.8**	**1.8**	**3.0**	**1.1**	1.9
2% parallel interest rate shift	**8.6**	**7.5**	**17.9**	**2.2**	2.8

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.

b) 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 funding issues denominated in foreign currency are immediately swapped into Sterling.

The Group has a small exposure to foreign currency interest rates at the year end. These arise from a Sterling mortgage product whose rate is linked to US Dollar interest rates, and the hedge of a medium term Euro debt issuance. However, due to the effect of cross currency swaps the net exposure is immaterial.

The Group also has equity investments in its subsidiary undertakings Jade Software Corporation Limited and Northwest Investments NZ Limited and its associate Wynyard Group Limited which are denominated in New Zealand Dollars. The foreign currency fluctuations in relation to these investments 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.

c) Other price risk

The Group has a number of savings products outstanding where the return is dependent on the performance of certain equity markets. 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. Following its flotation in July 2013, the Group holds a 24.5% stake in Wynyard Group Limited, which is listed on the New Zealand Stock Exchange. The equity risk of this investment is not hedged.

37. 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); and
- wholesale counterparties (including other financial institutions). Credit risk within our treasury portfolio 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. An economic downturn and falls in house prices and commercial property values would 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 Retail Credit Committee and the Group Wholesale Credit Committee provide 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.

37. Credit risk *(continued)*

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 £159.3m (2012: £210.2m) 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 by Skipton International Limited in the Channel Islands and the UK.

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. We ceased new lending in these portfolios in 2008.

Commercial lending to customers and businesses

The Society's commercial loan portfolio was closed to new lending in November 2008. We have retained an appropriately skilled team of people to manage and monitor the performance of these loans.

Other lending

These loans principally comprise 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 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.

a) Credit risk - loans and advances to customers

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

Loans and advances to customers	**Group**				**Society**			
	2013		2012		**2013**		2012	
	£m	**%**	£m	%	**£m**	**%**	£m	%
Total residential mortgages	**10,906.8**	**95.5**	9,908.3	94.8	**8,669.8**	**95.5**	7,595.4	94.3
Commercial loans	**409.8**	**3.6**	438.2	4.2	**409.8**	**4.5**	438.2	5.4
Other lending:								
Debt factoring loans	**58.9**	**0.5**	48.2	0.4	**-**	**-**	-	-
Other loans	**41.2**	**0.4**	61.4	0.6	**1.0**	**-**	21.9	0.3
Gross balances	**11,416.7**	**100.0**	10,456.1	100.0	**9,080.6**	**100.0**	8,055.5	100.0
Impairment provisions	**(59.1)**		(72.8)		**(33.5)**		(39.4)	
Fair value adjustment for hedged risk	**159.3**		210.2		**158.1**		205.6	
	11,516.9		10,593.5		**9,205.2**		8,221.7	

37. Credit risk *(continued)*

i) Residential mortgages

The majority of loans and advances to customers are secured on UK residential properties and are geographically diverse.

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 UK, 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				Society			
	2013		2012		**2013**		2012	
	£m	**%**	£m	%	**£m**	**%**	£m	%
Prime:								
Residential	**7,567.4**	**69.3**	6,717.5	67.7	**6,739.0**	**77.8**	5,901.4	77.7
Buy-to-let	**2,081.5**	**19.1**	1,809.3	18.3	**1,772.7**	**20.4**	1,500.1	19.8
Self build	**84.7**	**0.8**	96.7	1.0	**33.1**	**0.4**	39.4	0.5
Fast track	**125.0**	**1.1**	154.5	1.6	**125.0**	**1.4**	154.5	2.0
Self certified	**589.8**	**5.4**	635.8	6.4	**-**	**-**	-	-
Sub-prime:								
Residential	**105.9**	**1.0**	116.6	1.2	**-**	**-**	-	-
Buy-to-let	**62.0**	**0.6**	65.1	0.7	**-**	**-**	-	-
Self build	**0.6**	**-**	0.7	-	**-**	**-**	-	-
Self certified	**289.9**	**2.7**	312.1	3.1	**-**	**-**	-	-
	10,906.8	**100.0**	9,908.3	100.0	**8,669.8**	**100.0**	7,595.4	100.0

Geographical analysis	Group				Society			
	2013		2012		**2013**		2012	
	£m	**%**	£m	%	**£m**	**%**	£m	%
North	**414.4**	**3.8**	369.6	3.7	**366.4**	**4.2**	318.2	4.2
Yorkshire	**1,127.5**	**10.3**	1,059.3	10.7	**1,017.9**	**11.8**	937.2	12.3
East Midlands	**733.0**	**6.7**	644.4	6.5	**628.2**	**7.2**	531.4	7.0
East Anglia	**681.2**	**6.2**	603.5	6.1	**575.7**	**6.6**	488.9	6.4
London	**1,293.1**	**11.9**	1,239.0	12.5	**1,018.2**	**11.7**	932.8	12.3
South East	**2,031.5**	**18.7**	1,836.1	18.4	**1,657.0**	**19.2**	1,428.0	18.9
South West	**936.2**	**8.6**	868.4	8.7	**806.8**	**9.3**	723.9	9.5
West Midlands	**634.8**	**5.8**	579.8	5.9	**524.9**	**6.1**	462.0	6.1
North West	**1,156.0**	**10.6**	1,056.4	10.7	**982.8**	**11.3**	875.2	11.5
Wales	**212.1**	**1.9**	192.9	2.0	**147.6**	**1.7**	124.3	1.6
Scotland	**969.1**	**8.9**	800.9	8.1	**902.7**	**10.4**	728.4	9.6
Northern Ireland	**68.5**	**0.6**	75.0	0.8	**41.6**	**0.5**	45.1	0.6
Channel Islands	**649.4**	**6.0**	583.0	5.9	**-**	**-**	-	-
	10,906.8	**100.0**	9,908.3	100.0	**8,669.8**	**100.0**	7,595.4	100.0

37. Credit risk *(continued)*

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

Indexed loan-to-value analysis	Group				Society			
	2013		2012		**2013**		2012	
	£m	**%**	£m	%	**£m**	**%**	£m	%
<70%	**5,073.1**	**46.5**	4,045.6	40.9	**4,520.3**	**52.1**	3,527.6	46.5
70% - 80%	**2,115.2**	**19.4**	1,589.9	16.0	**1,798.8**	**20.7**	1,363.0	17.9
80% - 90%	**2,103.0**	**19.3**	1,776.5	17.9	**1,611.2**	**18.6**	1,444.9	19.0
90% - 100%	**1,026.2**	**9.4**	1,333.7	13.5	**552.1**	**6.4**	839.6	11.1
>100%	**589.3**	**5.4**	1,162.6	11.7	**187.4**	**2.2**	420.3	5.5
	10,906.8	**100.0**	9,908.3	100.0	**8,669.8**	**100.0**	7,595.4	100.0

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.

At 31 December 2013, the average indexed loan-to-value of Group residential mortgages was 52.9% (2012: 57.0%) and for Society residential mortgages was 49.6% (2012: 53.0%).

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

	Group				Society			
	2013		2012		**2013**		2012	
	£m	**%**	£m	%	**£m**	**%**	£m	%
Neither past due nor individually impaired	**10,484.9**	**96.1**	9,417.9	95.1	**8,528.7**	**98.4**	7,454.1	98.2
Past due but not impaired:								
Up to 3 months	**1.8**	**-**	2.8	-	**-**	**-**	-	-
3 to 6 months	**0.6**	**-**	0.2	-	**-**	**-**	-	-
	10,487.3	**96.1**	9,420.9	95.1	**8,528.7**	**98.4**	7,454.1	98.2
Individually impaired:								
Low risk	**159.9**	**1.5**	162.1	1.6	**74.6**	**0.8**	63.9	0.8
High risk	**240.8**	**2.2**	303.9	3.1	**60.8**	**0.7**	71.4	0.9
Possessions	**18.8**	**0.2**	21.4	0.2	**5.7**	**0.1**	6.0	0.1
	10,906.8	**100.0**	9,908.3	100.0	**8,669.8**	**100.0**	7,595.4	100.0

The analysis of residential loans has been enhanced to provide further analysis of those assets which are individually impaired. Low risk accounts in the table above relate to loans with an indexed loan-to-value of less than or equal to 70%. High risk accounts relate to loans either with an indexed loan-to-value of more than 70%, or where other factors indicate that these loans are considered high risk.

Where appropriate for customers' needs, the Group applies a policy of forbearance and may grant a concession to borrowers. This may be applied where the 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 work towards the best outcome for both the customer and the business through dealing with arrears at an early stage. Possession balances represent loans against which the Group has taken ownership of properties pending their sale. Possession is generally only considered as a last resort once all other options for the customer have been exhausted. As at 31 December 2013 the balance of residential loans where the property in question has been taken into possession represents 0.2% of total outstanding loans for the Group (31 December 2012: 0.2%), and 0.1% of total outstanding loans for the Society (31 December 2012: 0.1%). The Group does not occupy repossessed properties for business use, or use assets acquired in its operations. All customer accounts are monitored to ensure that these strategies remain appropriate.

37. Credit risk *(continued)*

The table below provides further information on residential mortgages at 31 December 2013 by the type of account renegotiations applied to customers over the last two years. This includes renegotiations regardless of whether or not the customer has experienced financial difficulty in making repayments. For clarity, this table includes all accounts where we have renegotiated terms during the last two years, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms.

Group	**2013 £m**	**Capitalisation £m**	**Reduced payment £m**	**Transfer to interest only £m**	**Term extension £m**	**Total renego-tiations £m**	**%**
Neither past due nor individually impaired	**10,484.9**	14.2	101.7	58.9	117.2	**292.0**	**2.8**
Past due but not impaired:							
Up to 3 months	**1.8**	-	-	0.3	-	**0.3**	**16.7**
3 to 6 months	**0.6**	-	-	0.4	-	**0.4**	**66.7**
	10,487.3	**14.2**	**101.7**	**59.6**	**117.2**	**292.7**	**2.8**
Individually impaired:							
Low risk	**159.9**	2.3	12.3	6.8	4.6	**26.0**	**16.3**
High risk	**240.8**	3.9	15.3	11.6	4.8	**35.6**	**14.8**
Possessions	**18.8**	0.1	1.1	0.7	-	**1.9**	**10.1**
	10,906.8	**20.5**	**130.4**	**78.7**	**126.6**	**356.2**	**3.3**
Collective impairment	**(18.6)**	(0.1)	(0.2)	(0.2)	(0.1)	**(0.6)**	**3.2**
Individual impairment	**(29.9)**	-	(2.0)	(1.4)	(0.7)	**(4.1)**	**13.7**
	10,858.3	**20.4**	**128.2**	**77.1**	**125.8**	**351.5**	**3.2**

Group	2012 £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renego-tiations £m	%
Neither past due nor individually impaired	9,417.9	45.6	54.6	75.9	151.6	327.7	3.5
Past due but not impaired:							
Up to 3 months	2.8	-	-	1.3	1.0	2.3	82.1
3 to 6 months	0.2	-	-	-	0.2	0.2	100.0
	9,420.9	45.6	54.6	77.2	152.8	330.2	3.5
Individually impaired:							
Low risk	162.1	6.0	10.4	10.0	4.2	30.6	18.9
High risk	303.9	16.6	20.9	18.5	6.6	62.6	20.6
Possessions	21.4	1.3	1.0	0.6	0.1	3.0	14.0
	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

The 2013 reduced payments figures now include loans where, by negotiation, only one reduced monthly payment has been made on a customer's account; for example where one reduced monthly payment is immediately followed the next month by an increased payment to ensure the account remains up to date.

37. Credit risk *(continued)*

Society	2013 £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renego-tiations £m	%
Neither past due nor individually impaired	**8,528.7**	13.4	91.8	36.0	95.7	**236.9**	**2.8**
Past due but not impaired	**-**	-	-	-	-	**-**	**-**
	8,528.7	**13.4**	**91.8**	**36.0**	**95.7**	**236.9**	**2.8**
Individually impaired:							
Low risk	**74.6**	2.3	10.0	4.7	3.2	**20.2**	**27.1**
High risk	**60.8**	3.9	8.3	5.1	2.6	**19.9**	**32.7**
Possessions	**5.7**	0.1	0.2	0.6	-	**0.9**	**15.8**
	8,669.8	**19.7**	**110.3**	**46.4**	**101.5**	**277.9**	**3.2**
Collective impairment	**(15.8)**	(0.1)	(0.2)	(0.1)	(0.1)	**(0.5)**	**3.2**
Individual impairment	**(7.7)**	-	(1.1)	(0.7)	(0.4)	**(2.2)**	**28.6**
	8,646.3	**19.6**	**109.0**	**45.6**	**101.0**	**275.2**	**3.2**

Society	2012 £m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renego-tiations £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 impaired	-	-	-	-	-	-	-
	7,454.1	29.1	42.6	51.3	144.8	267.8	3.6
Individually impaired:							
Low risk	63.9	3.3	8.2	5.9	4.1	21.5	33.6
High risk	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

The 2013 reduced payments figures now include loans where, by negotiation, only one reduced monthly payment has been made on a customer's account; for example where one reduced monthly payment is immediately followed the next month by an increased payment to ensure the account remains up to date.

The factors considered by the Group in determining the level of individual impairment to be made are outlined in note 1f) to the accounts.

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 that losses are likely or the property is in possession or where fraud or negligence has been identified.

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 prices or indices of similar assets.

37. Credit risk *(continued)*

Some properties in the Group's mortgage book are in negative equity, which increases the possibility of the Group incurring a loss if the property is taken into possession. For the majority of the Group's loans, the Group holds excess collateral however this cannot be used to offset those instances where the loan amount exceeds the collateral held. The fair value of collateral in the table below is therefore calculated, on an individual loan basis, as the lower of the value of the property and the outstanding loan amount. It does not reflect the overall value of properties against which the loans are secured.

Fair value of capped collateral held:	**Group**		**Society**	
	2013 £m	2012 £m	**2013 £m**	2012 £m
Not individually impaired	**10,402.9**	9,336.0	**8,463.0**	7,378.6
Impaired	**387.9**	441.6	**133.6**	131.5
Possessions	**15.9**	18.0	**4.3**	4.7
	10,806.7	9,795.6	**8,600.9**	7,514.8

The fair value of residential property used to derive the figures in the table above is determined by reference to a recognised house price index (the Halifax house price index). Movements in this index to the reporting date are applied to all properties in the portfolio on a regional basis. As such, this fair value measurement is classified as a Level 2 fair value measurement as it uses market observable data, as described in note 38b).

ii) Commercial loans

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

	Group and Society			
	2013		2012	
	£m	**%**	£m	%
Leisure and hotel	**40.2**	**9.8**	42.5	9.7
Retail	**14.9**	**3.6**	15.7	3.6
Nursing / residential homes	**20.2**	**4.9**	22.0	5.0
Offices	**12.1**	**3.0**	14.2	3.2
Commercial investment and industrial units	**301.5**	**73.6**	321.9	73.5
Miscellaneous	**20.9**	**5.1**	21.9	5.0
	409.8	**100.0**	438.2	100.0

Geographical analysis	**Group and Society**			
	2013		2012	
	£m	**%**	£m	%
North	**20.5**	**5.0**	21.6	4.9
Yorkshire	**36.2**	**8.8**	39.3	9.0
East Midlands	**28.4**	**6.9**	30.1	6.9
East Anglia	**16.1**	**3.9**	17.0	3.9
London	**92.8**	**22.7**	100.8	23.0
South East	**81.0**	**19.8**	88.1	20.1
South West	**49.3**	**12.0**	52.3	11.9
West Midlands	**29.6**	**7.2**	30.9	7.1
North West	**41.3**	**10.1**	43.1	9.8
Wales	**8.1**	**2.0**	8.3	1.9
Scotland	**6.5**	**1.6**	6.7	1.5
	409.8	**100.0**	438.2	100.0

37. Credit risk *(continued)*

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

Indexed loan-to-value analysis	**Group and Society**			
	2013		2012	
	£m	**%**	£m	%
<75%	**311.8**	**76.1**	345.6	78.9
75% - 80%	**7.7**	**1.9**	10.7	2.4
80% - 90 %	**31.1**	**7.6**	27.1	6.2
90% - 100%	**18.5**	**4.5**	23.3	5.3
>100%	**40.7**	**9.9**	31.5	7.2
	409.8	**100.0**	438.2	100.0

The indexed loan-to-value is updated on an annual basis to reflect changes in the IPD (Investment Property Databank Ltd) commercial property index.

At 31 December 2013 the average indexed loan-to-value of commercial loans was 71.7% (2012: 71.3%).

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

	Group and Society			
	2013		2012	
	£m	**%**	£m	%
Neither past due nor individually impaired	**395.1**	**96.5**	425.5	97.1
Past due but not impaired	**-**	**-**	-	-
	395.1	**96.5**	425.5	97.1
Individually impaired:				
Low risk	**10.0**	**2.4**	9.5	2.2
High risk	**4.7**	**1.1**	3.2	0.7
	409.8	**100.0**	438.2	100.0

The analysis of commercial loans has been enhanced to provide further analysis of those assets which are individually impaired. Low risk accounts in the table above relate to loans with an indexed loan-to-value of less than or equal to 70%. High risk accounts relate to loans either with an indexed loan-to-value of more than 70%, or where other factors indicate that these loans are considered high risk.

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 commercial loans at 31 December 2013 by the type of account renegotiations applied to customers over the last two years. This includes renegotiations regardless of whether or not the customer has experienced financial difficulty in making repayments. For clarity, this table includes all accounts where we have renegotiated terms during the last two years, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms.

37. Credit risk *(continued)*

Group and Society	**2013 £m**	**Capitalisation £m**	**Transfer to interest only £m**	**Total renegotiations £m**	**%**
Neither past due nor individually impaired	**395.1**	1.8	21.4	**23.2**	**5.9**
Past due but not impaired	**-**	-	-	**-**	**-**
	395.1	**1.8**	**21.4**	**23.2**	**5.9**
Individually impaired:					
Low risk	**10.0**	0.1	7.4	**7.5**	**75.0**
High risk	**4.7**	-	2.7	**2.7**	**57.4**
	409.8	**1.9**	**31.5**	**33.4**	**8.2**
Collective impairment	**(5.4)**	-	(0.2)	**(0.2)**	**3.7**
Individual impairment	**(4.1)**	-	(2.8)	**(2.8)**	**68.3**
	400.3	**1.9**	**28.5**	**30.4**	**7.6**

Group and Society	2012 £m	Capitalisation £m	Transfer to interest only £m	Total renegotiations £m	%
Neither past due nor individually impaired	425.5	1.9	19.2	21.1	5.0
Past due but not impaired	-	-	-	-	-
	425.5	1.9	19.2	21.1	5.0
Individually impaired:					
Low risk	9.5	-	7.4	7.4	77.9
High risk	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

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 ultimately likely to be received, based upon objective evidence.

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

An analysis of capped collateral, where the collateral is capped to the lower of the value of the property and the amount outstanding on an individual loan basis, is shown below:

Fair value of capped collateral held:	**Group and Society**	
	2013 £m	2012 £m
Not individually impaired	**386.6**	419.7
Individually impaired	**12.3**	10.9
	398.9	430.6

37. Credit risk *(continued)*

The fair value of commercial property used to derive the figures in the table above is determined by reference to the IPD (Investment Property Databank Ltd) commercial property index. As such, this fair value measurement is classified as a Level 2 fair value measurement as it uses market observable data, as described in note 38b).

iii) Other lending

	Group			
	2013		2012	
	Gross £m	**Impairment £m**	Gross £m	Impairment £m
Factored debt and invoice discounting	**58.9**	**(0.7)**	48.2	(0.7)
Other loans	**41.2**	**(0.4)**	61.4	(19.5)
	100.1	**(1.1)**	109.6	(20.2)

	Society			
	2013		2012	
	Gross £m	**Impairment £m**	Gross £m	Impairment £m
Other loans	**0.9**	**(0.4)**	21.9	(19.5)
	0.9	**(0.4)**	21.9	(19.5)

The majority of these loans have an original maturity of less than one year. As at 31 December 2013, there are £0.4m (2012: £0.4m) of these loans for Group and £nil (2012: £nil) for Society which are past due but not individually impaired.

The balances of those assets within our factored debt and invoice discounting business which are individually impaired amount to £3.0m (2012: £2.7m). The factors considered in determining whether these assets are impaired include the existence of objective evidence to doubt ultimate recoverability of the Group's net exposure, due to client insolvency.

The balances of those assets within other loans which are individually impaired amounts to £0.4m (2012: £21.7m) 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.

b) 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 2013, £9.9m (2012: £7.4m) of the Group's treasury portfolio exposure was either past due or impaired. A provision of £6.0m (2012: £4.8m) is held against the impaired assets in question. There are £5.7m (2012: £1.6m) 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 considers, amongst other factors, objective evidence of deterioration in the counterparty's financial health, the normal volatility in valuation, and industry and sectoral performance.

As at 31 December 2013, 99.0% (2012: 99.6%) 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.

37. Credit risk *(continued)*

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

Rating	2013		2012	
	£m	%	£m	%
Aaa	436.9	18.4	1,933.2	76.4
Aa1	1,366.7	57.4	26.0	1.0
Aa2	143.1	6.0	106.7	4.2
Aa3	131.6	5.5	104.1	4.1
A1	22.1	0.9	-	-
A2	149.7	6.3	188.5	7.4
A3	106.9	4.5	164.5	6.5
Baa1	18.8	0.8	2.0	0.1
Baa2	-	-	1.1	-
Baa3	-	-	1.8	0.1
Ba1	1.7	0.1	1.7	0.1
Ca	1.6	-	2.2	0.1
Unrated:				
Other	2.0	0.1	-	-
	2,381.1	100.0	2,531.8	100.0

The move of a significant proportion of the Group's treasury investment portfolio from Aaa to Aa1 during the year is due to the downgrade of the UK Government's bond rating during the year.

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

Industry sector / asset class	2013		2012	
	£m	%	£m	%
Cash in hand and balances with the Bank of England	859.4	36.1	1,014.8	40.1
Cash with banks and building societies	326.2	13.7	383.1	15.1
Gilts	478.8	20.1	278.7	11.0
Treasury bills	-	-	23.2	0.9
Certificates of deposit	62.6	2.6	55.1	2.2
Fixed rate bonds	170.6	7.2	255.8	10.1
Floating rate notes	203.7	8.6	204.5	8.1
Residential mortgage backed securities	261.2	10.9	295.2	11.7
Commercial mortgage backed securities	18.6	0.8	21.4	0.8
	2,381.1	100.0	2,531.8	100.0

Geographical exposure	2013		2012	
	£m	%	£m	%
UK	1,987.5	83.5	2,050.9	81.0
Rest of Europe	286.7	12.0	409.5	16.2
North America	36.3	1.5	36.0	1.4
Australasia	70.6	3.0	35.4	1.4
	2,381.1	100.0	2,531.8	100.0

37. Credit risk *(continued)*

c) Credit risk – derivative financial instruments

A credit exposure could arise in respect of derivative contracts entered into by the Group if the counterparty was unable to fulfil its contractual obligations. The Group address the risks associated with these activities by monitoring counterparty credit exposure and requiring additional collateral to be posted or returned as necessary. The only form of collateral accepted by the Group is cash. 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.

38. Fair values

a) Classification and measurement

The table below summarises the classification of the carrying amounts of the Group's financial assets and liabilities:

	2013			
	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	859.4	-	-	859.4
Loans and advances to credit institutions	326.2	-	-	326.2
Debt securities	143.0	1,052.5	-	1,195.5
Derivative financial instruments	-	-	148.8	148.8
Loans and advances to customers	11,516.9	-	-	11,516.9
Equity share investments	-	37.1	-	37.1
Trade receivables	32.4	-	-	32.4
Total financial assets	12,877.9	1,089.6	148.8	14,116.3
Other non-financial assets				370.4
Total assets				14,486.7
Shares	10,260.1	-	-	10,260.1
Amounts owed to credit institutions and other customers	1,977.1	-	-	1,977.1
Debt securities in issue	554.7	-	-	554.7
Derivative financial instruments	-	-	287.6	287.6
Trade payables	6.0	-	-	6.0
Fair value of put option obligation	-	-	13.5	13.5
Fair value of liability of management incentive scheme	-	-	8.9	8.9
Subordinated liabilities and subscribed capital	218.5	-	-	218.5
Total financial liabilities	13,016.4	-	310.0	13,326.4
Other non-financial liabilities				231.1
Total liabilities				13,557.5

38. Fair values *(continued)*

	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
Loans and advances to credit institutions	383.1	-	-	383.1
Debt securities	173.3	960.6	-	1,133.9
Derivative financial instruments	-	-	202.7	202.7
Loans and advances to customers	10,593.5	-	-	10,593.5
Equity share investments	-	3.1	-	3.1
Trade receivables	34.8	-	-	34.8
Total financial assets	12,199.5	963.7	202.7	13,365.9
Other non-financial assets				394.3
Total assets				13,760.2
Shares	9,462.4	-	-	9,462.4
Amounts owed to credit institutions and other customers	1,805.3	-	-	1,805.3
Debt securities in issue	730.9	-	-	730.9
Derivative financial instruments	-	-	370.8	370.8
Trade payables	6.3	-	-	6.3
Fair value of put option obligation	-	-	12.0	12.0
Fair value of liability of management incentive scheme	-	-	1.3	1.3
Subordinated liabilities and subscribed capital	320.0	-	-	320.0
Total financial liabilities	12,324.9	-	384.1	12,709.0
Other non-financial liabilities				215.7
Total liabilities				12,924.7

38. Fair values *(continued)*

b) Valuation of financial instruments carried at fair value

The following tables provide an analysis of financial assets and liabilities held within the Group Statement of Financial Position at fair value, grouped into Levels 1 to 3 of the fair value hierarchy based on the degree to which the fair value is observable:

Group	2013			
	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	989.9	62.6	-	1,052.5
Equity share investments	-	-	37.1	37.1
Financial assets at fair value through profit or loss:				
Derivative financial instruments	-	110.9	37.9	148.8
	989.9	173.5	75.0	1,238.4
Financial liabilities				
Financial liabilities at fair value through profit or loss:				
Derivative financial instruments	-	143.3	144.3	287.6
Fair value of put option obligation	-	-	13.5	13.5
Fair value of liability of management incentive scheme	-	-	8.9	8.9
	-	143.3	166.7	310.0
	989.9	30.2	(91.7)	928.4

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 share investments	-	-	3.1	3.1
Financial assets at fair value through profit or loss:				
Derivative financial instruments	-	135.6	67.1	202.7
	905.5	190.7	70.2	1,166.4
Financial liabilities				
Financial liabilities at fair value through profit or loss:				
Derivative financial instruments	-	209.2	161.6	370.8
Fair value of put option obligation	-	-	12.0	12.0
Fair value of liability of management incentive scheme	-	-	1.3	1.3
	-	209.2	174.9	384.1
	905.5	(18.5)	(104.7)	782.3

38. Fair values *(continued)*

Certain index swaps, included within derivative financial instruments in the tables above and originally stated as Level 2 and reported as such in 2012, have now been reclassified as Level 3 due to the use of estimated redemption rates as inputs, which are considered unobservable. As a result, Level 3 would have more appropriately reflected the basis of these fair values and the 2012 comparatives have therefore been restated accordingly.

Level 1

The most reliable fair values of financial instruments are quoted market prices in an actively traded market. The Group's Level 1 portfolio mainly comprises gilts, fixed rate bonds and floating rate notes for which traded prices are readily available.

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 when no active market exists and quoted prices are available for similar instruments in active markets. Where discounting techniques are used in arriving at derivative fair values, 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.

When considering the credit quality of instruments and their sensitivity to changes in market rates, the Market and Liquidity Risk function make use of quoted prices available for other similar instruments.

Basis swaps are valued using discounted cash flow models, including observable market data, either by our internal Treasury function or by our external counterparties.

Level 3

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

Valuation techniques include net present value and discounted cash flow models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, similar market products, 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.

Transfers between different levels of the fair value hierarchy

The Group makes transfers between the different levels of the fair value hierarchy where the inputs used to measure the fair value of the financial instruments in question no longer satisfy the conditions required to be classified in a certain level within the hierarchy. This could occur, for example, where a listed company whose share price is used as a basis for fair value measurement becomes de-listed, and so the share prices are no longer shown in a recognised listing and therefore cannot be classified as Level 1 inputs.

Notes to the Accounts
Continued

38. Fair values *(continued)*

The table below analyses the movements in the Level 3 portfolio during the year:

Group			2013		
	Equity share investments £m	Derivative financial instruments £m	Fair value of put option obligation £m	Fair value of liability of management incentive scheme £m	Total £m
At 1 January	3.1	(94.5)	(12.0)	(1.3)	(104.7)
Loss / expense recognised in Income Statement	-	(11.9)[1]	(0.1)[2]	(7.7)[3]	(19.7)
Gain recognised in Other Comprehensive Income	33.2[4]	-	-	-	33.2
Revaluation of market values	-	-	(3.3)	-	(3.3)
Dividends paid to non-controlling shareholders	-	-	1.9	-	1.9
Additions	0.8	-	-	-	0.8
Forfeit of share options	-	-	-	0.1	0.1
At 31 December	37.1	(106.4)	(13.5)	(8.9)	(91.7)

1. Included in the 'Fair value gains on financial instruments' line in the Income Statement. As noted below, these derivatives are held to hedge the Group's equity release mortgage book, and a corresponding gain is recognised through the same line in the Income Statement in respect of the underlying mortgages that are being hedged. The overall impact on the Income Statement is therefore nil.
2. Included in the 'Interest payable and similar charges' line in the Income Statement and arises from the unwind of the liability and changes to exercise dates.
3. Included in the 'Administrative expenses' line in the Income Statement.
4. Included in the 'Available-for-sale investments: valuation gains / (losses) taken to equity' line in the Statement of Comprehensive Income.

Group			2012		
	Equity share investments £m	Derivative financial instruments £m	Fair value of put option obligation £m	Fair value of liability of management incentive scheme £m	Total £m
At 1 January	-	(76.9)	(11.6)	-	(88.5)
Loss / expense recognised in Income Statement	-	(17.6)[1]	(0.2)[2]	-	(17.8)
Revaluation of market values	-	-	(1.5)	-	(1.5)
Dividends paid to non-controlling shareholders	-	-	1.3	-	1.3
Additions	3.1	-	-	-	3.1
Issue of share options	-	-	-	(1.3)	(1.3)
At 31 December	3.1	(94.5)	(12.0)	(1.3)	(104.7)

1. Included in the 'Fair value gains on financial instruments' line in the Income Statement. As noted below, the overall impact of the changes in fair value of these derivatives on the Income Statement is nil, due to the associated hedge accounting relationship within loans and advances to customers.
2. Included in the 'Interest payable and similar charges' line in the Income Statement and arises from the unwind of the liability and changes to exercise dates.

38. Fair values *(continued)*

Equity share investments

The Group's equity share investments represent a 4.9% (2012: 4.8%) holding in Zoopla Group Limited and a 21.0% (2012: 22.7%) holding in Hearthstone Investments Limited. At 31 December 2012, in the absence of a recognised market for these investments, the Directors assessed their fair values to be approximately equal to their cost.

At 31 December 2013, the Directors have reviewed the fair value of Zoopla, which is a private company, and so any assessment of its fair value is judgemental. The Directors consider that recent arm's-length share transactions in the company during November 2013 represent their best estimate of the current fair value of this company. These value Zoopla at £723m, with the Group's share being £35.1m, resulting in an unrealised gain of £33.2m being recorded in the available-for-sale reserve during the year. The cumulative balance recognised in the available-for-sale reserve as at 31 December 2013 in respect of Zoopla, gross of taxation, is £33.2m (2012: £nil).

The Directors believe that it remains appropriate to hold the Group's investment in Hearthstone at cost as, in the absence of any observable inputs or other relevant information, the fair value of the company cannot be reliably measured.

The fair value of Zoopla has been determined by reference to a recent transaction price and the fair value of Hearthstone is equal to its cost. In the absence of any other reliable information, the Directors do not consider that any reasonably possible alternative valuation assumptions exist for either of these investments.

Derivative Financial instruments

The derivative financial instruments included in the previous tables comprise index swaps which are used to hedge the Group's equity release mortgage book. Derivatives hedging equity release mortgages are valued using discounted cash flow models using market observable benchmark rates consistent with accepted economic methodologies for pricing financial instruments, and also include estimated redemption profiles that are based on historic data and reviewed periodically to ensure forecasts remain broadly in line with actual data.

These redemption profiles are not market observable, therefore these derivatives are categorised as Level 3 financial instruments within the fair value hierarchy.

Where there is a value in the previous tables with no apparent offsetting value, it should be noted that an offsetting value will exist but the instrument to which it relates is not held at fair value. Index swap derivatives are held at fair value, but the underlying equity release mortgages being hedged are held at amortised cost and therefore are not included in the table above.

Any change in the fair value of the index swaps would be offset by a corresponding but offsetting change in the value of the associated hedge relationship within loans and advances to customers. Any resultant overall impact is deemed by the Group to be insignificant and therefore no sensitivity has been provided.

Fair value of put option obligation

Key inputs into the calculation of the fair value of the put option obligation include an estimate of the market value of the non-controlling shareholding and an estimate of when the put option will be exercised by the non-controlling shareholders. As these inputs are based on the judgement of senior management, the valuation of the put option obligation is considered to be a Level 3 valuation technique. The impact of alternative valuation assumptions for the fair value of the put option obligation are shown in note 1u) to the financial statements.

Fair value of liability of management incentive scheme

Key inputs into the calculation of the fair value of the liability of the management incentive scheme include the forecast profits and cash flows of Connells Limited over the period to exercise, and an estimate of when the options will be exercised by the non-controlling shareholders. As these inputs are based on forecasts prepared by the Group and involve the judgement of senior management, the valuation of the fair value of the liability of the management incentive scheme is considered to be a Level 3 valuation technique. The impact of an alternative valuation assumption for the fair value of the liability of the management incentive scheme is shown in note 1u) to the financial statements.

38. Fair values *(continued)*

c) Fair values of financial assets and liabilities not carried at fair value

The tables below summarise the carrying values and fair values of those financial assets and liabilities not presented within the Statement of Financial Position at fair value.

	Group 2013		Society 2013	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Cash in hand and balances with the Bank of England	**859.4**	**859.4**	**859.4**	**859.4**
Loans and advances to credit institutions	**326.2**	**326.2**	**195.5**	**195.5**
Debt securities	**143.0**	**144.6**	**674.6**	**679.8**
Loans and advances to customers	**11,516.9**	**11,470.7**	**9,205.2**	**9,261.1**
Trade receivables	**32.4**	**32.4**	**0.2**	**0.2**
	12,877.9	**12,833.3**	**10,934.9**	**10,996.0**
Financial liabilities				
Shares	**10,260.1**	**10,338.6**	**10,260.1**	**10,338.6**
Amounts owed to credit institutions	**1,046.3**	**1,044.6**	**1,149.4**	**1,147.7**
Amounts owed to other customers	**930.8**	**934.1**	**1,268.9**	**1,269.2**
Debt securities in issue	**554.7**	**564.7**	**49.7**	**49.4**
Trade payables	**6.0**	**6.0**	**0.5**	**0.5**
Subordinated liabilities and subscribed capital	**218.5**	**210.1**	**218.5**	**210.1**
	13,016.4	**13,098.1**	**12,947.1**	**13,015.5**

	Group 2012		Society 2012	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Cash in hand and balances with the Bank of England	1,014.8	1,014.8	1,014.6	1,014.6
Loans and advances to credit institutions	383.1	383.1	232.0	232.0
Debt securities	173.3	173.6	800.8	801.9
Loans and advances to customers	10,593.5	10,432.6	8,221.7	8,171.7
Trade receivables	34.8	34.8	0.8	0.8
	12,199.5	12,038.9	10,269.9	10,221.0
Financial liabilities				
Shares	9,462.4	9,547.0	9,462.4	9,547.0
Amounts owed to credit institutions	907.6	907.6	969.0	969.0
Amounts owed to other customers	897.7	904.9	1,541.9	1,543.0
Debt securities in issue	730.9	744.3	60.1	58.1
Trade payables	6.3	6.3	0.2	0.2
Subordinated liabilities and subscribed capital	320.0	295.9	320.0	295.9
	12,324.9	12,406.0	12,353.6	12,413.2

Key considerations in the calculation of fair values of those financial assets and liabilities not presented on the balance sheet at fair value are set out below unless there is no significant difference between carrying and fair value. During the year, the Group has reviewed and enhanced its approach for estimating certain of the fair values disclosed in the tables above in line with IFRS 13. Accordingly both the Group and Society comparatives for loans and advances to customers have been updated to ensure consistency enabling meaningful year-on-year comparison, in line with the methodologies described below.

38. Fair values *(continued)*

Loans and advances to customers

For fixed rate and 'tracker' mortgage products, the Group has estimated the fair value of these products using a discounted cash flow, and has applied applicable current market product rates as discount rates in order to also incorporate an element of future expected credit losses. Incurred losses have also been included. Fixed rate and tracker mortgages have been discounted using current market product rates that are specific to the particular market to which they relate.

Market prices will generally have moved since the fixed or tracker rate was taken out, therefore the valuation of these products will change reflecting upwards or downwards movements in market rates. The valuation includes information and expectations regarding estimated redemption profiles, which are regularly reviewed and updated in light of experience.

As these redemption profiles are not considered to be observable by the market, then the fair value of loans and advances to customers is considered to be derived by using Level 3 valuation techniques.

For standard variable rate mortgage products, the interest rate on such products is equivalent to a current market product rate and as such the Group considers the discounted future cash flows of these mortgages to be equal to their carrying value.

Shares

Savings products at variable rates are at current market rates and therefore the Group regards the fair value to be equal to the carrying value.

The fair value of fixed rate savings products has been determined using discounted cash flows, discounted using a combined yield curve of cash and swap term rates.

Changes in market prices since the product was taken out will result in increases or decreases in the fair value of the fixed rate savings products. Penalties for early withdrawal on notice accounts are such as to suggest a negligible early withdrawal rate and none has therefore been applied; as a result the valuation of shares is considered to be a Level 2 valuation technique.

Amounts owed to credit institutions

Balances in this category with re-pricing dates greater than six months are valued using discounted cash flows which use only observable market inputs consisting of the combined yield curve of cash and swap term rates, discounted using this same yield curve, as their rates are now considered "off-market". The Group considers balances with re-pricing dates of less than six months to be at current rates and these therefore have a carrying value materially the same as fair value. All inputs to this valuation technique are market observable and as such they are categorised within Level 2 of the fair value hierarchy.

Amounts owed to other customers

As with the above category, the Group considers that balances with re-pricing dates of less than six months are at current rates and thus have a fair value equal to their carrying value. All remaining longer term balances are fair valued using discounted cash flows which use the combined yield curve of cash and swap term rates, discounted using this same yield curve. Again, these are therefore considered to be Level 2 valuation techniques.

Debt Securities in issue

Where securities are actively traded in a recognised market, with readily available and quoted prices, these have been used to value the securities. These securities are therefore regarded as having Level 1 fair values. Where such prices are not available, discounted cash flows are used, again using only market observable inputs consisting of a combined yield curve of cash and swap term rates, together with adjustments for credit risk derived from similar instruments issued by the Group where an actively quoted price is readily available. As such, these securities are categorised as having Level 2 fair values.

Subordinated liabilities and subscribed capital

Where prices are quoted for instruments in actively traded markets, these prices have been used in the valuation. As a result, these instruments are categorised as having Level 1 fair values. Where these prices are not available, valuations have been derived from discounted cash flows which utilise a combined yield curve of cash and swap term rates, adjusted for credit risk for similar instruments of the same maturity. These inputs are considered to be observable market inputs and therefore the resulting valuations are categorised as Level 2.

d) Fair values of non-financial assets and liabilities not carried at fair value

The fair values of certain non-financial assets and liabilities, that are not carried at fair value, are also disclosed in these financial statements. These relate to investments in associates (see note 17) and investment property (see note 19). Relevant disclosures are made of the valuation techniques used in estimating these fair values, together with the resulting categorisation of these valuation techniques within the fair value hierarchy, within these particular notes.

39. 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 and the UK 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 and Darrowby No. 2 plc, and the intermediate holding company Skipton Group Holdings Limited.
- Estate Agency – including survey and valuations, conveyancing, lettings, asset management and mortgage broking carried out through the Connells group.
- Mortgage Services – mortgage administration services, principally Homeloan Management Limited and its subsidiaries.
- 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.

No geographical analysis is presented because substantially all of the Group's activities are conducted within the UK. Of the total external income, £55.7m (2012: £23.9m) was generated outside the UK.

A more detailed breakdown of the allocation of goodwill to each segmental area is given within note 20.

39. Group segmental reporting *(continued)*

	2013						
	Mortgages and Savings £m	Estate Agency £m	Mortgage Services £m	Financial Advice £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Total £m
Interest receivable and similar income	392.1	0.6	-	0.2	3.1	(2.6)	393.4
Interest payable and similar charges	(251.3)	(0.1)	-	(0.2)	(1.9)	2.7	(250.8)
Fees and commissions receivable	23.6	284.1	59.3	49.6	30.8	(21.5)	425.9
Fees and commissions payable	(7.3)	(1.7)	(0.7)	(9.1)	(0.9)	14.7	(5.0)
Fair value gains on financial instruments	3.9	-	-	-	-	-	3.9
(Loss) / profit on disposal of subsidiary undertakings	(0.1)	-	-	-	24.8	-	24.7
Dividend income from equity share investments	-	1.1	-	-	-	-	1.1
Share of profits / (losses) from joint ventures and associates	-	2.2	-	-	(0.9)	-	1.3
Other income	2.9	(0.5)	-	-	3.1	1.1	6.6
Total income	163.8	285.7	58.6	40.5	58.1	(5.6)	601.1
Employee and pension costs	(50.4)	(151.4)	(32.5)	(26.4)	(22.6)	0.5	(282.8)
Depreciation, amortisation and impairment of investment property	(4.8)	(6.8)	(4.2)	(1.0)	(3.4)	0.7	(19.5)
Other administrative expenses	(26.7)	(67.1)	(20.5)	(8.3)	(11.4)	(19.0)	(153.0)
Operating profit / (loss) before impairment losses and provisions	81.9	60.4	1.4	4.8	20.7	(23.4)	145.8
Impairment losses / provisions for liabilities	(31.5)	(10.2)	(0.5)	(0.9)	(0.2)	-	(43.3)
Profit / (loss) before tax	50.4	50.2	0.9	3.9	20.5	(23.4)	102.5
Taxation	(11.8)	(11.8)	(0.1)	(0.9)	(2.6)	1.0	(26.2)
Profit / (loss) after tax	38.6	38.4	0.8	3.0	17.9	(22.4)	76.3
Total assets	14,238.0	219.0	25.2	31.2	134.4	(161.1)	14,486.7
Total liabilities	13,428.5	91.9	2.6	5.9	105.1	(76.5)	13,557.5
Capital expenditure	2.1	9.3	2.8	1.3	3.7	(0.2)	19.0

Total income can be analysed as follows:

	2013						
	Mortgages and Savings £m	Estate Agency £m	Mortgage Services £m	Financial Advice £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Total £m
External income	158.1	280.3	53.3	48.4	56.9	4.1	601.1
Income from other segments	5.7	5.4	5.3	(7.9)	1.2	(9.7)	-
Total income	163.8	285.7	58.6	40.5	58.1	(5.6)	601.1

39. Group segmental reporting *(continued)*

	2012 Restated*						
	Mortgages and Savings £m	Estate Agency £m	Mortgage Services £m	Financial Advice £m	Investment Portfolio £m	Sundry incl. 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)
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)
Fair value gains on financial instruments	3.6	-	-	-	-	-	3.6
Share of profits from joint ventures and associates	-	1.6	-	-	-	-	1.6
Other income (restated*)	3.4	0.3	0.3	-	7.0	(1.9)	9.1
Total income	103.2	252.9	60.6	44.4	36.5	(7.1)	490.5
Employee and pension costs	(44.7)	(128.6)	(33.3)	(26.1)	(25.2)	-	(257.9)
Depreciation, amortisation and impairment of investment property	(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	28.3	46.5	1.1	6.9	(1.7)	(0.7)	80.4
Impairment losses / provisions for liabilities	(23.8)	(10.9)	(0.3)	(7.8)	(2.2)	-	(45.0)
Profit / (loss) before tax	4.5	35.6	0.8	(0.9)	(3.9)	(0.7)	35.4
Taxation	(0.7)	(9.0)	-	0.2	0.1	0.6	(8.8)
Profit / (loss) after tax	3.8	26.6	0.8	(0.7)	(3.8)	(0.1)	26.6
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 Restated*						
	Mortgages and Savings £m	Estate Agency £m	Mortgage Services £m	Financial Advice £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Total £m
External income	99.5	249.2	55.9	51.7	34.8	(0.6)	490.5
Income from other segments	3.7	3.7	4.7	(7.3)	1.7	(6.5)	-
Total income	103.2	252.9	60.6	44.4	36.5	(7.1)	490.5

* The 2012 comparatives have been restated as described in notes 1a) and 41.

40. Capital structure

The PRA regulates the Group which is required to manage its capital in accordance with the rules and guidance issued by the PRA and, until 31 December 2013, was under Basel II regulations. 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 depositors. The internal level of capital is set with the aim of ensuring that the business has sufficient levels of capital for current and projected future activities, to withstand downturn stresses, and to ensure that the minimum regulatory requirement is always met.

Throughout the year the Group complied with, and maintained surplus capital above, the externally imposed capital requirements.

The following table shows the composition of the Group's regulatory capital at 31 December 2013 under Basel II:

	2013 £m	2012 £m
Tier 1		
Reserves	**922.3**	827.7
Permanent Interest Bearing Shares (note 1)	**90.0**	90.0
Pension fund deficit add back (note 2)	**23.4**	13.6
Deductions from Tier 1 capital (note 3)	**(174.2)**	(196.2)
Unrealised (gains) / losses on available-for-sale debt securities	**(20.5)**	2.3
Unrealised losses on cash flow hedges	**11.0**	14.6
Total Tier 1 capital	**852.0**	752.0
Tier 2		
Subordinated debt (note 1)	**82.7**	188.9
Collective impairment allowance	**24.0**	11.1
Net gain from change in fair value	**26.0**	-
Total Tier 2 capital	**132.7**	200.0
Total capital	**984.7**	952.0

Notes

1. Under PRA 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 PRA rules intangible assets must be deducted from regulatory capital.

41. Adoption of new and revised International Financial Reporting Standards

Disclosed below are new standards which have been adopted during the year:

- 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. These changes have been reflected in the presentation of the Statement of Other Comprehensive Income for the Group and Society.
- 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, reported net interest income would have been £1.0m and £0.4m lower for Group and Society respectively, with an equivalent increase in Other Comprehensive Income. The 2012 comparatives included in these financial statements have been restated accordingly. There has been no impact on the Group's or Society's net assets or reserves. The impact of applying the previous basis of calculation on the current year position is not material.
- 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 also requires 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, has had 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 within the Statement of Financial Position. This amendment has had no impact on the financial statements of the Group.

Disclosed below are the new IFRSs and amendments relevant to the Group which at 31 December 2013 have been endorsed by the EU but were not effective and have therefore not been applied in preparing these financial statements:

- 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 into the consolidated financial statements. The standard 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.

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 2013 including IFRS 9. IFRS 9 is still subject to EU endorsement, the timing of which is uncertain, but the effective date is expected to be no earlier than 1 January 2016. This standard is expected to require financial assets to be classified at either amortised cost or at fair value, and removes the available-for-sale (AFS) category for financial assets. In addition the standard will address impairment of financial assets and general hedge accounting. As such the Group is monitoring developments and considering the associated impact on the Group financial statements, which may be significant.

42. Subsequent events

There have been no material subsequent events between 31 December 2013 and the approval of this Annual Report and Accounts by the Board.

Annual Business Statement

1. Statutory percentages

	As at 31 December 2013 %	Statutory limit %
Lending limit	**8.36**	25.00
Funding limit	**15.37**	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 within 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

	2013 %	2012 %
As a percentage of shares and borrowings:		
(i) Gross capital	**8.97**	9.63
(ii) Free capital	**7.11**	7.31
(iii) Liquid assets	**18.61**	21.10
As a percentage of mean total assets:		
(i) Group profit after taxation	**0.54**	0.19
(ii) Group management expenses	**3.22**	2.96
(iii) Society management expenses	**0.50**	0.44

These percentages form part of the audited accounts.

Explanation

The above percentages have been calculated from the Group and Society Income Statements and 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 within 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 within 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 2013 and 2012 total assets.

Management expenses represent administrative expenses.

Annual Business Statement
Continued

3. Information relating to Directors at 31 December 2013

The Board of Directors at 31 December 2013, their dates of birth and dates of appointment as a Director are as follows:

	Date of Birth	Date of Appointment
C Black	20 August 1958	1 March 2013
M Cassoni	27 December 1951	31 July 2012
I M Cornelius*	11 February 1969	11 June 2012
D J Cutter*	1 January 1962	1 January 2000
R D East	18 March 1960	29 November 2011
M H Ellis	4 August 1951	24 May 2011
M R Fleet*	5 January 1964	6 December 2011
P R Hales	21 October 1946	29 May 2007
G E Picken	21 April 1949	17 January 2012
H C Stevenson	10 November 1960	1 March 2013
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 Directors' business occupations and other Directorships at 31 December 2013 were:

C Black	Non-Executive Director	Cheryl Black & Partners Limited Skipton Group Holdings Limited Southern Water Services Limited Telefonica UK Pension Trustee Limited
M Cassoni	Non-Executive Director	GFI Group Inc Jacob's Island (Providence Square Blocks A, B & C) Limited Partnership Group Assurance Plc 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 KB Analytics Limited Leeds Share Shop Limited Malsis School Trust Mortgage Systems Limited North West Investments NZ Limited Savings Management Limited Sequence (UK) Limited Skipton Group Holdings Limited Skipton Group Limited Skipton Investments Limited Skipton Limited Skipton Mortgages Corporation Limited

D J Cutter (continued)	Building Society Group Chief Executive	Skipton Mortgages Limited Skipton Premier Mortgages Limited Skipton Premises Limited Skipton Share Dealing Services Limited Skipton Trustees Limited Specialist Mortgage Services Limited Thomson Shepherd Holdings Limited Thomson Shepherd Limited
R D East	Non-Executive Director	Cattles Holdings Limited Cattles Limited Cattles Properties (Ruddington) Limited Compass Credit Limited Dial4aloan Limited LGH Delta Limited Moneytopia Bank Limited Moneytopia Limited Recordpoint Limited Shopacheck Financial Services Limited Shopacheck Limited Skipton Group Holdings Limited Statusclaim Limited Supremeaccess Limited Welcome Financial Services Limited Welcome Insurance Services Limited Westernissue Limited
M H Ellis	Non-Executive Director & Chairman	M H Ellis Consulting Limited Skipton Group Holdings Limited
M R Fleet	Building Society Distribution Director	Baseline Capital Limited Homeloan Management Limited KB Analytics Limited Life Policies Direct Limited Mortgage Systems Limited P.S. 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

G E Picken	Non-Executive Director	Connells Limited HICL Infrastructure Company Limited Skipton Group Holdings Limited
H C Stevenson	Non-Executive Director	Henley Business School Skipton Group Holdings Limited St Ives Plc
P J S Thompson	Non-Practising Solicitor	Giggleswick School Henderson Insurance Brokers Limited Institute of Directors Judicium Business Services Limited Judicium Plc Rushbond Plc Skipton Group Holdings Limited TEP Electrical Distributors Limited
R J Twigg	Building Society Group Finance Director	Amber Homeloans Limited Arkose Funding Limited Beckindale No. 1 Limited Cashflow4Business.com Limited Connells Limited Connell Financial Services Limited Darrowby No. 1 plc Darrowby No. 2 plc Jade Software Corporation Limited Jade Software Corporation UK Limited Leeds Share Shop Limited MBO 1994 Limited North West Investments NZ Limited North Yorkshire Mortgages Limited Sequence (UK) 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 Group Holdings Limited Skipton Group Limited Skipton International Limited Skipton Investments Limited Skipton Limited Skipton Mortgages Corporation Limited Skipton Mortgages Limited Skipton Premier Mortgages Limited Skipton Premises Limited Skipton Share Dealing Services Limited Skipton SIBL Limited Skipton Trustees Limited Thomson Shepherd Holdings Limited Thomson Shepherd Limited Wynyard Group 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.

Glossary

Set out below are the definitions of terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue.
Asset backed securities (ABS)	An asset backed security is a security whose value and income payments are derived from and collateralised (or 'backed') by a specified pool of underlying assets. Typically these assets are pools of residential or commercial mortgages.
Basel II	Basel II is the second of the Basel Accords, issued by the Basel Committee on Banking Supervision, which defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the PRA Handbook.
Basel III	Basel III became effective in the UK on 1 January 2014 and sets out details of strengthened global regulatory standards on bank capital adequacy and liquidity.
Buy-to-let mortgages	Mortgages offered to customers purchasing residential property to be rented to others to generate a rental income.
Code Staff	A group of employees to which the FCA'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 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 repaid.
Common Equity Tier 1 capital	Common Equity Tier 1 (CET1) capital primarily comprises internally generated capital from retained profits. An adjustment is made to deduct intangible assets and goodwill. CET1 capital is fully loss absorbing.
Core Tier 1 capital	Defined by the PRA as Tier 1 capital less hybrid capital instruments (innovative Tier 1 securities and Permanent Interest Bearing Shares for building societies) and certain regulatory adjustments.
CRD IV	CRD IV is made up of the Capital Requirements Regulation (CRR), which is directly applicable to firms across the EU, and the Capital Requirements Directive (CRD), which must be implemented through national law. CRD IV has implemented the Basel III agreement in the EU.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Delinquency	A debt or financial obligation is considered to be in a state of delinquency when payments are overdue.
Derivative financial instruments	A derivative financial instrument is a type of financial instrument (or an agreement between two parties) that has a value based on the underlying asset, index or reference rate it is linked to. The Group uses derivative financial instruments to hedge its exposures to market risks such as interest rate, equity and currency risk.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period.

Fair value	Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FCA 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 funding 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 the 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.
Help to Buy	A government-backed scheme in the UK that aims to help first time buyers, whereby the Government effectively provides an equity loan to assist the purchase of new build properties.
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.
Individual Capital Adequacy Assessment Process (ICAAP)	The Group's own assessment, as part of regulatory 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 PRA's regulatory BIPRU 12 requirements.
Internal ratings-based approach (IRB)	An advanced approach to measuring capital requirements in respect of credit risk under Basel II and, from 1 January 2014, CRD IV. The IRB approach may only be used with permission from the PRA.
International Swaps and Derivatives Association (ISDA) Master Agreement	A standardised contract developed by ISDA and used to enter into bilateral derivative transactions.

Investment grade	The highest range of credit ratings, from Aaa to Baa3, as measured by external credit rating agencies.
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.
Leverage ratio	The ratio of Tier 1 capital divided by total exposure, which includes on and off balance sheet assets, after netting derivatives.
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.
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 a 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.
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 backed by underlying mortgage collateral.
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.
Permanent Interest Bearing Shares (PIBS) or subscribed capital	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 or not our customer is experiencing financial difficulty in repaying their loan with the Group.
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, which can typically be resold or repledged if desired.

Glossary
Continued

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 firm transfers these assets to a special purpose vehicle which then issues securities backed by the assets. The Group has established securitisation structures as part of its funding activities. These securitisation structures use retail mortgages as the asset pool.
Shares	Money deposited by non-corporate depositors 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 other 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	Amounts owed to credit institutions, amounts owed to other customers and debt securities in issue excluding balances deposited by offshore customers.

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