Report and Accounts 2009

Yorkshire
BUILDING SOCIETY

The Yorkshire is well-positioned to face future challenges with resilience and to deliver excellent results.

Our vision is **to be the best organisation that our customers deal with** and we strive to achieve this by delivering financial security and long-term value to our members along with excellent service.

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Chairman's report

Ed Anderson

A landmark year for the Yorkshire

This is my fourth annual review as your Chairman and it has been another year in which the harsh economic climate tested the Yorkshire's resilience. I am pleased to report that the Group maintained a strong underlying position despite these conditions, while continuing to protect members. The market conditions presented us with challenges as well as opportunities, the most obvious of these being our merger with Chelsea Building Society, which will take effect on 1 April 2010 subject to confirmation by the Financial Services Authority (FSA). The merger is a transformational development for the Group, which will strengthen considerably our ability to deliver value to our members.

Once the merger completes, I look forward to welcoming members of Chelsea to the Yorkshire and can assure them of our commitment to providing them, and all of our members, with financial security and long-term value backed up by excellent service.

Details of our performance and the merger are set out in the Chief Executive's report on pages 4 to 11.

Your board, in particular the non-executive directors, are responsible for and committed to providing rigorous oversight of the management of the Group. We are committed to adopting best practice in corporate governance and believe that we do so. Details of our approach and of the board structure and formal committees in place to achieve this, are set out in the corporate governance report on pages 31 to 37.

As a result of the activity undertaken by the board during 2009, I am certain that the Group remains in a very strong position to continue to operate effectively, and prosper, as an independent mutual building society for the foreseeable future.

Over recent years the Yorkshire has taken a number of steps directed at strengthening our corporate governance framework and engaging with our members. I would like to take this opportunity to highlight some of these before looking at the regulatory developments that arose during 2009:

- the Group Risk Committee was established in 2006 and is made up of non-executive directors and senior executives. The Committee's role is to oversee the Group's risk governance framework and to provide oversight in relation to all risk matters. Lynne Charlesworth, a non-executive director, took on the role of Chairman of the Committee during the year. During 2009, this Committee along with the Audit Committee led the scrutiny of the extensive due diligence carried out on Chelsea Building Society;
- the Audit Committee is made up of non-executive directors and is chaired by Philip Johnson. The Committee met five times during 2009 and is responsible for assisting the board in fulfilling its oversight responsibilities in respect of matters including: the integrity of the Yorkshire's financial statements, internal and external audit processes and the Society's ethical and business standards;
- the composition of your board is carefully reviewed to ensure that the Group benefits from an appropriately high degree of expertise and breadth of knowledge from its board members. The appointment of new directors is overseen by the Nominations Committee. Recruitment of non-executive directors is undertaken via a transparent and structured process which normally includes advertising positions externally. Newly-appointed non-executive directors are formally inducted, to ensure that they are fully familiarised with the operations of the Group;
- the Remuneration Committee, of which I am a member, is well-established and has sole responsibility for determining the pay and benefits of the Yorkshire's executive team, as well as determining the overall remuneration policy for all staff. The Committee is made up solely of non-executive directors and is chaired by Simon Turner;
- a range of forums have been established to enable our members to engage directly with the Society. These include inviting large numbers of members to 'Question Time' sessions and informal 'Meet The Chief Executive' events held around the country. We consult our Member Panel on a continuous basis, through which we receive many thousands of items of feedback every year, and hold Member Forum sessions in which we solicit the views of a group representing a cross-section of our members; and
- in accordance with good practice, we periodically put the external audit work, which is required to be undertaken on an annual basis on the Group, out to tender. We undertook this process during 2009, resulting in the appointment of Deloitte LLP.

Regulation

As a result of the unprecedented events which have taken place in the financial services sector over the past two years, the regulatory environment has become more onerous for all institutions regulated by the FSA, including building societies. The Society is supportive of these developments where they are proportionate, are balanced in the treatment of building societies and serve to protect the interests of members, taxpayers and consumers.

During 2009 your board reviewed the recommendations set out in the Walker Review on corporate governance of the UK banking industry, many of which are reflected in our current practice. The Review covers areas including: board size and composition, functioning of the board and evaluation of performance, governance of risk and remuneration. We will voluntarily adopt the revised Combined Code on corporate governance (in so far as the provisions apply to building societies), which is expected to be issued later in the year and which will reflect the recommendations in the Walker Review.

Other key regulatory developments affecting the Group in 2009 and into 2010 include:

- the Turner Review; a wide-ranging review was undertaken by Lord Turner of global banking regulation and of the events leading to the financial crisis. A number of reforms were recommended, covering many areas including capital, liquidity and the power of regulators;
- the proposed specialist rule book for building societies (BSOG); proposals by the FSA to develop their supervisory approach to building societies. We are lobbying against a specific rule book where it hampers the ability of societies to provide effective competition to the banks on level terms;
- the publication of Individual Liquidity Adequacy Standards (ILAS); a new regime began to be introduced from 1 December 2009 to protect customers and other participants in the financial services market from imprudent liquidity risk management practices. As detailed in the Chief Executive's report on pages 4 to 11, the Yorkshire maintains a very strong position in terms of the level and quality of liquidity it holds;
- the FSA review of stress testing; throughout 2009 the FSA ran stress tests on a number of 'high impact' firms in the banking and building society sector. We were subject to this process which took place in addition to our own internal stress testing procedures. Stress testing is one of the ways in which your board understands the ability of the Group to withstand extreme market events;
- Individual Capital Guidance (ICG) confirmation; the Group received confirmation from the FSA of the level of capital resources it is required to hold. I can confirm that we already hold and plan to continue to hold capital in excess of the level set out in the guidance to provide further security and protection to our members;
- the FSA Remuneration Code; although targeted at large banks and investment firms, the Group falls within the remit of the Code which requires that remuneration policies are consistent with effective risk management. Our Remuneration Committee, details of which are included in the corporate governance report on pages 31 to 37, will oversee our adherence to the Code and best practice more generally with regard to remuneration policies for senior staff; and
- the Mortgage Market Review; the FSA set out proposals for major reforms to the UK mortgage market to deliver better outcomes for consumers. This is an important review and the Yorkshire is contributing to the consultation process both directly and via the Building Societies Association.

In summary, we are proactive in addressing the requirements of all relevant regulation and in the adoption of best practice with regard to corporate governance.

Your board

I would like to thank my fellow directors for their work in 2009. I greatly appreciated the value that their objectivity, deep knowledge and extensive experience brought to the Yorkshire during the year, in particular throughout the merger process.

Profiles of the Group's non-executive directors and General Management team, comprising executive directors and General Managers, can be found of pages 14 to 17. Details of the Group's policy in respect of directors' remuneration, along with details of each director's remuneration are set out in detail in the report on pages 38 to 42.

There were no changes to the composition of your board during 2009.

Our people

I wish to take this opportunity to thank all of our staff for their continued efforts during 2009. The year held many challenges for the Group and I was proud to see how our senior management team and staff dealt with them while continuing to provide our members with excellent service.

Looking ahead

In conclusion, we are looking forward with confidence in our future following the planned merger with Chelsea. The Yorkshire is well-positioned to face future challenges with resilience and to deliver excellent results.

Ed Anderson
Chairman

Chief Executive's report

Iain Cornish

A year of opportunity and challenge

The extreme uncertainty and challenges experienced in 2009 followed on from the severe deterioration in market conditions witnessed during the previous year. In 2009 the recession, which the UK entered in the second half of 2008, officially became the longest and deepest since records began.

I am pleased to report that, whilst not being immune to the prevailing economic conditions, the Yorkshire has demonstrated continued resilience and has maintained a strong underlying position. In an extreme economic environment we achieved a core operating profit of £7.7m with an improvement in performance in the second half of the year. This improved position in the second half reduced our overall statutory loss to £12.5m. We have strengthened our capital, maintaining our position as one of the strongest of the major lenders and continue to hold high levels of liquid assets – both of these factors provide protection to our members. Where it is in the interests of our members, we have also taken advantage of opportunities presented by market conditions, the most important of which is our proposed merger with Chelsea Building Society. Throughout the recession our decision making continued to be driven by our desire to provide financial security and long-term value to our members.

2009 began with significant structural change in the UK's retail banking landscape with the acquisition of HBOS by Lloyds TSB Group, creating Lloyds Banking Group, the largest retail bank in the UK. As the year progressed, additional state-provided capital was needed by both Lloyds and the Royal Bank of Scotland. This resulted in the near nationalisation of the latter, which also reported the biggest loss in British corporate history. 2009 brought news of the disappearance from the high street of familiar names including Alliance & Leicester and Bradford & Bingley. National Savings & Investments and Northern Rock made headlines when they were accused of offering unfairly-competitive rates fully backed by the government. The consolidation of the retail-banking sector, combined with the distorting effect of state guarantees, has dramatically changed the competitive landscape in which the Yorkshire, along with other building societies, operates.

Between October 2008 and March 2009, the Bank of England cut the base rate of interest from 5% to 0.5% and the rate remains at this historically-low level. Low interest rates have been helpful to many borrowers but have damaged the returns available to savers.

Over the same period, the financial crisis that started in the banking sector developed into a significant recession, in turn impacting building societies owing to their natural dependence on the housing and savings markets.

As the year progressed, the wider economic landscape continued to deteriorate. Specifically:

- the Bank of England commenced a programme of quantitative easing in March 2009 which had reached £200bn by the end of 2009 with uncertain consequences for credit supply and inflation;
- unemployment rose throughout the year, ending 2009 at nearly 2.5m people unemployed, the highest level for 13 years;
- activity in the UK housing market remained at very low levels, due in large part to the low supply of credit available;
- the UK's national debt increased to record levels of £844.5bn, or over 60% of overall UK economic output, by November 2009; and
- the money markets remained difficult with the availability of wholesale funding remaining restricted and costly.

As set out in the Chairman's report on pages 2 to 3, a number of significant developments in the regulatory environment occurred during 2009 to which the Group responded in line with requirements and best practice.

Overall, market conditions were very tough throughout 2009 and the outlook for the economy in 2010 remains challenging despite the UK's tentative return to growth in the last three months of 2009.

Our merger with Chelsea Building Society

We were pleased to announce on 2 December 2009 our intention, subject to member approval, to merge with Chelsea Building Society. I am delighted to confirm that the members of both societies approved the merger at their respective Special General Meetings held during January this year and that, subject to confirmation by the Financial Services Authority (FSA), the merger will take effect on 1 April 2010. The merged Society will be called Yorkshire Building Society and Chelsea will operate as a separate and distinct brand within the Yorkshire.

The merger is the most significant development in the Group's recent history. The merger will considerably strengthen the Yorkshire's ability to deliver value, security and excellent service to members of the enlarged Society. The key reasons for our confidence in merging with Chelsea include:

- greater scale, improved efficiency and better market positioning present a unique opportunity for the Yorkshire to enhance its ability to compete effectively in an increasingly consolidated market dominated by big retail banks. We believe that consumers will value the choice that a strong mutual alternative to the banks will provide them with;
- the additional scale will allow the Group to access wholesale funding markets on a more cost-effective and sustainable basis, although the Society will continue to be funded mainly by retail deposits;
- the complementary geographical location of the Yorkshire's and Chelsea's branch networks will provide the Group with much wider access to mortgage and savings markets across the country;
- Chelsea has a strong presence in key markets which will be important to the Group's future success; and
- whilst Chelsea has had financial difficulties over the past two years, we have undertaken extensive due diligence and have taken steps to appropriately provide for losses, as well as acting to strengthen the capital and funding position of the enlarged Society.

The enlarged Society will have assets of approximately £35bn and, although the capital ratios of the enlarged Society will initially be below those of the Yorkshire on a standalone basis, the Group will remain one of the most strongly capitalised of any UK building society or bank. As part of the merger agreement, a capital exchange was negotiated with Chelsea's existing subordinated bond holders which has the result of supporting the Group's tier one capital position. The capital exchange also involved the innovative use of a new form of contingent convertible capital or "CoCo", a first for the building society sector. Following the merger announcement, each of the three major rating agencies which follow the Yorkshire issued updated rating opinions, resulting in our existing ratings being affirmed.

Our preparation and planning for the merger with Chelsea is progressing well and we look forward to successfully integrating the business into the Group - firmly establishing the Yorkshire as a major UK mutual organisation, with a strong position in the financial services sector.

Chief Executive's report continued

Our performance

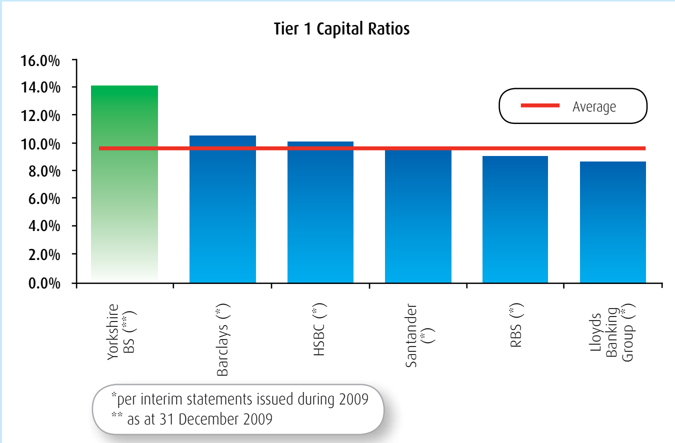
In spite of the extremely challenging environment, I am able to report a resilient performance in 2009, with an upturn in performance since the results reported in our Merger Booklet in respect of the first half of the year. The Yorkshire's results have, naturally, been affected by the challenging conditions of 2009. More importantly, they have been affected by decisions we have taken to protect members' interests rather than managing the Group to maximise profits as would a plc.

The highlights of the year's performance are outlined below:

- **we delivered value to our members**, in particular protecting many of our savers from the full impact of the cuts in interest rates - providing them with an estimated benefit of over £85m in 2009 and we recorded continued high levels of member satisfaction;
- **we ended 2009 as the UK's 2nd largest building society**, having maintained a very robust capital position and a high level of liquidity – both of these factors provide protection to our members;
- **we expanded our distribution network with the net addition of 10 agencies**. Following the merger with Chelsea our total distribution network will include 178 branches and 75 agencies;
- In an extreme economic environment **we achieved a core operating profit of £7.7m, with an improvement in performance in the second half of the year.** This improved position in the second half reduced our overall statutory loss to £12.5m;
- **our continued focus on efficiency and cost management** allowed us to deliver a ratio of management expenses to mean assets of 57p per £100 of assets, 54p excluding costs associated with the merger, compared to 56p in 2008;
- **we achieved non-interest income of £30.7m** in comparison to £31.5m in 2008, this was despite a major reduction in gross lending by the Society in the year, £0.9bn vs. £2.5bn in 2008. This success was directly as a result of offering competitive, good-value insurance, protection and investment products;
- **we continued to focus on effective arrears management**. We proactively seek to help borrowers who are, or who are likely to be, facing difficulties. This bore fruit during 2009 as arrears levels began to fall;
- **our colleague opinion surveys provided us with strong results** for employee satisfaction and motivation;
- **we completed the integration of Barnsley Building Society**, which is now operating successfully as a distinct brand, offering an improved product range and maintaining its own branch network within the Group;
- **we announced our intention to merge with Chelsea Building Society**, the details of which are covered earlier in this report; and
- **YBS Share Plans achieved further success**, acquiring 13 new corporate clients in 2009.

	2009 £m	2008 £m
Core operating profit	**7.7**	**53.0**
Treasury investments		
profit/(losses) from fair value volatility	7.8	(67.1)
impairment/losses realised	(0.9)	(7.0)
	6.9	(74.1)
Other fair value volatility	(18.1)	38.3
Other non-recurring items*	(6.3)	5.8
	(9.8)	23.0
Financial Services Compensation Scheme levy	(2.7)	(14.7)
Statutory (loss)/profit before tax	**(12.5)**	**8.3**

* Further details are provided in the Directors' report on page 20



Results

Rather than seek to maximise short-term profits, our priority is to deliver financial security and value to our members through providing products that are good value over the long term and enable us to build sustainable relationships with them. It is in this context that our financial performance, set out below, should be viewed.

We are reporting a statutory loss for 2009 of £12.5m. This represents a fall from a corresponding profit of £8.3m in 2008 but an improvement on the position at 30 June 2009 when, in the Merger Booklet, we reported a statutory loss for the half year of £22m. The statutory loss for the year includes £18.1m which relates to timing differences which do not reflect underlying performance. We reported a core operating profit for the half year of £1m, but by the year-end this figure had risen to £7.7m. Core operating profit is down from £53.0m in 2008; however, under the unprecedented economic conditions of 2009, the ability of the Group to continue to provide real value and protection to members, under even the worst conditions, is encouraging. The key elements of the reduction in our core operating profit are our net interest margin and the charges made to appropriately provide for mortgage losses:

- our net interest margin has fallen to 0.65% from 0.76% in 2008, as a result of a number of factors:
  - to provide members with greater security, we have protected our liquidity position by increasing our holdings of very high quality realisable investments e.g. gilts and cash held in a Bank of England account. These generate a low return, negatively impacting our net interest income, but improving our overall liquidity ratio to 31.9%;
  - while the bank base rate has fallen and remained at record low levels, we have continued to protect savers, whilst at the same time offering competitive mortgage products to our existing borrowers; and
  - due to the harsh economic conditions, we maintained a prudent approach to new lending, concentrating on our core business of undertaking lower-risk lending on prime residential mortgages. This change in lending mix combined with low volumes of new business also reduced our earnings.
- as a result of providing for a substantial increase in mortgage loan losses arising from the recessionary conditions, we incurred a charge to the income statement of £59m in 2009, in contrast to £25m in 2008.

We bore a lower FSCS charge in 2009 of £2.7m versus £14.7m in 2008. We continue to lobby against the inequitable way in which the levy is calculated, as it unfairly penalises lower-risk organisations such as building societies, who adopt a safer funding model based on retail deposits rather than excessive dependence on wholesale funding.

In 2009, market conditions meant that we are able to report a modest profit on our small book of structured credit investments, in the income statement, of £6.9m versus losses previously incurred. We will continue to closely manage and monitor these investments. These assets now represent just 0.3% of total assets and do

Chief Executive's report continued

not present a material risk to the financial strength of the Group.

Resilience

Our capital position strengthened over the year. Our Group solvency ratio was 15.6% at the end of the year, compared to 14.8% at the end of 2008, reflecting some internal capital restructuring.

The Yorkshire ended the year with a strong balance sheet; the graph on page 7 shows that the Yorkshire's tier 1 capital ratio is extremely strong when compared to leading banks, even where the banks are in receipt of additional taxpayer-provided capital. Tier 1 capital is largely accumulated profits and provides the ability to absorb losses.

Total assets were £22.7bn, 1.3% down compared to £23.0bn in 2008. This is largely because our gross mortgage lending was much lower in 2009 at £936m versus £2,529m in 2008. In a similar way our net lending of £267m in 2008 became a net repayment of £1,148m in 2009 as the amount by which borrowers redeemed their mortgages remained in line with 2008's level of £2.3bn compared to £2.1bn in 2009. Low lending was largely a reflection of low demand from potential borrowers and our conservative approach to lending in an uncertain climate.

The Group continued to focus on maintaining high quality prime residential mortgage assets, this being the traditional role of a building society. The Group's average indexed loan-to-value ratio rose to 51.95% from 50.14% in 2008. During a recession it is inevitable that some borrowers will face difficulties. We continually review and develop our arrears management policy in line with best practice and regulatory requirements to ensure that it supports those members facing difficulties while protecting the interests of all members. This bore fruit during 2009 as arrears levels began to reduce from their first quarter peak. At the end of 2009 the percentage of loans over three months in arrears had increased only slightly to 1.84% compared to 1.59% in 2008, and we believe remains below the industry average as measured by the Council of Mortgage Lenders.

At the year-end the Group's liquidity ratio was 31.9% up from 26.2% at the half-year and from 25.4% in 2008. Under the current economic conditions, we believe that it is appropriate to maintain this extra level of protection despite the short-term impact on profits. Another factor that contributed to a very high level of liquidity at the year-end was our decision to access the Credit Guarantee Scheme (CGS) following the announcement of the proposed merger with Chelsea and prior to withdrawal of the CGS. The CGS is available on commercial terms to institutions which satisfy the scheme's conditions.

At the year-end, member savings balances had increased to £13.8bn compared with £13.7bn in 2008. Maintaining the level of savings balances allowed the Group to fund 92% of our mortgages by member savings deposits, compared to 84% in 2008, illustrating that the Yorkshire funds its activities predominantly from its retail markets.

Delivering security and value to members

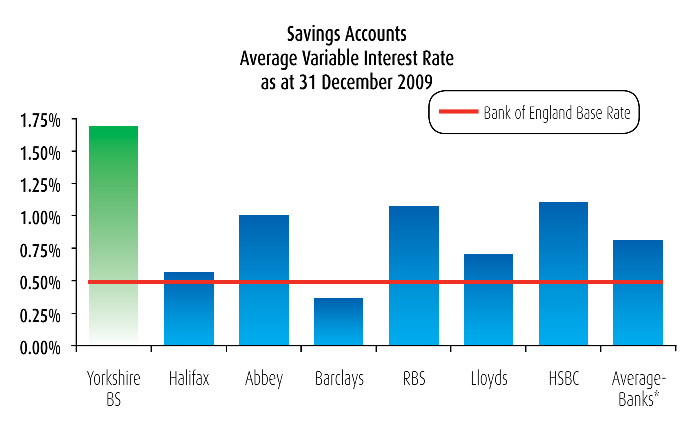
Our vision is **to be the best organisation that our customers deal with** and we continually strive to deliver financial security and long-term value to our members across both mortgage and savings products. This ambition becomes more challenging in a sustained very low interest rate environment, in which savers see returns falling and our interest margin is reduced. During 2009, due to the competitive pressures in the market-place, many institutions were obliged to offer unsustainable rates on savings products simply to bolster their funding position. We believe that it is not in the long-term interests of our members for the Yorkshire to compete with such products, as such an approach would harm the Group's long-term resilience. Our approach to managing our range of savings products continues to be focused on protecting our loyal long-standing investors, while ensuring that our products are competitive on a sustainable basis.

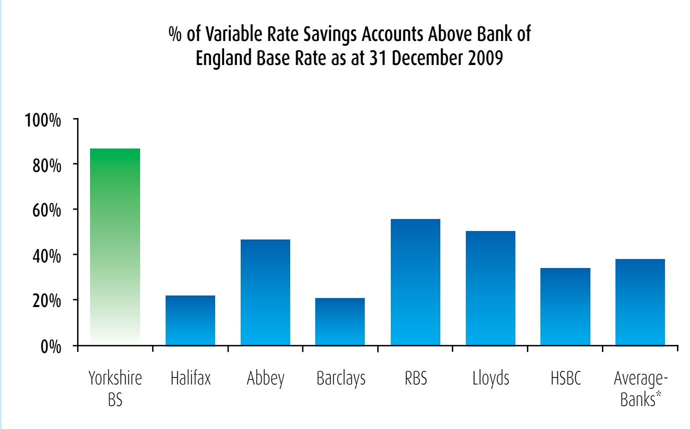
To illustrate our competitive positioning during 2009, we achieved over 1,100 'Best Buy' mentions for our savings and mortgage products, over 15% more than in 2008. These Best Buy mentions reflect the decisions we made concerning in which parts of the market we could compete on a sustainable basis. During 2009 over a quarter of a million new savings accounts were opened.

Savings

Once again, during 2009 we made decisions on savings rates to provide protection to our investing members, in contrast to many of our competitors, who cut rates on their variable rate products more steeply. We estimate that the decisions we made not to pass on the full Bank of England base rate cuts means that during 2009 our savers are better off than they otherwise would have been by over £85m a year.

Independent financial information provider 'Moneyfacts' identified in November 2009 that despite the base rate remaining unchanged since March 2009, 1 in 10 banks had reduced the rate on their variable





* Simple average of banks shown

savings products and nearly half of all variable-rate accounts paid base rate or less. In contrast, as shown on the graph (above left), at the end of 2009 the Yorkshire offered savers a range of accounts with an average variable interest rate of 1.69%, more than twice the average level of rates offered by the banks (0.80%). In addition, 86% of the Yorkshire's variable rate savings accounts paid interest at above base rate, compared to less than 40% on average of such accounts offered by the retail banks (see graph above right). The Yorkshire's average rate on variable products is better than any of the major banks by a considerable margin.

Borrowers

As a result of the downturn in the housing market, a number of borrowers have seen the loan-to-value ratio on their homes increase. We have offered our existing customers further fixed-rate mortgage products at the end of their current mortgage deal, regardless of the loan-to-value on their property at the time. By providing our borrowers with this option, we are proactively helping them to manage their finances in what are difficult conditions, and in circumstances in which many of them would otherwise be unable to replace maturing fixed-rate deals with an attractive alternative.

Share Plans

YBS Share Plans achieved further success in 2009, delivering a net contribution to profit of over £9m to the Group. The team acquired 13 new corporate clients during the year, including Invensys plc, Next plc, Catlin Group Limited, The Black Sheep Brewery plc and SSL International plc. YBS Share Plans implements, manages and provides a wide range of aftercare services (e.g. share dealing) to UK corporate Share Plan clients. The plans include Saving Related Share Option Schemes (Sharesave), both UK and globally, the Share Incentive Plan and offer a range of bespoke plans. YBS Share Plans currently manages plans of 350 clients, representing 56% of the market, and with the further development of the Global Share Plan web portal there are plans to grow this market share still further.

Recognition

The results of our regular customer satisfaction surveys provide us with reassurance that we are continuing to act in members' interests and deliver value and excellent service. We are happy to report that 9 out of 10 respondents to our customer satisfaction surveys said they would recommend us to their family or friends.

In addition to the direct feedback we seek from our members, during 2009 the Group also achieved significant external recognition for its products and services, including:

- **Short-listed** - Which? - Best Financial Services Provider;
- **Commended** - Moneyfacts - Best Monthly Savings Account Provider;
- **Commended** - Moneyfacts - Best Internet Savings Account Provider;
- **Winner** - Moneyfacts - Best Long Term Fixed Rate

Chief Executive's report continued

Mortgage Provider;

- **Highly Commended** - Mortgage Finance Gazette Awards - Excellence In Treating Customers Fairly - Large Lender;
- **Second Place** - Mortgage Finance Gazette Awards - Best National Building Society;
- **Commended** - Moneyfacts - Best Short Term Fixed Rate Mortgage Provider; and
- **Runner Up** - Telegraph & Argus - Bradford's Best Awards.

For our subsidiary, Accord Mortgages Ltd:

- Financial Adviser - **5 Star Service Award**; and
- Financial Adviser - **4 Star Online Service Award**.

Our YBS Share Plans business won two ifs Proshare Annual Awards:

- **Winner** - Best Commitment To Employee Share Ownership - The Black Sheep Brewery plc; and
- **Winner** - Best International Share Plan - Catlin Group Limited.

At the heart of our communities

Central to our mutual ethos is being a good corporate citizen and that means playing an active role as a responsible member of the communities in which we live and work. Our responsible business practices include fundraising for good causes, staff volunteering and a commitment to sound environmental practices.

We are pleased to note that:

- in 2009 our Charitable Foundation donated over £450,000 to some 2,400 good causes, of which 85% were suggested by members. This represents the highest donation and number of causes supported in any year to date, bringing the total donated since its inception in 1998 to over £3.4m. Just under half of the total funds contributed to the Foundation have come from members through the "Small Change, Big Difference™" scheme;
- Over 300 of our staff gave a day volunteering to community projects through our Actionteering programme, the highest number ever and more than double the level in 2008; and
- we maintained our commitment to making our supply chain more environmentally friendly, including purchasing electricity from renewable sources, operating an extensive waste recycling programme and making a range of operational changes to make optimal use of the resources we need to consume.

More detail of these activities can be found in the responsible business practices report on pages 12 to 13.

Our people

Once again I would like to pay tribute to the continued efforts of all of my colleagues throughout the Group. Despite the fact that 2009 was another challenging year for staff we are pleased to report the following achievements:

- absenteeism and staff turnover levels both fell to record low levels; and
- during 2009 we achieved strong staff opinion survey results. For example, 94% of staff said that they are prepared to "go the extra mile" when required.

I would like to thank management and staff for their efforts on behalf of members during 2009 and, in advance, for the effort that will be required over the coming year – especially regarding the challenges they will doubtless rise to in respect of our merger with Chelsea.

I also look forward to welcoming new colleagues from Chelsea Building Society. I have been hugely impressed by the professionalism and commitment they have demonstrated during a period of some uncertainty and I very much look forward to working with them.

I am confident that all colleagues will continue to live up to our values as we take the Yorkshire forward through 2010 and beyond, and preserve the positive culture in which we work.

The future

The UK economy returned to growth in the last three months of 2009, by a weaker-than-expected 0.1%, and thereby exited recession; however, we anticipate that some indicators will continue to deteriorate and that further volatility remains an unwelcome but distinct possibility and one that we are prepared for.

Specifically:

- unemployment levels look set to rise during 2010, albeit not to the levels previously expected. In spite of our efforts to help borrowing members who find themselves in difficulties, this will initially mean elevated levels of arrears;
- despite the fact that house prices rose modestly in 2009, we expect them to remain flat in 2010 with a risk of price falls;

- economic growth in 2010 will be muted at best, with a fuller recovery not expected until 2011 and beyond; and
- the Bank of England's policy of maintaining interest rates at historically-low levels is likely to continue with the bank rate remaining at low levels in 2010, inevitably limiting the returns available to savers.

The regulatory environment will continue to evolve. Notable developments that will impact the Group during 2010 include:

- a new Combined Code detailing the best practice approach to corporate governance, following the Walker Review in 2009;
- the Individual Liquidity Adequacy Standards (ILAS), a new regime covering liquidity management;
- a new specialist rule book for building societies (BSOG) that will impose new rules on the way building societies can operate; and
- anticipated regulatory change arising from implementation of the FSA's findings from the Mortgage Market Review which they undertook during 2009.

Overall we expect that market conditions will continue to be every bit as tough in 2010 as they were in 2009, in both the UK retail savings and residential mortgage markets. Notwithstanding this, we are very optimistic about the future prospects of the Group; in particular we look forward to welcoming members of Chelsea to the Yorkshire and to providing all our members with the benefits of being part of a much larger Society. Our commitment to remaining an independent mutual will remain unaltered because we continue to believe that it is in the best interests of current and future members. We will stick to the same values that the Yorkshire aims to live up to, with an emphasis on the delivery of long-term value backed up by excellent personal service.

We will continue to operate very much as a traditional building society. Our lending will be very largely focussed on traditional mortgage lending which allows people to own their own homes, funded mainly by the savings of individual members. We will build on the strengths of both societies to enhance our ability to deliver benefits to our members.

In summary, we will continue to manage the Group in a way that enhances its resilience despite the challenging times, delivers optimal results with the longer term in mind, and further enhances the Yorkshire's reputation as a leading independent mutual building society.

Iain Cornish
Chief Executive

Responsible business practices

As a mutual, we care about our members, staff and local communities. Since our members and staff are part of wider communities, it's right for the Society to seek to play an active role in those communities, working with them in a practical way to help bring about positive changes. We can do this through practical actions and grant giving. The Society's commitment to our Responsible Business Practices programme is strong, even in these difficult times. It is embedded in our culture and embraces our values.

Everything we do in the community and environment, including the work of Yorkshire Building Society Charitable Foundation, our Community Investment Fund, Actionteering (staff volunteering) and environmental initiatives, comes under the title of Responsible Business Practices. Staff participate without obligation and with enthusiasm, and find the work they do extremely rewarding. With support from our members and community partners, our programme is going from strength to strength.

The National Appeal, held during the Christmas period, has helped 10 charities since the first event in 1999, including Mencap, Marie Curie Cancer Care, Starlight Children's Foundation and the charity chosen for 2009, the British Heart Foundation - Heart to Heart Appeal. All money raised by member donations and staff events was matched, pound for pound, by the Charitable Foundation which **resulted in a total donation of £115,000 being made to the British Heart Foundation.**

What have we done in 2009?

Yorkshire Building Society Charitable Foundation was established as a registered charity in 1998, aiming to support good causes throughout the UK, principally in areas where our members and staff live and work. Society members are essential to the success of the Foundation, which is funded from Society donations, employee fund raising and, primarily, members who participate in the "Small Change, Big Difference™" (SCBD) scheme. Under this scheme, introduced in 1999, members donate the pence of interest from their savings and mortgage accounts to the Foundation. The maximum annual donation is 99p per account – but when multiplied by more than 620,000 members that take part in the scheme, it's easy to see how in 2009, it accounted for more than £310,000 of the Foundation's annual funding. Our aim is to increase the number of participating accounts to over 1 million.

By the end of 2009 the Foundation had donated more than £450,000 to over 2,400 charities and causes, bringing total donations to over £3.4m to more than 9,600 good causes across the UK. These ranged from SNAP (Special Needs Action Project) in Inverness to St Francis Home for Animals in Newquay. Of these causes, 85% had been nominated by members and employees. Just less than half of the total donated has now been provided by the SCBD scheme. A fantastic achievement – thank you to everyone who has been involved.

During 2009, following the merger of Yorkshire Building Society and Barnsley Building Society, the Barnsley's customers and staff were welcomed to the Charitable Foundation and the SCBD scheme, which we launched through the Charity Choice campaign. Members were invited to vote on a choice of 10 charities local to Barnsley (and chosen by Barnsley staff) to receive a share of £10,000 from the Foundation. Ashgate Hospice, that cares for the terminally ill and supports their families, was the most popular and received a donation of £3,500.

Yorkshire Air Ambulance has received £90,000 through the Barnsley Building Society savings account, which pays an amount equivalent to 1% of all balances in the account to the charity. Paul Gowland from Yorkshire Air Ambulance gave a message to all account holders "We believe in the Golden Hour. If we can take a patient from accident to medical attention within that period, the chances of recovery are dramatically increased. We now believe in golden pennies and pounds, because of your commitment to save for your own future it will ensure that ours continues at the same time. We aim to provide a platinum air ambulance service for Yorkshire and we see our link with Barnsley Building Society as a platinum partnership. As we search to strengthen our funding, this affinity account provides benefits for all involved and ultimately saves lives."

One charity that has benefited from a grant from the Foundation this year is Brooklands Community Special School in Skipton, North Yorkshire. Head Teacher of the school, John Fryer, said, "On behalf of the school I would like to say a huge thank you to the Yorkshire Building Society Charitable Foundation, who have very generously agreed to donate £1,000 towards our residential programme. We are very grateful for the support and consideration. Such donations make a massive difference to small schools like ourselves and so we are delighted with this news."

The Foundation holds two annual campaigns – Make a Difference Week and the National Appeal.
Make a Difference week is held in June and members and staff are encouraged to recommend a local charity and join the Small Change, Big Difference™ scheme. This emphasises the Foundation's aim to support as many different good causes as possible within local communities, where local knowledge is essential to prevent these being overlooked. Members of the public are also welcome to nominate charities at their local branch or agency. 2009 was the most successful Make a Difference Week to-date with 1,212 good causes receiving a share of a total donation of £68,600.

Society teams have worked at local schools, creating outside educational spaces including building raised growing beds which allow the children to learn about fruit and vegetables, healthy eating, physical exercise and attracting wildlife.

Our Lady and St Brendan's Primary School in Bradford was so impressed with murals that we completed at another school, that their year 2 class wrote to us and asked if we could visit them. Business Intelligence Department duly answered their plea for help and a team of 11 volunteers arrived at the school with paint brushes in hand and plenty of enthusiasm. Anne Springer, Deputy Head, said, "The friendship our school has established with YBS, I feel, will be a long and lasting one. The team who visited us recently to improve our outdoor learning environment will never be forgotten. They worked tirelessly to enhance the outdoor provision for our children and we will always be grateful to them."

Staff can also get involved by undertaking individual activities such as becoming a school governor, student or business mentor and taking part in 'Masterclasses' with local college students. One volunteer, Tony Lubbock from Business Design Department, has been mentoring a local photographer, Derek Boocock, through the Bradford Kickstart programme. Derek said, "Tony has given me real confidence. It is daunting going into business on your own for the first time, a quite frightening prospect, but with Tony's help I've kept my feet on the ground. He's got the business experience I need and he's also great to bounce ideas off."

Predominantly the volunteer work that has been done is based in the Bradford area, but 2009 has seen the first team challenge take place in the branch network, and more are planned for 2010. Mill Hill Primary School in Northallerton asked for help in decorating their reception and main corridor to make a brighter and more welcoming area for children and visitors. Jon Vening, the Society's North East Area Manager, said, "As a team, it was great to see everyone working together with everyone playing a part, and knowing the children will benefit from this is a win-win situation."

A major development for 2009 has been the integration of the Actionteering programme into the Leadership Development scheme which the Society has in place for current and future managers. Linking with community partners through Actionteering allows Society personnel to plan, manage and undertake real activities with real benefits to others – at far less cost than conference centre team building activities could do.

We all have a responsibility to our environment and we are very aware of our individual impact both within the business and local communities. Our extensive recycling programme allows us to recycle up to 90% of Head Office waste – from aluminium cans, vending cups and batteries to food waste from the Head Office restaurant. Our commitment to purchase electricity from renewable sources continues, and throughout 2009 the Society has used 100% recycled copy paper in all offices.

2009 has seen the introduction of a Nightwatchmen software package that will automatically and safely power down all the Society's desktop computers during non-working hours. A programme of installing infra red taps throughout washroom facilities at Head Office has begun and is due to be completed in 2010. These two initiatives will reduce the consumption of electricity and water within the Society and also our impact on the environment. Wherever possible the Society seeks opportunities to 'green' our supply chain.

The level of support we receive for our work in local areas is impressive, so a big "thank you" to our members and staff for their support and contribution. We know that donating our time as well as funds can make a real difference to local projects, and we're fully committed to continuing our community work.

Non-executive directors

Ed Anderson, BSc CPFA (age 59)
Chairman

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

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

Richard Davey, BA (age 61)
Vice Chairman

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

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

Lynne Charlesworth, BA MBA (age 53)
Non-executive Director

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

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

Philip Johnson, FCA (age 63)
Non-executive Director

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

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

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

David Paige, BSc FCA (age 58)
Non-executive Director

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

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

Simon Turner, BSc (age 58)
Non-executive Director

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

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

Indira Thambiah, BSc MBA (age 42)
Non-executive Director

Indira Thambiah was appointed to the board in May 2008 and is a member of the Remuneration Committee.

Indira qualified as a Chartered Accountant and has spent most of her professional life within the retail sector. She has worked with Asda Walmart in a number of roles, including setting up Asda's online operation. In 2002, Indira moved to the Home Retail Group, initially as Head of E-commerce for the Argos business and latterly as Head of Multi-Channel Retail which covered e-commerce business across the Group including Argos, Homebase and their associated financial services operation.

At the beginning of 2008, Indira became a freelance consultant, continuing to work in the retail sector.

Executive directors

Iain Cornish, BSc (age 49)
Chief Executive

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

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

Andy Caton, BA (age 46)
Corporate Development Director

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

Ian Bullock, BSc FIA (age 49)
Sales and Marketing Director

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

Andrew Gosling, MA FCA (age 54)
Finance Director

Andrew Gosling joined the Society as Finance Director in 2001. Prior to that he was a partner in the professional services firm Ernst & Young, where he was in charge of its financial services practice in the North of England and also led the firm's Building Societies Group. Andrew is responsible for the Group's Finance, Audit, Legal & Secretarial and Facilities functions. He is also a director of the subsidiary Yorkshire Guernsey Ltd.

General managers

Robin Churchouse, MA ACA (age 44)
General Manager Risk and Planning

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

Rachel Court, BA (age 43)
General Manager Human Resources & Customer Service

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

David Henderson, BSc (age 49)
Chief Information Officer

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

The directors have pleasure in presenting their annual report, together with the Group Accounts and Annual Business Statement, for the year ended 31st December 2009.

Business objectives and activities

The Group's purpose is to maximise long-term benefits for a growing membership. This is achieved by the pursuit of two principal aims:

- to attract and retain as many members as possible who want long-term benefits; and
- to continually improve the ability to deliver member benefits through:
  - a range of long-term value products and services;
  - excellent service and communication through all distribution channels;
  - continued focus on cost effectiveness; and
  - maintaining a high level of financial security.

Principal risks, uncertainties and going concern

The principal risks and uncertainties faced by the Group and our approach to managing them are set out in the Risk Management Report on pages 23 to 30.

As set out on page 43 the directors are required to prepare these financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Society will continue in business.

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

The future risks considered in the latest review, performed in February 2010, included uncertainty around recovery in both the UK housing market and the general economy, the potential for restricted access to funding, excessive demands on liquidity and the impact of increasing levels of regulation.

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

In the light of the intended merger with Chelsea Building Society the board has satisfied itself that the going concern assessment adequately addressed the risks and uncertainties faced by the enlarged group as well as the additional risks presented by the completion of the integration exercise itself.

As a result of the detailed assessment performed in February 2010 the board concluded that the Group has sufficient resources to continue in operational existence for the foreseeable future and as a result that it is appropriate to prepare these financial statements on the going concern basis.

One key tool for mitigating risk is the requirement for all institutions to hold minimum levels of capital. In this regard, the Group uses the standardised approach under the Capital Requirements Directive (Basel II), and holds well in excess of its regulatory requirement. The disclosures required under Basel Pillar III will be published on the Society's website.

Business review

Key developments in the business, an overview of the impacts of, and the Group's reaction to, recent market turmoil and the Chief Executive's assessment of the future outlook are detailed on pages 4 to 11.

The Group uses various performance indicators to monitor its progress. The following sections look at key areas of the business and how the performance indicators for these areas have moved during the year.

Financial performance

Group loss before tax was £12.5 million (2008 – profit £8.3 million); this can be analysed into the following key areas:

	2009 £m	2008 £m	2009 % of mean assets	2008 % of mean assets
Net interest income	**147.8**	164.5	**0.65**	0.76
Non-interest income	**30.7**	31.5	**0.13**	0.14
Volatility on assets held at fair value	**7.8**	(67.1)	**0.03**	(0.31)
Fair value volatility on derivatives and hedging	**(18.1)**	38.3	**(0.08)**	0.18
Net realised profits/(losses)	**11.5**	(1.0)	**0.05**	–
Total income	**179.7**	166.2	**0.78**	0.77
Management expenses	**(131.0)**	(122.4)	**(0.57)**	(0.56)
Operating profit before provisions	**48.7**	43.8	**0.21**	0.21
Provisions for impairment of mortgages	**(59.0)**	(25.0)	**(0.26)**	(0.11)
Provisions for impairment of debt securities	**(0.9)**	–	**–**	–
Other provisions released	**1.4**	1.0	**0.01**	–
Operating (loss)/profit before exceptional provision	**(9.8)**	19.8	**(0.04)**	0.10
Financial Services Compensation Scheme levy	**(2.7)**	(14.7)	**(0.01)**	(0.07)
Operating (loss)/profit	**(12.5)**	5.1	**(0.05)**	0.03
Negative goodwill	**–**	3.2	**–**	0.01
(Loss)/profit before tax	**(12.5)**	8.3	**(0.05)**	0.04

In an extreme economic environment we achieved a core operating profit of £7.7 million (see page 20) with an overall statutory loss of £12.5 million, which is analysed further below. The Group's underlying position remains strong.

The net interest margin has reduced from 2008 for a number of reasons, including the action we have taken to further protect our funding position by increasing our holdings of very high quality liquid assets which, whilst improving our overall liquidity position, generate relatively low rates of return. In addition, we have continued to protect savers in the face of record low bank base rates whilst offering competitive mortgage products – this combination has inevitably squeezed our interest margin. Given the continuing harsh economic conditions we have concentrated on core, lower-risk lending which, combined with lower business volumes, has further reduced our interest earnings.

Non-interest income has only reduced slightly from 2008 levels despite a major reduction in gross lending.

The £7.8 million gain on assets held at fair value arises in the main from the reversal of falls in the prices of certain investments experienced in 2008.

Fair value volatility on derivatives and hedging results from changes in the value of certain financial instruments as a result of fluctuations in money market interest rates. This item is mainly due to timing differences which will reverse in future. The hedges in question remain effective commercial hedges which reduce the Group's real risk exposures.

The Group places great importance on cost control as long as this is not at the expense of the service we offer to our members. The continued success in this area has meant that, when merger costs of £6.7 million are excluded, management expenses have grown by just 1.6% over 2008. As a proportion of mean assets, management expenses excluding merger costs are 54p per £100 compared to 56p in 2008.

Provisions for impairment of mortgage loans have increased due to house prices continuing to be significantly lower than their peak and rising unemployment. We have continued to take a prudent view of losses and a 3% fall in house prices in 2010 has been assumed, together with 15% "forced sale discounts" on properties in possession.

The Financial Services Compensation Scheme levy has resulted in a further charge of £2.7 million, in addition to the £14.7 million in 2008. The levy has reduced materially from 2008, principally due to lower interest rates. The Chief Executive has commented further on the circumstances surrounding this charge in his report on page 7.

After adjusting for items that are considered to be one-off in nature, or the result of either timing differences or the recent market turbulence, the Group's core operating profit was as follows:

	2009 £m	2008 £m
(Loss)/profit before tax:	**(12.5)**	8.3
Net losses from fair value volatility		
Structured assets	**(7.8)**	67.1
Derivatives and hedging	**18.1**	(38.3)
	10.3	28.8
Impairment of/net realised losses on structured assets	**0.9**	7.0
Other non-recurring items		
Release of provisions for liabilities	**(1.4)**	(1.0)
Net losses/(profits) on property, shares and debt repurchase	**1.0**	(1.6)
Merger costs	**6.7**	–
Negative goodwill written off on merger	**–**	(3.2)
	6.3	(5.8)
Financial Services Compensation Scheme levy	**2.7**	14.7
Core operating profit	**7.7**	53.0

As highlighted above, the key contributors to the fall in core operating profit are the levels of provisioning and the reduction in interest margin as the Society has sought to protect savers from the full extent of interest rate falls, whilst carrying significant levels of low yield, high quality liquid assets.

Liquidity

The Group's approach to managing liquidity risk is set out in the Risk Management Report on page 25. Liquidity has increased in absolute terms from £5.3 billion to £6.7 billion, with its ratio to shares and borrowings increasing from 25.4% to 31.9%. As outlined above this increase resulted from deliberate action taken to protect our funding position despite the resultant detrimental impact on earnings.

Capital

The Group's principal measure to monitor the level of capital within the business (a key indicator of financial strength) is the solvency ratio, the calculation of which is in note 30 on page 77. The Group's solvency ratio (which is also the key capital ratio used by our regulator, the Financial Services Authority, to measure our capital strength) has increased to 15.6% (2008 – 14.8%) following the repatriation of some capital previously held overseas. Capital levels remain well above the Group's internal and prudential minima and reflect its continued capital strength.

Gross capital and free capital, as defined in Section 2 of the Annual Business Statement on page 97, were 5.58% (2008 – 5.66%) and 5.13% (2008 – 5.22%) respectively.

Business volumes

Members' savings balances increased slightly to £13.8 billion which represents 92% of mortgage balances.

One result of our decision to strengthen our liquidity position was reduced lending. By achieving a net repayment position on our mortgage book we were able to retain more funds in the form of liquidity although this, inevitably, had a detrimental impact on earnings.

	2009 £m	2008 £m	2009 Estimated share of UK market	2008 Estimated share of UK market
Gross mortgage lending i.e. new loans	**936**	2,529	**0.7%**	1.0%
Net mortgage lending i.e. after repayments of existing loans	**(1,148)**	267		
			% (decrease)/increase	
Mortgage balances excluding fair value adjustments and impairment provisions	**14,756**	15,904	**(7.2)**	3.7

Assets
The main component of our assets remains mortgage loans, which are discussed above. The other key category is liquid assets in the form of cash and authorised securities (see Liquidity above).

Asset quality – mortgage arrears
During 2009 the Group's overall arrears position deteriorated, driven by the downturn in the UK economy, although arrears levels have fallen from their peak in early 2009. Furthermore, the high quality of the Group's mortgage book means that we believe that these figures continue to be lower than the industry average.

Accounts with payments in arrears

Accounts with payments more than three months and less than 12 months in arrears, excluding possessions

	2009	2008	2009 % of mortgage accounts/balances	2008 % of mortgage accounts/balances
Number of accounts	**2,770**	2,684	**1.69**	1.52
Balances outstanding on accounts	**£330.3m**	£302.2m	**2.24**	1.90
Amount of arrears included in balances	**£10.7m**	£10.3m	**0.07**	0.07

Accounts with payments 12 months or more in arrears plus possessions
The position on our more serious arrears cases, being those with payments twelve months or more in arrears, has deteriorated but, we believe, remains below the industry average.

	2009	2008	2009 % of mortgage accounts/balances	2008 % of mortgage accounts/balances
Number of accounts	**622**	530	**0.38**	0.30
Balances outstanding on accounts	**£87.7m**	£76.0m	**0.60**	0.47
Amount of arrears included in balances	**£6.8m**	£5.9m	**0.05**	0.04

Appropriate provisions have been made for potential losses on mortgages in accordance with the impairment policy set out in Note 1 on page 53.

Members and customers
During 2009 our membership increased to 2.1 million.

The Society uses a number of measures to track customer satisfaction. In particular, a customer satisfaction measure is maintained based on monthly surveys. During 2009 92% of our customers rated the service they received as Excellent or Good, slightly more than last year.

Merger with Chelsea Building Society

Having received the approval of the members of both societies, subject to confirmation by the Financial Services Authority, Yorkshire Building Society will merge with Chelsea Building Society on 1st April 2010.

Further details relating to the impact of this merger are given in the Chief Executive's report on page 5.

Staff

Our staff are key to our operations. Staff numbers and associated costs and ratios can be summarised as follows:

	2009	2008
Staff costs (salaries and wages, social security costs and pension costs)	**£74.2m**	£71.7m
Number of staff employed (full and part time)	**2,379**	2,365
Number of staff employed (full time equivalent)	**2,106**	2,097
Per full time equivalent member of staff:		
Total management expenses (£000)	**62.2**	58.4
Average total assets (£000)	**10,863**	10,379

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

An equal opportunities policy is followed and the Group gives full consideration to applicants and staff who are disabled. The Group continues to retain its Investor in People accreditation.

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

Directors

The names of the directors of the Society at 31st December 2009 are shown on pages 98 and 99 of the Annual Business Statement.

At the 2010 Annual General Meeting (AGM), Ed Anderson, Lynne Charlesworth, Iain Cornish and David Paige retire as directors in accordance with the Society's rules and the Building Societies Act 1986 and, being eligible, offer themselves for re-election.

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

Charitable donations

In 2009 Yorkshire Building Society Charitable Foundation donated over £450,000 to some 2,400 causes, of which 85% were suggested by members, maintaining the Foundation Trustees' desire to support causes across the UK with the assistance of member nominations. The funds were primarily raised through the 'Small Change, Big Difference™' scheme. Further details can be found in the Responsible Business Practices Report on pages 12 and 13.

Supplier payment policy

It is the general policy of the Group to pay supplier invoices on a weekly basis.

The creditor days were three days at 31st December 2009.

Auditors

During 2009 the Audit Committee invited a number of firms to tender for the statutory audit of Yorkshire Building Society and its subsidiaries; further details of this process are set out in the Corporate Governance Report on page 34. As a result of the tender process the committee recommended the appointment of Deloitte LLP, which the board subsequently approved.

The directors would like to record their appreciation to KPMG Audit Plc, the Group's previous auditors, for many years of professional service.

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

On behalf of the board

Ed Anderson
Chairman

24th February 2010

Introduction

The activities of all financial institutions inevitably involve a degree of risk taking. With this in mind the Group's risk management framework and governance structure is intended to provide appropriate and comprehensive monitoring, control and ongoing management of the major risks to which it is exposed, so as to ensure the security of its members' funds. The Group's ability to properly identify, measure, monitor and report risk is critical to its soundness and its ability to provide value to its membership.

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

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

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

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

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

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

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

- credit risk – This risk arises from the Group's retail lending and wholesale investment activities and is overseen by the Group Credit Committee. It is the risk that retail borrowers or wholesale counterparties fail to repay monies due to the Group;
- market risk – The Group's balance sheet and financial position is exposed to market risk through the normal course of the Group's business. Market risk arises from balance sheet positions that are exposed to changes in interest rates (or similar indices) and from the need to maintain adequate liquidity to meet the Group's cash flow requirements as they arise, as well as to meet its ongoing regulatory requirements. This risk is overseen by the Group Asset and Liability Committee; and

- operational and regulatory risk – Overseen by the Group Operational Risk Committee, this risk arises from the possibility of loss or other damage caused by human or technical errors across the Group's operations and includes risks that relate to non-compliance with the statutory and regulatory requirements under which the Group operates.

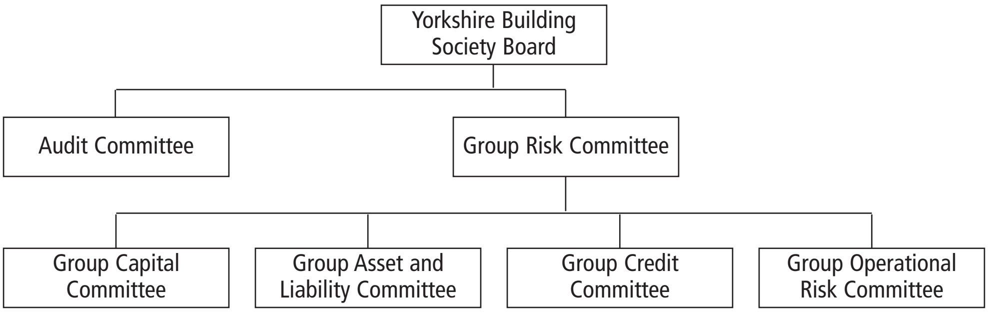
The environment in 2009 was characterised by recession and by large-scale government intervention in the financial services sector. The Bank of England maintained interest rates at a historical low and introduced quantitative easing to provide the financial system with new money, while new financial regulations and proposals for further regulation have been launched to try and repair the financial services sector, to enhance its resilience and to re-build its reputation. The Group maintains a continuous review of its risk profile in the light of the highly volatile environment in which it currently operates. The board review the active management of the principal risks to the achievement of the Group's objectives, and ensure that those risks are brought within the approved risk appetite of the board. At the end of 2009 and the beginning of 2010, the principal risks and uncertainties can be broadly summarised as follows:

- financial markets remain in a state of flux, and key credit concerns appear to have shifted from institutions to sovereign states; the Group's risk management processes have consequently been adapted to reflect this. New regulation on liquidity compels institutions to hold government and supranational securities as high quality (and low yielding) liquid assets. Access to external capital has become more uncertain for the mutual sector at the same time as profitability has been squeezed. The sector therefore faces significant challenges and the Group's strategy has been formulated to address these directly;
- the UK economy went into recession in 2008 and the housing market has been in downturn, at least in terms of volumes, during the period since then. It is not clear how sustainable the recovery may be; however it is likely that the UK will be faced with, at best, low growth and high unemployment for at least the next year. As a result, the Group's exposure to potential retail credit losses will continue at a heightened level, and must be monitored, analysed and managed as intensively as ever;
- the wholesale and retail savings markets in which the Group operates have continued to demonstrate uncertainty and volatility, and the way in which institutions decide to manage these conditions can bring with it reputational risks and doubts about the soundness and strength of an organisation. The Group has not been damaged in this way – but the environment does mean that we have to remain vigilant at all times to ensure that no doubt is cast on our strength and financial soundness in the eyes of our members and counterparties;
- in these difficult times the Government and regulatory authorities have launched an array of new initiatives including guaranteeing debt issuance, new regulations to strengthen liquidity and revised rules around remuneration. Some of these actions can have consequences that may be damaging to the Group (e.g. the high degree of cost faced by all building societies in funding the Financial Services Compensation Scheme). Again, the Group must remain strongly focused on analysing and managing the impact of such action; and
- on a wider level, the level of fraud and other financial crime within the UK retail financial services markets remains high and the current economic situation is likely to increase the pressures in this area. Whilst the Group has not been directly exposed to what it considers to be the higher risk areas of the market, it nonetheless continues to maintain a strong focus on minimising the level of fraud and other financial crime to which it is inevitably exposed.

The proposed merger with Chelsea Building Society alters the risk profile of the Group and brings with it additional risk around the execution of the merger and integration of the two businesses. A risk map has been prepared for the merged business with the individual risks discussed with the risk owners in detail. A number of the existing risks to the business change in terms of impact and likelihood; for example, risks of a more operational nature have increased in likelihood of occurrence but remain within appetite. In addition, risks such as risk of downgrade and access to wholesale funding have diminished. There are new risks that include areas where Chelsea's lending is different to that of the Group, such as commercial lending and buy-to-let; and risks around integration such as those posed by cultural differences between the two organisations, and the risk of error during a period of significant change. The risk profile also includes the opportunity afforded for significant cost synergies presented by this merger. As noted above, these risks have been discussed in detail with mitigations put in place as an integral part of the merger.

Group Risk Committee (GRC)

The Group Risk Committee was established in 2006 by the board to oversee the Group's risk governance framework and to provide an entity-wide perspective on all risk matters. It comprises non-executive directors and senior executives and is chaired by a non-executive director. It is responsible for establishing appropriate risk management committees as detailed below and its broader terms of reference include establishing the Group's risk appetite, monitoring key risks indicators, setting the direction of risk management, and the improvement of the Group's risk management processes. Further details of the membership and responsibilities of the committee can be found on page 34 of the Corporate Governance Report.



Group Capital Committee

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

This includes:

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

Capital and capital ratios are detailed in Note 30 and include an increased solvency ratio from 14.8% to 15.6% owing to the repatriation of Yorksafe capital.

Group Asset and Liability Committee (GALCO)

This committee is responsible, under delegated authority of the board, for managing the Group's liquidity, market risk and currency risk.

Liquidity risk

The board recognises that a structural maturity mismatch inevitably exists within the Group's balance sheet, caused by the fundamental purpose of the Group's business, that is, providing its members with long-term mortgage advances funded, primarily, by contractually short-term retail share accounts.

The Group's liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding so as to ensure the ability of the Group to meet its financial obligations as they fall due. This is achieved through maintaining a prudent level of appropriate and high quality liquid assets, through maintaining appropriate wholesale funding facilities, and through the management of the growth of the business.

A liquidity cash flow projection under various stress scenarios is produced on a daily basis and distributed within the business. This has recently been updated to take account of the requirements of the FSA's new liquidity regime, the relevant element of which came into effect in December 2009. Sufficient liquid assets are held to ensure that the Group can weather the potential stressed conditions defined in these daily liquidity stress tests. The results of the stress tests are reported to GALCO and to the board, and the assumptions incorporated in the liquidity stress test model are reviewed by GALCO on at least an annual basis.

During 2009, we continued to see unprecedented events in both the wholesale markets in the UK and the wider global financial markets. Whilst the majority of the Group's funding is in the form of retail savings balances, the Group was nonetheless affected by the overall market conditions because it has an involvement in these wholesale markets in terms of both its funding and its liquid asset investment programmes. The Group has responded to market conditions by maintaining ample liquidity, enhanced monitoring and analysis of the overall liquidity position, and by carefully reviewing its exposures to (and exposure limits for) a wide range of wholesale counterparties. Action was taken in a number of cases to reduce our existing or potential exposures, including suspension of limits for a number of institutions.

The Group has responded to the difficult wholesale funding conditions prevalent during 2009 by taking advantage of the UK government credit guarantee scheme which was available to all eligible deposit-taking institutions on commercial terms. The Group issued four bonds during the year comprising £750m, £600m, €750m and $350 million to bolster the funding and liquidity position of the Group. The funding policy and the contingency funding plan have been reviewed and revised in order to meet the requirements of the new liquidity regime. Additionally, the frequency with which its liquidity is reviewed by senior management has been maintained at the high levels implemented in late 2007, with weekly reviews of both the market conditions and the Group's own projected funding and liquidity positions.

Detail of actual exposures is contained in Note 34.

A new regulatory regime governing liquidity risk management has, as noted above, been launched by the Financial Services Authority. The qualitative aspects of this regime became live in December 2009 and have been complied with by the Group; these aspects include new systems and controls provisions, updated liquidity stress testing, board approval of the Group's liquidity risk appetite, and a revised contingency funding plan. The quantitative aspects, primarily the development of an individual liquidity adequacy assessment, come into force mid 2010 and the Group has a project in place to ensure compliance with this regime by the due date.

Market risk

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

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

The Group's policies for the management of risks arising from movements in interest or currency exchange rates and the composition of the balance sheet provide the framework for the Group's Asset and Liability Management (ALM) and Treasury Risk Management activities. The primary purpose of the Group's ALM process is to ensure the accurate and timely identification, measurement and control of risk faced by the Group on its entire balance sheet. The primary purpose of the Treasury Risk Management process is to ensure that risks connected with all aspects of treasury activity are identified and that suitable measures and risk management practices are applied. Treasury Risk Management also monitors the suitability of and compliance with the operating limits set for the activities of the Group's Treasury function by the board and it reports and recommends accordingly. ALM and Treasury Risk Management form part of the Group Risk function and both submit monthly reports to GALCO.

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

- Value at Risk provides a measure of the maximum likely loss that could be sustained over a specified time period at a stated level of confidence;
- Basis point value sensitivity provides a measure of the sensitivity of the present value of the balance sheet to a one basis point (0.01%) parallel shift in interest rates;
- balance sheet structural analysis monitors the composition of the balance sheet in terms of the different interest rate bases of assets and liabilities, in particular between LIBOR and other rates; and
- repricing gap analysis is used primarily for the identification of instrument repricing concentrations.

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

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

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

Currency risk

The Group has certain money market instruments denominated in currencies other than sterling. Its policy is to eliminate currency risk, other than a small operational mismatch, through the use of cross currency interest rate swaps and foreign exchange contracts.

Detail of actual exposures is contained in Note 36.

Other risks

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

Group Credit Committee

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

Retail credit risk

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

The Group's mortgage lending is conducted, and hence is monitored and managed, within three key portfolios. The largest two, accounting for 88% of balances, are 'prime' quality lending to borrowers with a good credit history. These consist of lending by the Society (through its branches or via the internet) and by its subsidiary Accord Mortgages Ltd (through financial intermediaries). The third portfolio is 'credit repair' lending (made via intermediaries and managed within Accord) to borrowers with poorer credit histories. The Group aims to help restore the customers' creditworthiness and ideally, in time, will offer them a prime mortgage. Clearly the credit risk associated with this latter portfolio is higher than for the two prime portfolios, particularly at a time when the housing market has been in a downturn. The Group is well aware of this risk disparity, and differentiates its lending criteria, its pricing and its monitoring and management processes and techniques accordingly.

Retail credit exposures are managed in accordance with the board approved Group Lending Policy and through the use of credit scoring systems that factor in the profile of the borrower, the nature of the loan, environmental conditions and the collateral that may be provided as security for the loan. These scoring systems, and the way they are used within the initial lending process, are varied to suit the different risks and profiles of the Group's three loan portfolios. Lending criteria are subject to constant review, and in the past year an affordability model has been introduced to widen the scope of the assessment of customer creditworthiness, and lending has been significantly de-risked in 2009. Actual and forecast retail exposures are monitored and managed against policy limits by the Group Credit Committee. In particular the committee monitors arrears, loan-to-value ratios, expected losses and scorecard performance.

The monitoring of retail credit risk is tailored to the different loan portfolios and to the economic and housing market conditions that are in place at any given time. The current focus is strongly on the impact of the housing downturn on our borrowers' behaviour and therefore on identifying, and seeking to help those borrowers where the exposure to such a downturn is greatest. Considerable additional resource has been applied during 2009 to identify borrowers who are at greatest risk of falling into arrears and helping them manage the situation before they get into difficulties. Similarly, additional resource has been applied to helping borrowers who are in arrears with their mortgage payments to get back to a "not-in-arrears" status.

The credit repair lending, where borrowers have had previous problems, is inherently more likely to suffer in any housing or economic downturn. This was recognised by the Group when they were entered into and so was reflected in the rates (and other terms) in place and in the overall exposure limits. There has been no new credit repair lending in 2009.

Detail of actual exposures is contained in Note 38.

Wholesale credit risk

The Group Credit Committee also takes primary responsibility for the task of assessing and monitoring wholesale counterparty creditworthiness and conducting credit research and analysis. It does this by reviewing the Group's exposures and through setting limits to individual counterparties based on its internal ratings methodology. Limits are also set against the aggregate exposure to equally rated institutions and to all institutions based in any one country.

The board recognises that it is not possible to limit the Group's exposure just to institutions with the very highest credit ratings. Nevertheless it considers that the Group's approach is prudent and is designed to minimise the risk of losses.

Prior to the financial crisis, the Group invested a limited amount of funds into higher yielding, and hence higher risk, structured credit instruments. The purpose of this portfolio was to maintain a range of investments that contributed to the Group's earnings and made effective use of the capital and treasury management resources available to the Group. The Group is aware that this portfolio carries greater credit and market risk than the core liquidity it holds, and for that reason additional risk management techniques have, from inception, been applied to this portfolio. These additional credit monitoring and portfolio valuation techniques have been specifically designed to allow independent oversight of this portfolio's risks and performance.

The events of the past two-and-a-half years have adversely impacted the value of these structured credit investments, principally through the illiquid state of the market but also, in a limited number of cases, through underlying credit issues. The Group was aware that the value of these investments could be impacted by a liquidity shortage but, in common with nearly all institutions and regulatory authorities, it did not foresee the extent of the liquidity issues that have arisen. The Group's response to these events has been to further increase its levels of performance monitoring, in particular if any individual investments have displayed signs of stress, including frequent liaison with investment managers. At the same time it has looked, where available, at all alternatives for the future structure of individual investments and has adopted a prudent approach to their valuation and treatment within the Group's financial statements. During 2009, the Group Risk Committee amended the risk management policy to state that the mandate for net new investment in structured credit is withdrawn.

Structured credit investments are currently valued at £73.2 million. Details of all actual exposures are contained in Note 37.

Group Operational Risk Committee

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

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

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

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

Operational risk category	Definition
People & resources risk	People risk is the risk that staff may not be appropriately recruited, retained, trained and managed to achieve Group objectives whilst complying with external laws and regulations. Resources risk is the risk that physical resources, external suppliers or service providers may not satisfy the Group's requirements, and/or may not be managed effectively.
Theft & financial crime risk	The Group's assets may not be adequately protected resulting in fraud, theft, damage and other criminal acts.

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

The Group aims to maintain a sound system of internal controls that provides reasonable, but not absolute, assurance that it will not be hindered in achieving its business objectives, or in the orderly and legitimate conduct of its business, by circumstances that may be reasonably foreseen. The focus is adapted to current conditions. For example, recent years have seen the development of more refined fraud and financial crime strategies and controls in response to increasing levels of such activity in the financial services market, however the Group has not suffered any material frauds in 2009.

On behalf of the board

Ed Anderson
Chairman

24th February 2010

The board is accountable to the Society's members for the conduct of the Society's business. To ensure that the board manages the Group in a prudent and effective manner, it is committed to complying with best practice in corporate governance.

This report provides members with information on the Society's corporate governance framework. It is based on the principles and provisions of the Combined Code 2008 issued by the Financial Reporting Council (the Code), which applies to listed companies, to the extent that they are relevant to a building society. In the interest of transparency, the Financial Services Authority (FSA) also encourages each building society to explain in its Annual Report and Accounts whether, and to what extent, it adheres to the Code.

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

The board

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

- the board normally holds ten board meetings each year. However, in 2009 the board held an additional four meetings to consider further business, including the proposed merger with Chelsea Building Society, as well as two sessions for a detailed review of the Group's strategy. The attendance record of each director at board meetings and relevant board committee meetings is set out on page 37;
- the non-executive directors are responsible for bringing independent judgement to debate and decisions and to constructively challenge the General Management team. The non-executive directors meet without the executive directors present at least twice a year;
- the board's principal role is to focus on the Group's strategy and ensure that the necessary resources are in place for the Group to meet its objectives and that financial and internal controls and systems of risk management are robust. In particular, its role is to provide general direction to the organisation and to safeguard the interest of members;
- the board maintains a schedule of reserved matters in order to ensure that it exercises control over the Group's affairs. These include the approval of the annual results and strategic aims of the Group as well as approval of policies and matters which must be approved by the board under legislation and the Society's Rules. The board is also responsible for the recruitment and terms of employment of the General Management team, which is made up of the executive directors and other General Managers. Details of all the General Managers can be found on pages 16 and 17;
- other matters are delegated to the General Management team or to other specified members of staff or committees, including the board committees referred to on pages 33 to 35 and the Group Asset and Liability Committee;
- all directors have access to independent professional advice if required and have the benefit of appropriate liability insurance cover at the Society's expense; and
- the size and composition of the board is kept under review to ensure that there is adequate succession planning for executive and non-executive directors and that there are the optimum skills and experience represented on the board for the direction of the Group's activities.

Appointments to the board and re-elections

The appointment of new directors is considered by the Nominations Committee (see page 34), which makes recommendations to the board. All directors are subject to election by members at the Annual General Meeting (AGM) following their appointment. In addition, all directors must receive approval from the FSA as Approved Persons in order to fulfil their controlled function as a director.

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

At the 2010 AGM, members will be asked to re-elect non-executive directors Ed Anderson (Chairman), Lynne Charlesworth and David Paige. The board has confirmed that the performance of these directors continues to be effective and that they continue to show commitment to their role. In addition Iain Cornish, Chief Executive, will also be put forward for re-election at the AGM.

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

Chairman and Chief Executive

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose.

The Chairman is responsible for leadership of the board and for ensuring that the board acts effectively. The Chief Executive has overall responsibility for managing the Society and its subsidiaries and for implementing the strategies and policies agreed by the board.

Board balance and independence

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

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

Information and professional development

The Chairman ensures that the directors receive accurate, timely and clear information to enable the board to effectively carry out its responsibilities.

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

All directors have access to the advice and services of the Group Secretary who is responsible for ensuring that board procedures are complied with and for advising the board, through the Chairman, on governance matters.

Performance evaluation

The Group has a formal performance evaluation system for all members of staff including the executive directors. The Chief Executive appraises the executive directors on their performance and the Chairman undertakes an appraisal of the Chief Executive. These appraisals take into account the views of the non-executive directors on the performance of each executive director.

A performance evaluation system for non-executive directors, including the Chairman, is undertaken annually. In 2009 this took the format of an appraisal of each individual director by other members of the board and the General Management team through the completion of an anonymous questionnaire. The Chairman reviewed the output of all questionnaires and used these as a basis for an evaluation interview with each non-executive director which took place at the beginning of 2010. The Vice Chairman and Chief Executive undertook the evaluation interview for the Chairman. This procedure identifies any individual and board training requirements and provides the evidence to the board as to whether to recommend to members that a director should be re-elected.

In 2009 and early 2010 internal performance evaluations of the board, the Audit Committee, the Remuneration Committee and the Group Risk Committee were carried out in order to review the effectiveness of how the board and the board committees operate. The board evaluation was undertaken through the means of a questionnaire, which asked all directors and General Managers to appraise a range of factors relating to the make-up and operation of the board. The results were reviewed by the board and any appropriate improvement was identified for action. A similar process was undertaken for each of the committees referred to above.

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

The terms of reference of the committees are available on request from the Group Secretary or on the Society's website at www.ybs.co.uk/committees.

The Chairman of each committee reports to the subsequent board meeting on the matters discussed at each committee meeting. The minutes of each committee meeting are circulated to all directors.

Audit Committee
The members of the committee are:

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

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

The responsibilities of the committee are in line with the provisions of the Financial Reporting Council Guidance on Audit Committees (the "Smith Guidance"). The main function of the committee is to assist the board in fulfilling its oversight responsibilities, specifically the ongoing review, monitoring and assessment of:

- the integrity of the financial statements, any formal announcements relating to financial performance and significant financial reporting judgements contained in them;
- the effectiveness of the system of internal control processes;
- the internal and external audit processes;
- the Society's ethical and business standards;
- the appointment, re-appointment and removal of external auditors and the periodic review of their performance and independence; and
- the policy on the use of the external auditors for non-audit work.

During 2009 the committee met five times in the execution of its responsibilities and, in particular considered reports on the following matters which were provided by the independent Group Internal Audit function, the Group Finance function and the external auditors:

- the system of internal control;
- the integrity of financial statements;
- new accounting policies and application of existing policies;
- the activities of internal and external auditors;
- the effectiveness of the Group Internal Audit function;
- the performance of the external auditor; and
- the effectiveness of the committee.

The committee considers that it has met its responsibilities and performed its duties with appropriate levels of care and expertise during 2009.

During 2009, the Society decided to tender the external audit appointment to a number of firms, including the then existing auditor, KPMG Audit Plc (the previous tender for this service was undertaken in 2000). This tender had the objective of ensuring that the external audit offered the highest quality, continued to be fully independent, and offered an effective service for the Society.

The external audit tender process consisted of a formal evaluation for which a selection committee was established, which was led by the non-executive members of the Audit Committee. Following the provision of formal written submissions and an oral presentation, the committee evaluated the tenders against a number of predetermined criteria. The evaluation was undertaken without the presence of the chairman of the Audit Committee, who had previously been a partner in one of the tendering firms. As a result of the selection process, the board appointed Deloitte LLP as the external auditors.

A resolution to re-appoint Deloitte LLP will be put forward to the forthcoming AGM.

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

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

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

The committee is responsible for considering matters relating to the composition of the board, including nominating candidates for the position of non-executive director, taking into account the balance of skills, knowledge and experience on the board and making recommendations to the board as appropriate. It also reviews the succession planning for directors and other senior executives. Generally, vacancies for non-executive directors are advertised in national and local press and referred to on the Society's website to bring them to the attention of as many members as possible. In addition, an independent specialist agency is used to assist in the recruitment and search process.

Remuneration Committee
The members of the committee are:

Ed Anderson, Society Chairman
David Paige, non-executive director
Indira Thambiah, non-executive director (appointed 1st July 2009)
Simon Turner, non-executive director (committee Chairman from 1st January 2009)

The committee is responsible for considering and approving the remuneration of the executive directors and other General Managers as well as agreeing the remuneration policy for the whole organisation. Further details of the committee, the remuneration policy and directors' service contracts can be found in the Directors' Remuneration Report on pages 38 to 42.

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

Group Risk Committee
The members of the committee are:

Ed Anderson, Society Chairman
Andy Caton, Corporate Development Director
Lynne Charlesworth, non-executive director (committee Chairman from 1st July 2009)
Robin Churchouse, General Manager Risk and Planning
Iain Cornish, Chief Executive
Rachel Court, General Manager Human Resources and Customer Service
Richard Davey, Society Vice Chairman
Andrew Gosling, Finance Director
David Paige, non-executive director

Iain Cornish resigned as Chairman of the committee on 1st July 2009. Lynne Charlesworth, non-executive director, took over this role to ensure the committee has greater independence.

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

The committee's primary responsibilities are:

- establishing methods for measuring risk appetite and positions;
- recommending for board approval the Group risk management policies, standards and limits;
- monitoring on-going risk positions and issues, in particular for compliance with Group risk management policies, standards and limits;
- the annual review and approval of the Group's Basel II/ICAAP reviews and validations, on recommendation from the Group Capital Committee;
- reviewing the Group's current and proposed activities against its risk appetite and capital budgets;
- reviewing and approving the Group's compliance with the new liquidity regime;
- overseeing the due diligence process, including the scope, of major acquisitions; and
- establishing and monitoring appropriate sub-committees and associated governance structures.

The Group Risk Committee has established a number of sub-committees with day-to-day responsibility for risk management oversight. All of the sub-committees meet at least quarterly and are chaired by an executive director or a General Manager. At 31st December 2009 the sub-committees were as follows:

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

Further details of the Group's approach to risk management can be found in the Risk Management Report on pages 23 to 30.

System of internal controls

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

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

The Group Internal Audit function provided independent assurance to the board on the effectiveness of the internal control framework through the Audit Committee. The information received and considered by the committee provided reasonable assurance that during 2009 there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate internal control framework that met the principles of the Code and the supplementary Turnbull guidance.

Further details of actual risk management practices are provided in the Risk Management Report on pages 23 to 30.

Auditors

The Society has a policy on the use of the external auditor for non-audit work which is implemented by the Audit Committee. The purpose of this policy is to ensure the continued independence and objectivity of the external auditor. The external auditor, Deloitte LLP (and prior to their appointment, KPMG Audit Plc) undertook a number of non-audit related assignments for the Group during 2009. These were conducted within the limits set out in the policy and are considered to be consistent with the professional and ethical standards expected of the external auditor in this regard.

Deloitte LLP has received significant non-audit fees in 2009 since their appointment. These have principally related to the proposed merger with Chelsea Building Society, largely for due diligence services, tax structuring work and project management assistance for planning the integration of the businesses. The Audit Committee approved the appointment of Deloitte LLP for these roles, and it actively monitors the scope of services provided and the level of fees incurred. The committee would normally expect due diligence services to be provided by the external auditor. The appointment for project management assistance was made following a separate competitive tender process.

Relations with members

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

This feedback takes various forms, including member 'Question Time' meetings and 'Meet the Chief Executive' events which give members the opportunity to meet and ask questions of the Chief Executive, the senior management team and local branch staff. The Members' Forum is currently made up of 19 members who are drawn from a cross section of the Society's membership. It meets twice a year and the aim is to debate and obtain views on specific relevant issues.

The Society operates a Member Panel, consisting of more than 10,000 members, who are invited to complete surveys on a variety of topical issues. In addition, a monthly customer satisfaction survey is undertaken, the results of which are a key performance indicator, which is monitored by the board on a monthly basis.

AGM

At the AGM, the Chairman and Chief Executive give presentations on the previous financial year's performance and on future plans. The meeting also provides an opportunity for members to question the Chairman and Chief Executive on the resolutions to be proposed at the meeting and on any other aspect of the Society's business. All directors attend the AGM (unless their absence is unavoidable) including the chairmen of all of the board committees.

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

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

Forthcoming changes to Corporate Governance

The Financial Reporting Council has published a revised draft version of the Code which will come into effect in June 2010. This revised Code will implement some of the recommendations contained in the Walker Review on the corporate governance of banks and other financial institutions. During 2010 the board will have regard to any resulting changes to the Building Societies Association Guidance referred to above and implement any necessary changes which might arise out of the proposed governance code for building societies. Consideration will also be given to any changes arising out of the review of the Turnbull guidance on internal control and the good practice guidance from the Higgs Report on the roles of the chairman and non-executive directors, both of which are due to be completed in 2010.

Board and committee membership and attendance record 2009

Set out below are details of the directors during 2009 and their attendance record at board meetings and relevant board committee meetings in the year. The figure in brackets indicates the number of meetings that the director was eligible to attend during 2009.

	Board	Board Committees				
Director	Meetings	Audit	Chairman's	Nominations	Remuneration	Risk
Ed Anderson Chairman	14(14)	–	3(3)	1(1)	8(8)	5(5)
Ian Bullock Sales & Marketing Director	14(14)	–	–	–	–	–
Andy Caton Corporate Development Director	14(14)	–	–	–	–	5(5)
Lynne Charlesworth Non-executive director	13(14)	–	2(2)	–	–	5(5)
Iain Cornish Chief Executive	14(14)	–	1(3)	1(1)	–	5(5)
Richard Davey Vice Chairman	13(14)	5(5)	3(3)	1(1)	–	4(5)
Andrew Gosling Finance Director	14(14)	–	2(2)	–	–	4(5)
Philip Johnson Non-executive director	14(14)	5(5)	–	–	–	–
David Paige Non-executive director	14(14)	5(5)	–	–	8(8)	5(5)
Indira Thambiah Non-executive director	14(14)	–	–	–	4(4)	–
Simon Turner Non-executive director	11(14)	5(5)	–	–	8(8)	–

Notes:

In addition to the above, the board considered business on a further three occasions and the Chairman's Committee on a further six occasions using the written resolution procedure under the Society's Rules.

On behalf of the board

Ed Anderson
Chairman

24th February 2010

Directors' remuneration report

Introduction

This report:

- explains to members the policy for the remuneration of executive and non-executive directors;
- voluntarily addresses the statutory disclosure requirements for listed companies in relation to directors' remuneration that are considered relevant to a building society; and
- includes a table showing each director's remuneration for the year ended 31st December 2009.

A summary of this report will be sent to all members eligible to vote at the 2010 Annual General Meeting and members will have the opportunity to vote on the report.

Remuneration Committee

The committee is responsible for determining, on behalf of the board, the overall remuneration policy for all staff and, in particular, the policy and the level of remuneration of the executive directors and other senior managers. The full terms of reference of the committee can be found at www.ybs.co.uk/committees.

The committee normally meets four times a year with additional meetings if required. It takes independent external professional advice, as appropriate, and monitors comparative remuneration packages within the financial sector.

The committee is made up of four non-executive directors. In 2009, they were Ed Anderson (Chairman of the Society), David Paige, Indira Thambiah and Simon Turner (Chairman of the committee).

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

Remuneration policy for non-executive directors

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

A recommendation is made to the full board, which determines any change in the remuneration of non-executive directors, which takes effect from 1st July. Additional fees (details of which are given on page 41) are paid to those non-executive directors who undertake additional duties and responsibilities, including membership of certain board committees.

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

Remuneration policy for executive directors

The overall policy is that:

- the remuneration of executive directors should comply with the Financial Services Authority's (FSA) Rules on Remuneration Policy, with an appropriate balance being struck between performance and risk;
- the remuneration of executive directors (together with that of other General Managers) should be competitive with those of comparable organisations in the financial sector so as to attract and retain high calibre individuals with the relevant experience;
- a significant part of the remuneration of executive directors should be based on the Society's financial and service performance (including customer satisfaction) and individual performance using pre-determined targets to motivate and reward successful business and personal performance which is in the interests of current and future members;
- personal reviews of the executive directors are carried out at least annually to assess their performance in meeting individual and strategic objectives. These are reflected in pay reviews which take effect from 1st May each year; and
- no executive director should be involved in deciding his or her remuneration.

The various elements of the policy are set out below.

(a) Basic salary

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

The Chief Executive declined to receive any increase in basic salary during 2009. The increase in reported salary in 2009 compared with 2008 is due to the previous year's pay review being effective from May 2008.

The committee considers external data from independent national salary surveys of the financial sector and a comparator group of financial institutions to ensure salaries remain competitive. Independent reward specialists carry out an overall review of remuneration, generally once every three years. The last review was undertaken in 2007 by Hays Plc. The review concluded that the basic pay of the executive directors was in line with the market median position, but that overall packages including performance pay were lower than those offered by competitors, due to the absence of a long term incentive scheme. Hays Plc also undertakes recruitment consultancy services on behalf of the Group.

The next external review of executive directors' remuneration will be conducted during the course of 2010.

(b) Performance pay

In 2009 the executive directors participated in a non-pensionable performance incentive scheme, the elements of which reflected the Society's key measures of retail savings inflow, cost control, underlying profit and customer satisfaction. A scheme with similar characteristics is in place for all other staff. The scheme also contained threshold conditions regarding sustainable levels of capital and liquidity. In addition, executive directors (together with other senior managers) had an element of their performance pay based on the achievement of personal objectives.

These measures were all set to provide challenging objectives giving the executive directors an incentive to perform at the highest level in a manner consistent with the interests of members. There was no minimum amount of performance pay and the maximum amount, as a percentage of basic salary, was 50% for executive directors with 60% for the Chief Executive.

The Chief Executive has voluntarily waived his entitlement to the payment of any bonus for 2009. Bonuses have been paid to other executive directors, managers and staff in line with the underlying performance of measures in the scheme. We can confirm that bonuses for executive directors and those senior managers with a significant impact on the Society's risk profile meet with the requirements of the FSA's rules on remuneration policy.

The committee has reviewed the Society's performance pay schemes for executive directors in the light of the FSA's Rules on Remuneration Policy in Financial Services published in August 2009 referred to above. The review demonstrated that the Society's scheme already complied with best practice in key areas, following a number of changes made to the 2009 scheme last year. However, a number of further changes have been agreed for the 2010 scheme as follows:

- the introduction of deferral of a substantial proportion of the annual bonus over a three year period; and
- the linkage of the deferred payments to underlying profit and risk performance in future years.

The committee has previously agreed in principle to introduce a long-term incentive plan for executive directors and other General Managers in response to the last external review by Hays Plc. In the light of the introduction of deferral over a three year period into the annual scheme, however, the committee has decided not to proceed with the introduction of a separate long-term scheme at the present time. To address the gap in overall packages, it has agreed to increase the maximum payments in the deferred annual scheme from 2010 onwards to 65% of basic salary for executive directors and 90% for the Chief Executive.

The committee will continue to review the operation of the performance pay scheme for the executive directors in light of emerging best practice and to take into account the performance of the Society as a whole and the interests of members.

(c) Benefits

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

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

The executive directors are either members of the contributory defined benefit section or the defined contribution section of the Society's pension scheme. The defined benefit section of the scheme is currently designed to provide a pension of up to two-thirds of final pensionable salary on retirement (based on the number of years' service). With effect from 1st April 2010, in keeping with changes being made to the defined benefit section of the Society's pension scheme for all staff, future accrual for participating executive directors will be on a career average revalued earnings basis rather than a final salary basis. The pension scheme also provides for dependents' pensions and a lump sum of four times basic salary on death in service.

With effect from 1st January 2010, the Chief Executive has voluntarily ended his membership of the defined benefit section of the Society's pension scheme, and has transferred to the defined contribution section for future benefit accrual.

Service contracts

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

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

Executive directors' remuneration

	Salary £000	Performance pay £000	Taxable benefits £000	Increase in accrued pension £000	Society's contribution to pension scheme* £000	Total £000
Executive directors						
2009						
Ian Bullock	**221**	**56**	**11**	**–**	**35**	**323**
Andy Caton	**230**	**46**	**–**	**6**	**–**	**282**
Iain Cornish	**327**	**–**	**15**	**13**	**–**	**355**
Andrew Gosling	**250**	**51**	**–**	**10**	**–**	**311**
	1,028	**153**	**26**	**29**	**35**	**1,271**
2008						
Ian Bullock	215	–	11	–	34	260
Andy Caton	224	–	–	10	–	234
Iain Cornish	323	–	15	19	–	357
Andrew Gosling	244	–	–	9	–	253
	1,006	–	26	38	34	1,104

*Defined contribution section.

The increase in accrued pension represents the change in the annual pension to which each director is entitled as a result of changes in pensionable earnings (excluding inflation) and increases in pensionable service during the year. For Andy Caton, Iain Cornish and Andrew Gosling, the value of executive directors' pension benefits includes those arising from unfunded arrangements.

Executive directors' pension benefits (defined benefit section) in 2009

	Contributions from directors £000	Increase in accrued pension £000	Accrued pension as at 31st December 2009 £000	Transfer value of accrued benefits as at 1st January 2009 £000	Transfer value of accrued benefits as at 31st December 2009 £000	Movement in transfer value less directors' contributions £000
Andy Caton	**18**	**6**	**80**	**902**	**1,081**	**161**
Iain Cornish	**26**	**13**	**190**	**2,399**	**2,820**	**395**
Andrew Gosling	**19**	**10**	**70**	**1,032**	**1,392**	**341**
	63	**29**	**340**	**4,333**	**5,293**	**897**

Ian Bullock is a member of the defined contribution section of the pension scheme and therefore he is not included in the above table.

Non-executive directors' fees

	Fees		Committee fees (notes 1 and 2)		Total	
	2009 £000	2008 £000	**2009 £000**	2008 £000	**2009 £000**	2008 £000
Ed Anderson (Chairman)	**77**	75	**9**	9	**86**	84
Julie Baddeley (retired 31.12.08)	**–**	36	**–**	10	**–**	46
Lynne Charlesworth	**37**	36	**16**	6	**53**	42
Richard Davey (Vice Chairman)	**50**	49	**12**	11	**62**	60
Philip Johnson	**37**	36	**14**	13	**51**	49
David Paige	**37**	36	**16**	11	**53**	47
Indira Thambiah (appointed 01.05.08)	**37**	27	**2**	–	**39**	27
Simon Turner	**37**	36	**12**	9	**49**	45
	312	331	**81**	69	**393**	400

Details of the committee fees paid to non-executive directors are set out in the notes on page 42.

Notes:

1. 2009 committee fees for non-executive directors consist of:
    - member of the Audit Committee – £6,000 per annum;
    - member of the Group Risk Committee – £6,000 per annum;
    - member of the Remuneration Committee – £3,500 per annum;
    - Chair of the Audit Committee – £13,500 per annum;
    - Chair of the Group Risk Committee – £13,500 per annum;
    - Chair of the Remuneration Committee – £6,000 per annum (£5,000 per annum up to 30th June 2009); and
    - 'Treating Customers Fairly' oversight role – £6,000 per annum (£5,000 per annum up to 30th June 2009).
2. Membership of these committees is set out in the Corporate Governance Report on pages 31 to 37. Significant changes in 2009 were:
    - Lynne Charlesworth took over the 'Treating Customers Fairly' oversight role from 1st January 2009 and became Chair of the Risk Committee from 1st July 2009.
    - David Paige became a member of the Remuneration Committee from 1st January 2009.
    - Indira Thambiah became a member of the Remuneration Committee from 1st July 2009.
    - Simon Turner became Chair of the Remuneration Committee from 1st January 2009.

On behalf of the board

Simon Turner
Chairman of the Remuneration Committee

24th February 2010

Statement of directors' responsibilities

The following statement, which should be read in conjunction with the statement of the Auditors' responsibilities on page 44, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report.

The directors are required by the Building Societies Act 1986 (the Act) to prepare, for each financial year, annual accounts which give a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of the affairs of the Society and the Group as at the end of the financial year and which provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it.

The Act states that references to International Financial Reporting Standards (IFRS) accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing these annual accounts, the directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether the Annual Accounts have been prepared in accordance with IFRS; and
- prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

In addition to the Annual Accounts, the Act requires the directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Society and its subsidiary undertakings.

Directors' Responsibilities for Accounting Records and Internal Control
The directors are responsible for ensuring that the Society and its subsidiary undertakings:

- keep accounting records in accordance with the Building Societies Act 1986; and
- take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000.

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

On behalf of the board

Ed Anderson
Chairman

24th February 2010

Independent auditors' report

to the members of Yorkshire Building Society

We have audited the financial statements of Yorkshire Building Society for the year ended 31 December 2009 which comprise the Group and Society Income Statements, the Group and Society Statements of Financial Position, the Group and Society Statements of Comprehensive Income, the Group and Society Statements of Cash Flows, the Group and Society Statements of Changes in Members' Interests and the related notes 1 to 44. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

We have examined the Annual Business Statement (other than details of directors and officers upon which we are not required to report) and the Directors' Report.

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 auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report including the Directors' Report, the Annual Business Statement, and the Annual Accounts in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Annual Accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). We are also responsible for examining the Annual Business Statement (other than the details of Directors and officers) and for reading the information in the Directors' Report and assessing whether it is consistent with the accounting records and the Annual Accounts.

We report to you our opinion as to whether the Annual Accounts give a true and fair view and whether the Annual Accounts are properly prepared in accordance with the Building Societies Act 1986, regulations made under it and, as regards the Group Annual Accounts, Article 4 of the IAS Regulation. In addition, we report to you our opinion as to whether certain information in the Annual Business Statement gives a true representation of the matters in respect of which it is given, whether the information in the Directors' Report is consistent with the accounting records and the Annual Accounts and whether 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 made under it. The information given in the Directors' Report includes that specific information given in the Chief Executive's Review that is cross referred from the Business Review section of the Directors' Report. We also report to you if, in our opinion, the Society has not kept proper accounting records or if we have not received all the information and explanations that we require for our audit.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited Annual Accounts. The other information comprises only the Chairman's Statement, Chief Executive's Review, Corporate Governance Report and the Directors' Remuneration Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Annual Accounts, Annual Business Statement and Directors' Report. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Annual Accounts and the Annual Business Statement. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the Annual Accounts, and of whether the accounting policies are appropriate to the Group's and Society's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Annual Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Annual Accounts.

Opinion

In our opinion:

(a) the Annual Accounts give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of affairs of the Group and of the Society as at 31st December 2009 and of the income and expenditure of the Group and of the Society for the year then ended;

(b) 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;

(c) the information given in the Directors' Report is consistent with the accounting records and the Annual Accounts; and

(d) the Annual Accounts, the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986, regulations made under it and, as regards the Group Annual Accounts, Article 4 of the IAS Regulation.

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

24th February 2010

Income statements

for the year ended 31st December 2009

	NOTES	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 Restated* £m
Interest receivable and similar income	3	**1,050.8**	1,229.1	**993.1**	1,255.5
Interest payable and similar charges	4	**(903.0)**	(1,064.6)	**(958.8)**	(1,175.5)
Net interest income		**147.8**	164.5	**34.3**	80.0
Fees and commissions receivable		**33.9**	32.1	**31.2**	28.9
Fees and commissions payable		**(7.8)**	(5.4)	**(7.7)**	(4.7)
Net fee and commission income		**26.1**	26.7	**23.5**	24.2
Income from investments in subsidiaries	10	**–**	–	**133.0**	3.5
Net (losses)/gains from fair value volatility on financial instruments	5	**(10.3)**	(28.8)	**3.9**	(41.6)
Net realised profits/(losses)	6	**11.5**	(1.0)	**10.8**	(0.9)
Other operating income		**4.6**	4.8	**16.8**	18.2
Total income		**179.7**	166.2	**222.3**	83.4
Administrative expenses	7	**(113.7)**	(113.1)	**(113.1)**	(112.5)
Chelsea Building Society merger costs		**(6.7)**	–	**(6.7)**	–
Depreciation and amortisation		**(10.6)**	(9.3)	**(10.0)**	(8.2)
Operating profit/(loss) before provisions		**48.7**	43.8	**92.5**	(37.3)
Impairment of loans and advances to customers	9	**(59.0)**	(25.0)	**(7.0)**	0.9
Impairment of debt securities	9	**(0.9)**	–	**(0.9)**	–
Provisions	27	**1.4**	1.0	**1.4**	0.9
Operating (loss)/profit before exceptional provisions		**(9.8)**	19.8	**86.0**	(35.5)
Financial Services Compensation Scheme levy	27	**(2.7)**	(14.7)	**(2.7)**	(14.7)
Operating (loss)/profit		**(12.5)**	5.1	**83.3**	(50.2)
Negative goodwill	42	**–**	3.2	**–**	3.2
(Loss)/profit before tax		**(12.5)**	8.3	**83.3**	(47.0)
Tax credit/(expense)	11	**9.2**	0.5	**(16.6)**	13.8
Net (loss)/profit		**(3.3)**	8.8	**66.7**	(33.2)

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

* The treatment of certain covered bond transactions has been changed, see note 44.

The notes on pages 52 to 96 form part of these accounts.

Statements of comprehensive income

for the year ended 31st December 2009

		Group		Society	
		2009	2008	**2009**	2008 Restated*
	NOTES	**£m**	£m	**£m**	£m
Available for sale investments:					
Valuation gains/(losses) taken to equity		**46.9**	(63.4)	**46.7**	(66.8)
Amounts transferred to income statement		**(3.0)**	6.1	**(0.4)**	6.1
Cash flow hedges:					
Gains/(losses) taken to equity		**3.5**	(34.7)	**3.5**	(34.7)
Amounts transferred to income statement		**(9.9)**	1.1	**(9.9)**	1.1
Actuarial (loss)/gain on retirement benefit obligations	25	**(50.4)**	17.8	**(50.4)**	17.8
Tax on items taken directly to or transferred from equity	11	**6.7**	11.1	**6.1**	12.1
Net expense not recognised directly in the income statement		**(6.2)**	(62.0)	**(4.4)**	(64.4)
Net (loss)/profit		**(3.3)**	8.8	**66.7**	(33.2)
Total comprehensive (losses)/income for the year		**(9.5)**	(53.2)	**62.3**	(97.6)

* The treatment of certain covered bond transactions has been changed, see note 44.

The notes on pages 52 to 96 form part of these accounts.

Group statement of financial position

as at 31st December 2009

ASSETS	NOTES	**2009 £m**	2008 £m
Liquid assets			
Cash in hand and balances with the Bank of England	12	**1,149.8**	291.9
Loans and advances to credit institutions	13	**988.4**	542.0
Debt securities	14	**4,562.2**	4,493.8
Loans and advances to customers			
Loans secured on residential property	15	**14,975.4**	16,287.2
Other loans	15	**4.0**	4.6
Derivative financial instruments	33	**904.5**	1,226.7
Investments	10	**2.1**	2.1
Intangible assets	16	**10.6**	8.6
Investment properties	17	**6.7**	7.2
Property, plant and equipment	18	**80.6**	82.7
Deferred tax assets	19	**30.2**	41.6
Retirement benefit surplus	25	**–**	30.7
Other assets	20	**7.5**	12.7
Total assets		**22,722.0**	23,031.8
LIABILITIES			
Shares	21	**13,793.4**	13,683.1
Amounts owed to credit institutions	22	**393.4**	1,090.5
Other deposits	23	**1,091.0**	1,762.0
Debt securities in issue	24	**5,698.7**	4,477.1
Derivative financial instruments	33	**468.1**	672.2
Current tax liabilities		**34.5**	16.7
Deferred tax liabilities	19	**4.8**	63.2
Retirement benefit obligations	25	**4.3**	1.9
Other liabilities	26	**50.4**	58.6
Provisions	27	**12.6**	17.1
Subordinated liabilities	28	**111.7**	112.9
Subscribed capital	29	**159.3**	167.2
		21,822.2	22,122.5
Total equity attributable to members		**899.8**	909.3
Total liabilities		**22,722.0**	23,031.8

The accounts on pages 46 to 96 were approved by the board of directors on 24th February 2010 and were signed on its behalf by:

Ed Anderson — Chairman
Richard Davey — Vice Chairman
Iain Cornish — Chief Executive

The notes on pages 52 to 96 form part of these accounts.

Society statement of financial position

as at 31st December 2009

ASSETS	NOTES	**2009** **£m**	2008 Restated* £m	2007 Restated* £m
Liquid assets				
Cash in hand and balances with the Bank of England	12	**1,149.8**	291.9	434.9
Loans and advances to credit institutions	13	**570.3**	486.9	732.2
Debt securities	14	**4,454.4**	4,149.3	3,184.5
Loans and advances to customers				
Loans secured on residential property	15	**8,840.3**	9,765.4	9,324.5
Other loans	15	**4.0**	4.6	4.2
Derivative financial instruments	33	**149.3**	264.2	120.9
Investments	10	**9,876.3**	10,607.0	8,431.2
Intangible assets	16	**10.2**	8.1	7.5
Investment properties	17	**6.5**	7.0	6.0
Property, plant and equipment	18	**62.1**	63.7	60.3
Deferred tax assets	19	**30.2**	39.2	4.0
Retirement benefit surplus	25	**–**	30.7	8.0
Other assets	20	**40.3**	37.0	19.8
Total assets		**25,193.7**	25,755.0	22,338.0
LIABILITIES				
Shares	21	**13,793.4**	13,683.1	12,448.2
Amounts owed to credit institutions	22	**866.0**	1,830.6	1,410.0
Other deposits	23	**3,239.9**	4,005.3	3,303.1
Debt securities in issue	24	**5,698.7**	4,477.1	3,967.4
Derivative financial instruments	33	**468.1**	672.2	94.0
Current tax liabilities		**23.9**	11.3	10.6
Deferred tax liabilities	19	**3.5**	22.0	7.7
Retirement benefit obligations	25	**4.3**	1.9	–
Other liabilities	26	**48.5**	52.8	51.3
Provisions	27	**12.5**	17.0	4.3
Subordinated liabilities	28	**111.7**	112.9	105.0
Subscribed capital	29	**159.3**	167.2	146.0
		24,429.8	25,053.4	21,547.6
Total equity attributable to members		**763.9**	701.6	790.4
Total liabilities		**25,193.7**	25,755.0	22,338.0

* The treatment of certain covered bond transactions has been changed, see note 44.

The accounts on pages 46 to 96 were approved by the board of directors on 24th February 2010 and were signed on its behalf by:

Ed Anderson	Chairman
Richard Davey	Vice Chairman
Iain Cornish	Chief Executive

The notes on pages 52 to 96 form part of these accounts.

Statements of changes in members' interest

as at 31st December 2009

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Group				
At 1st January 2009	**1,042.3**	**(43.6)**	**(89.4)**	**909.3**
Reallocation of tax*	**(27.2)**	**–**	**27.2**	**–**
Current year movement net of tax	**(39.5)**	**7.6**	**22.4**	**(9.5)**
At 31st December 2009	**975.6**	**(36.0)**	**(39.8)**	**899.8**
At 1st January 2008	995.8	(10.0)	(32.1)	953.7
Transfer of engagements**	8.8	–	–	8.8
Current year movement net of tax	37.7	(33.6)	(57.3)	(53.2)
At 31st December 2008	1,042.3	(43.6)	(89.4)	909.3

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Society				
At 1st January 2009 restated***	**837.0**	**(43.6)**	**(91.8)**	**701.6**
Reallocation of tax*	**(27.8)**	**–**	**27.8**	**–**
Current year movement net of tax	**30.6**	**7.6**	**24.1**	**62.3**
At 31st December 2009	**839.8**	**(36.0)**	**(39.9)**	**763.9**
At 1st January 2008 restated***	831.5	(10.0)	(31.1)	790.4
Transfer of engagements**	8.8	–	–	8.8
Current year movement net of tax	(3.3)	(33.6)	(60.7)	(97.6)
At 31st December 2008 restated***	837.0	(43.6)	(91.8)	701.6

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

** Merger with Barnsley Building Society, see note 42.

*** The treatment of certain covered bond transactions has been changed, see note 44.

The Hedging reserve relates to fair value adjustments on derivative financial instruments designated as cash flow hedges. It is expected that the forecast transactions will largely occur over the next five years and the amount deferred will be recognised over this period.

The notes on pages 52 to 96 form part of these accounts.

Statements of cash flows

for the year ended 31st December 2009

	NOTES	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 Restated* £m
Cash flows from operating activities:					
(Loss)/profit before tax		**(12.5)**	8.3	**83.3**	(47.0)
Working capital adjustments	41	**46.2**	59.9	**(10.5)**	42.3
Net decrease/(increase) in operating assets	41	**1,050.4**	33.9	**1,239.1**	(864.9)
Net (decrease)/increase in operating liabilities	41	**(1,257.8)**	1,059.5	**(1,619.7)**	2,002.7
Net cash flows from operating activities		**(173.7)**	1,161.6	**(307.8)**	1,133.1
Cash flows from investing activities:					
Cash acquired on transfer of engagements		**–**	0.5	**–**	0.5
Purchase of property, plant and equipment and intangible assets		**(10.8)**	(10.3)	**(10.6)**	(10.1)
Proceeds from sale of property, plant and equipment		**–**	0.4	**–**	0.4
Purchase of debt securities		**(10,293.7)**	(10,985.7)	**(9,777.2)**	(10,598.1)
Proceeds from sale and redemption of debt securities		**9,807.8**	9,774.7	**9,040.3**	9,348.0
Net cash flows from investing activities		**(496.7)**	(1,220.4)	**(747.5)**	(1,259.3)
Cash flows from financing activities:					
Redemption of securities		**(1,425.2)**	(1,439.1)	**(1,425.2)**	(1,439.1)
Issue of securities		**2,961.5**	936.2	**2,961.5**	936.2
Interest paid on subordinated liabilities and subscribed capital		**(16.2)**	(16.2)	**(16.2)**	(16.2)
Net cash flows from financing activities		**1,520.1**	(519.1)	**1,520.1**	(519.1)
Taxation (paid)/refunded		**(13.3)**	4.0	**(7.5)**	6.2
Net increase/(decrease) in cash and cash equivalents		**836.4**	(573.9)	**457.3**	(639.1)
Opening balance		**1,387.2**	1,961.1	**1,249.0**	1,888.1
Total closing cash and cash equivalents		**2,223.6**	1,387.2	**1,706.3**	1,249.0
Cash and cash equivalents:					
Cash and balances with central banks		**1,132.0**	270.0	**1,132.0**	270.0
Loans and advances to banks		**988.4**	542.0	**570.3**	486.9
Debt securities		**103.2**	575.2	**4.0**	492.1
		2,223.6	1,387.2	**1,706.3**	1,249.0

The statement of cash flows has been prepared in compliance with 'IAS 7 Statement of Cash Flows' and has been presented under the indirect method.

For the purposes of the statements of cash flows, cash and cash equivalents comprises cash and other financial instruments with original maturities of less than three months.

* The treatment of certain covered bond transactions has been changed, see note 44.

The notes on pages 52 to 96 form part of these accounts.

INTRODUCTION

Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) in issue that have been endorsed by the EU and are effective at 31st December 2009 and with those parts of the Building Societies Act 1986 and the Building Societies (Accounts and Related Provisions) Regulations applicable to societies reporting under IFRS.

The financial statements have been prepared on the historical cost basis, as modified by the revaluation of available for sale financial assets, derivative contracts and financial assets held at fair value through the income statement.

The financial statements have been prepared on the going concern basis. This is discussed in the Directors' Report on page 18, under the heading, 'Principal risks, uncertainties and going concern'.

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

Accounting Developments

The following Accounting Standard amendments have been applied in 2009:

- 'IFRS 3 Business Combinations (Revised)' was endorsed by the EU in 2009. Its principles and methodology were applied when accounting for the transfer of engagements of Barnsley Building Society in 2008;
- 'IFRS 8 Operating Segments' replaces 'IAS 14 Segmental Reporting'. However, its application does not have any impact upon the financial results of the Group as it does not change the recognition or measurement of transactions in the consolidated financial statements. The standard aligns the disclosure of operating segments in the financial statements with the internal reporting of segments to senior management;
- amendments to 'IAS 1 Presentation of Financial Statements: A Revised Presentation' affect the presentation of owner changes in equity, of comprehensive income and of restatement of financial position;
- amendments to 'IAS 23 Borrowing Costs' are applicable to borrowing costs related to qualifying assets. The application of this revised standard has not had a material impact on the financial statements;
- amendments to 'IAS 39 Financial Instruments: Recognition and Measurement: Eligible Hedged Items' clarify what can be designated as a hedged item in a hedge accounting relationship. This amendment has not had any impact on the Group's ability to achieve hedge accounting; and
- amendments to 'IAS 39 Reclassification of Financial Assets: Effective Date and Transition' clarify the effective date and transition requirements for the change to the standard issued in October 2008 which permits entities to reclassify non-derivative financial assets out of the fair value through income statement category in particular circumstances. The Group has not utilised any of the reclassification options available in this amendment.

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

- amendments to 'IFRS 7 Financial Instruments Disclosures' extend the scope of IFRS 7 disclosures but does not change the recognition or measurement of transactions in the financial statements; and
- amendments to IFRIC 9 and IAS 39 relating to the timing of recognition of embedded derivatives are not expected to have a material impact on the financial statements.

The following Standard is neither adopted by the European Union nor effective for the 2009 year end:

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

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The Group financial statements consolidate the financial statements of the Society and its subsidiary undertakings. Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Inter-company transactions and balances are eliminated upon consolidation.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

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

Derivative financial instruments and hedge accounting

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

Embedded derivatives
Certain derivatives are embedded in other financial instruments. These are treated as separate derivatives where the economic characteristics and risks are not closely related to the host instrument and the host instrument is not measured at fair value. These embedded derivatives are measured at fair value with movements in value being recognised in the income statement. Where the Group is unable to value separately the embedded derivative the entire instrument is measured at fair value with changes in value being taken to the income statement.

Hedging
All derivatives entered into by the Group are for the purposes of providing an economic hedge. Full details of hedging strategies are contained in Note 33. Hedge accounting is an optional treatment but the specific rules and conditions in IAS 39 have to be complied with before it can be applied. The Group has classified the majority of its derivatives as fair value and cash flow hedges in order to reduce volatility in the income statement.

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

Cash flow hedges
Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity and recycled to the income statement over the life of the forecasted transaction. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the income statement immediately. If the forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss recognised in equity is then recognised immediately in the income statement.

Impairment losses on loans and advances to customers
At each statement of financial position date the Group assesses whether or not there is objective evidence that individual financial assets (or groups of financial assets with similar credit characteristics) are impaired. In determining whether an impairment loss should be recognised, the Group makes judgements as to whether there is any evidence indicating a measurable decrease in the present value of cash flows expected from a financial asset or group of financial assets, resulting from an event (or events) that have occurred after initial recognition of the asset, but before the statement of financial position date.

Individual assessments are made of all loans and advances on properties which are in possession, or in arrears by two months or more. All other loans and advances are grouped according to their credit characteristics, and a collective review undertaken of any evidence of impairment. Future cash flows are estimated on grouped credit characteristics in all cases.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

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

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

In some cases a significant adverse change in one of the above factors will cause the Group to determine that there is objective evidence of impairment. In other cases it may not be possible to identify a single event that identifies impairment. The Group may additionally determine that there is impairment where there are a number of factors contributing to that view.

Where the Group determines that there is objective evidence of impairment or that trigger events exist at the statement of financial position date, then, in the case of available for sale instruments, the cumulative loss that had been recognised directly in reserves is removed from reserves and recognised in the income statement. In the case of held to maturity instruments an appropriate charge is made to the income statement.

If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be related to an event occurring after the impairment loss was recognised through the income statement, the impairment loss shall be reversed, with the amount of the reversal recognised through the income statement.

Business combinations between mutual organisations
Identifiable assets and liabilities are measured at fair value. Intangible assets are amortised through the income statement over their estimated useful lives, being between three and five years.

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

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

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

Financial assets
The Group classifies its financial assets into the following categories:

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

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

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Held to maturity

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

Available for sale financial assets

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

Financial liabilities

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

Joint ventures

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

Investment properties, property, plant and equipment

Investment properties

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

Property, plant and equipment

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

Subsequent costs

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

Depreciation

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

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

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

Intangible assets

Computer Software

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

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Employee benefits – Pension obligations

Defined contribution plans
Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

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

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

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

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

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

The following temporary differences are not provided for:

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

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

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

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

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

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

Pensions

The Group operates a defined benefit pension scheme. Significant judgements (on areas such as future interest and inflation rates, membership levels and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme, and hence of its net surplus/deficit. These are outlined in Note 25. The impact of a 0.1% increase in the rate used to discount the future value of the liabilities would be to reduce the present value of the liabilities by £6.7 million. The impact of a one year increase in each of the quoted life expectancies at age 60 would be to increase the present value of the liabilities by £8.7 million.

Effective interest rate

IAS 39 requires that all of the cash flows directly associated with financial instruments held at amortised cost must be recognised in the income statement through the interest margin using the effective interest rate method. When this approach is applied to a mortgage portfolio, judgements must be made to estimate the average life of that portfolio. These judgements are applied to segments of the mortgage portfolio, taking into account factors including the terms of the particular products, historic repayment data and economic conditions. These estimates are updated in each reporting period to reflect the portfolio's actual performance. The most critical estimate is that for Early Redemption Charges (ERCs) where the Group has experienced volatility in cash receipts. Towards the end of 2008 the Group was experiencing a downward trend of cash receipts and management expected this trend to continue into 2009. During 2009 the Group experienced an unexpected increase in ERCs. It is recognised that volatility in ERCs will have an impact on the effective interest rate.

Impairment of mortgage assets

The creation of impairment provisions for a portfolio of mortgage loans is inherently uncertain and requires the exercise of a significant degree of judgement. Provisions are calculated using historic default and loss experience but require judgement to be exercised in predicting future economic conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time before impairments are identified (emergence period). The most critical estimate is of the future level of house prices where a variance of 10% equates to £14.3 million of provision. Other sensitivities include the emergence period, where a variance of three months equates to £2.4 million, and the loss given default rate, where a 10% variance equates to £5.0 million of provision.

Debt securities

In current illiquid market conditions there is not a reliable market price for certain securities. In such instances models are used to estimate the fair value. These models use externally verifiable factors such as asset credit ratings, credit spreads, defaults in underlying instruments and credit enhancement or subordination factors.

Financial Services Compensation Scheme (FSCS)

The amount provided is the latest estimate of the contribution required for the 24 months to 31st March 2011 as advised by the FSCS. The Society is aware that further fees and exit fees are likely but has not made any provision for them as they cannot be reliably estimated. More detail of the FSCS and the Society's provision are contained in Note 27.

3. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group		Society	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
On assets held at amortised cost				
Loans fully secured on residential property	**802.1**	870.4	**426.0**	482.8
Connected undertakings	**–**	–	**400.3**	462.0
Other loans	**0.3**	0.3	**0.3**	0.3
Other liquid assets/cash and short-term funds	**5.9**	31.8	**5.7**	28.8
On available for sale securities	**68.4**	187.4	**62.8**	169.0
On held to maturity securities	**12.5**	38.1	**12.5**	38.1
On financial instruments held at fair value through the income statement				
Derivatives	**159.3**	95.8	**83.2**	69.2
Other assets	**2.3**	5.3	**2.3**	5.3
Total interest receivable	**1,050.8**	1,229.1	**993.1**	1,255.5

4. INTEREST PAYABLE AND SIMILAR CHARGES

	Group 2009	Group 2008	Society 2009	Society 2008 Restated*
	£m	£m	£m	£m
On liabilities held at amortised cost				
Shares held by individuals	**346.6**	606.2	**346.6**	606.2
Deposits from banks	**5.1**	41.4	**5.1**	41.4
Deposits from other financial institutions	**5.0**	23.1	**5.0**	23.1
Deposits from connected undertakings	**–**	–	**27.1**	74.1
Other deposits	**34.2**	94.3	**11.4**	40.1
Certificates of deposit	**7.1**	27.2	**7.1**	27.2
Other debt securities	**152.9**	157.9	**152.9**	157.9
Subordinated liabilities	**7.6**	7.6	**7.6**	7.6
Subscribed capital	**8.6**	8.6	**8.6**	8.6
Other interest payable	**0.8**	0.9	**0.7**	0.9
On financial instruments held at fair value through the income statement				
Deposits from connected undertakings	**–**	–	**51.6**	127.3
Derivatives	**335.1**	97.4	**335.1**	61.1
Total interest payable	**903.0**	1,064.6	**958.8**	1,175.5

* The treatment of certain covered bond transactions has been changed, see Note 44.

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

	Group 2009	Group 2008	Society 2009	Society 2008 Restated*
	£m	£m	£m	£m
Assets held at fair value	**3.3**	(29.9)	**3.3**	(29.4)
Embedded derivatives	**4.5**	(37.2)	**4.5**	(37.2)
Derivatives and hedging	**(18.1)**	38.3	**(3.9)**	25.0
Net (losses)/gains from fair value volatility on financial instruments	**(10.3)**	(28.8)	**3.9**	(41.6)

* The treatment of certain covered bond transactions has been changed, see Note 44.

Assets held at fair value relate to structured assets containing profit participation features that meet the definition of embedded derivatives. The Society is unable to separate the value of the embedded derivative from the host item and so has to treat the whole asset as held at fair value through the income statement in accordance with 'IAS 39 Financial Instruments: Recognition and Measurement'.

The embedded derivative category relates to synthetic features contained in certain structured investments which can be valued separately from the host instruments.

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

6. NET REALISED PROFITS/(LOSSES)

Net profits/(losses) on debt securities

	Group 2009	Group 2008	Society 2009	Society 2008
	£m	£m	£m	£m
Collateralised debt obligations	**–**	(7.0)	**–**	(7.0)
Other debt securities	**11.5**	4.0	**10.8**	4.1
	11.5	(3.0)	**10.8**	(2.9)
Profits on debt repurchase	**–**	2.0	**–**	2.0
	11.5	(1.0)	**10.8**	(0.9)

7. ADMINISTRATIVE EXPENSES

	Group		Society	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Staff costs				
Salaries and wages	**62.5**	60.4	**61.8**	59.7
Social security costs	**5.9**	5.8	**5.8**	5.7
Pension costs – defined benefit plans (see Note 25)	**3.6**	3.5	**3.6**	3.5
Other post retirement benefits	**2.2**	2.0	**2.1**	1.9
Operating lease rentals	**5.0**	4.4	**7.4**	6.8
Other expenses	**34.5**	37.0	**32.4**	34.9
	113.7	113.1	**113.1**	112.5

"Staff costs" includes a total of £79,000 that has been provided for bonus payments tax in relation to the 2009 performance related pay of three directors and three other employees.

The Society "Operating lease rentals" category above, contains rental payments paid by the Society to subsidiary companies in the Group which own properties and equipment.

Remuneration of auditors and their associates	Group		Society	
	2009	2008	**2009**	2008
	£000	£000	**£000**	£000
KPMG Audit plc prior to their resignation				
Audit	**21**	185	**21**	139
Other related services	**–**	17	**–**	17
Tax advice	**44**	53	**44**	49
Information technology	**–**	49	**–**	24
Internal audit	**–**	7	**–**	7
Advisory	**96**	85	**96**	85
All other services	**9**	33	**9**	33
Deloitte LLP from the date of appointment				
Audit	**162**	–	**115**	–
Information technology	**26**	–	**–**	–
Advisory	**1,011**	–	**1,011**	–
All other services	**25**	–	**20**	–
	1,394	429	**1,316**	354

The above figures, relating to auditors' remuneration, exclude value added tax. Deloitte LLP also earned £28,000 in 2009, prior to their appointment as auditors.

Staff numbers

The average number of persons employed by the Group during the year (including executive directors) was as follows:	2009		2008	
	Full time	**Part time**	Full time	Part time
Building Society				
Central administration	**1,086**	**295**	1,100	273
Branches	**710**	**272**	730	245
Subsidiaries' offices	**15**	**1**	16	1
	1,811	**568**	1,846	519

8. REMUNERATION OF AND TRANSACTIONS WITH DIRECTORS

Total directors' remuneration amounted to £1,664,000 (2008 – £1,504,000).

Full details of directors' remuneration, bonuses and pensions are given in the Directors' Remuneration Report on pages 38 to 42. In addition, past directors' pensions in respect of services as directors (closed scheme) amounted to £41,000 (2008 – £40,000).

None of the directors had an interest in shares in, or debentures of, any associated body of the Society at any time during the financial year. Details of transactions with directors and loans held by directors and connected persons are disclosed in Note 40.

A register is maintained at the Head Office of the Society, containing details of loans, transactions and arrangements between the Society and its directors and connected persons. A statement of the appropriate details for 2009 will be available for inspection at the Head Office for a period of fifteen days up to and including the Annual General Meeting.

9. IMPAIRMENT

Loans and advances to customers	**Group**		**Society**	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
At 1st January				
Collective	**5.8**	8.8	**0.2**	0.9
Individual	**35.6**	10.0	**0.5**	0.7
	41.4	18.8	**0.7**	1.6
Amounts written off during the year				
Collective	**(0.1)**	–	**–**	–
Individual	**(49.6)**	(2.5)	**(5.5)**	(0.1)
	(49.7)	(2.5)	**(5.5)**	(0.1)
Impairment adjustment for the year				
Collective	**(2.0)**	(3.0)	**(0.1)**	(0.7)
Individual	**61.0**	28.1	**7.1**	(0.1)
	59.0	25.1	**7.0**	(0.8)
At 31st December				
Collective	**3.7**	5.8	**0.1**	0.2
Individual	**47.0**	35.6	**2.1**	0.5
	50.7	41.4	**2.2**	0.7
The charge for the year comprises:				
Impairment adjustment for loans and advances	**59.0**	25.1	**7.0**	(0.8)
Recoveries relating to amounts previously written off loans and advances	**–**	(0.1)	**–**	(0.1)
Net provision charge/(credit) for the year	**59.0**	25.0	**7.0**	(0.9)

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

Debt Securities	**Group**		**Society**	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
At 1st January	**6.9**	6.9	**6.9**	6.9
Impairment adjustment for the year	**0.9**	–	**0.9**	–
At 31st December	**7.8**	6.9	**7.8**	6.9

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

10. INVESTMENTS

	Group		Society	
	2009	2008	**2009**	2008 Restated*
	£m	£m	**£m**	£m
Equities	**2.0**	2.0	**2.0**	2.0
Joint ventures	**0.1**	0.1	**0.3**	0.3
Subsidiaries	**–**	–	**9,874.0**	10,604.7
	2.1	2.1	**9,876.3**	10,607.0

* The treatment of certain covered bond transactions has been changed, see note 44.

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

Investment in joint venture

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

	2009	2008
	£m	£m
Share of joint ventures		
Gross assets	**0.1**	0.1
Gross liabilities	**–**	–
	0.1	0.1

Investment in subsidiaries

Society	Shares	Loans	Total
	£m	£m	£m
Cost			
At 1st January 2009 restated*	**242.3**	**10,362.9**	**10,605.2**
Additions	**0.5**	**424.8**	**425.3**
Repayments	**(30.4)**	**(1,125.6)**	**(1,156.0)**
At 31st December 2009	**212.4**	**9,662.1**	**9,874.5**
Impairment losses			
At 1st January 2009	**(0.5)**	**–**	**(0.5)**
Provided in year	**–**	**–**	**–**
At 31st December 2009	**(0.5)**	**–**	**(0.5)**
Net book value			
At 31st December 2009	**211.9**	**9,662.1**	**9,874.0**
Cost			
At 1st January 2008 restated*	294.6	8,134.9	8,429.5
Additions	–	2,483.7	2,483.7
Repayments	(52.3)	(255.7)	(308.0)
At 31st December 2008 restated*	242.3	10,362.9	10,605.2
Impairment losses			
At 1st January 2008	(0.5)	–	(0.5)
Provided in year	–	–	–
At 31st December 2008	(0.5)	–	(0.5)
Net book value			
At 31st December 2008	241.8	10,362.9	10,604.7

* The treatment of certain covered bond transactions has been changed, see note 44.

Included within Shares is an investment of £7.7million (2008 – £7.7 million) in Yorkshire Guernsey Ltd which is a credit institution.

Income from interest in subsidiaries
The Society has recognised dividend income of £133.0 million (2008 – £3.5 million) from its subsidiary Yorksafe Insurance Company Limited.

10. INVESTMENTS (continued)

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

	Principal activity
Accord Mortgages Ltd	Mortgage lending
YBS Properties Ltd	Property holding
YBS Properties (Edinburgh) Ltd	Property holding
Yorkshire Building Society Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds
Yorkshire Key Services Ltd	Computer services
Yorkshire Key Services (No. 2) Ltd	Retail deposit services
Yorkshire Guernsey Ltd	Deposit taking
Yorksafe Insurance Company Ltd	Insurance
YBS Investments (No. 1) Ltd	Investments
YBS Investments (No. 2) Ltd	Investments
Yorkshire Investment Services Ltd	Investments
YBS Properties (York) Ltd	Non-trading
Yorkshire Building Society Estate Agents Ltd	Non-trading
Yorkshire Computer Services Ltd	Non-trading
Barnsley Property Services Ltd	Non-trading

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

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

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

All the companies are wholly owned except for Yorksafe Insurance Company Ltd and Yorkshire Building Society Covered Bonds LLP. The Society's interests in these companies are, in substance, no different than if they were 100% held subsidiary undertakings and consequently they are consolidated in the Group accounts.

11. TAX CREDIT/EXPENSE

	Group		Society	
	2009	2008	**2009**	2008 Restated*
	£m	£m	**£m**	£m
Current tax:				
UK corporation tax at 28% (2008 – 28.5%)	**14.4**	–	**3.8**	(5.3)
Corporation tax – adjustment in respect of prior periods	**5.3**	(0.5)	**5.3**	(0.4)
Overseas tax	**0.2**	0.5	**–**	–
Total Current tax	**19.9**	–	**9.1**	(5.7)
Deferred tax (Note 19):				
Current year	**(33.3)**	(0.5)	**3.3**	(8.1)
Adjustment in respect of prior periods	**4.2**	–	**4.2**	–
Total tax (credit)/expense in income statement	**(9.2)**	(0.5)	**16.6**	(13.8)

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

	Group		Society	
	2009	2008	**2009**	2008 Restated*
	£m	£m	**£m**	£m
(Loss)/profit before tax	**(12.5)**	8.3	**83.3**	(47.0)
Tax calculated at a tax rate of 28% (2008 – 28.5%)	**(3.5)**	2.4	**23.3**	(13.4)
Effects of:				
Lower tax rate on overseas earnings	**(0.7)**	(2.5)	**–**	–
Income not subject to tax	**(16.2)**	(1.0)	**(17.8)**	(1.0)
Expenses not deductible for tax purposes	**1.7**	0.9	**1.6**	0.8
Adjustment to tax charge in respect of previous periods	**9.5**	(0.5)	**9.5**	(0.4)
Change in tax rate	**–**	0.2	**–**	0.2
Total tax (credit)/expense in income statement	**(9.2)**	(0.5)	**16.6**	(13.8)

* The treatment of certain covered bond transactions has been changed, see note 44.

Included in the adjustments in respect of previous periods is a credit of £9.0 million in relation to tax losses previously recognised in equity.

11. TAX CREDIT/EXPENSE (continued)

	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 £m
Tax expense/(credit) recognised directly in equity:				
Tax on available for sale securities	**12.4**	(16.4)	**13.0**	(17.3)
Tax on pension costs	**(14.1)**	5.1	**(14.1)**	5.1
Deferred tax on cash flow hedges	**(14.0)**	–	**(14.0)**	–
Utilisation of tax losses recognised in previous periods on available for sale securities	**9.0**	–	**9.0**	–
Change in tax rate	**–**	0.2	**–**	0.1
	(6.7)	(11.1)	**(6.1)**	(12.1)

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

	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 £m
Cash in hand	**12.6**	14.2	**12.6**	14.2
Cash ratio deposit with the Bank of England	**17.8**	21.9	**17.8**	21.9
Other deposits with the Bank of England	**1,119.4**	255.8	**1,119.4**	255.8
	1,149.8	291.9	**1,149.8**	291.9

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

13. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 £m
Loans and advances to banks	**708.3**	518.5	**290.2**	463.4
Loans and advances to other credit institutions	**280.1**	23.5	**280.1**	23.5
	988.4	542.0	**570.3**	486.9

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

14. DEBT SECURITIES

	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 £m
Debt securities issued by:				
Public bodies	**1,421.6**	1,355.4	**1,421.6**	1,355.3
Other borrowers	**3,140.6**	3,138.4	**3,032.8**	2,794.0
	4,562.2	4,493.8	**4,454.4**	4,149.3
Analysis by type:				
Listed on a recognised investment exchange	**3,589.6**	3,625.7	**3,581.0**	3,577.6
Unlisted	**972.6**	868.1	**873.4**	571.7
	4,562.2	4,493.8	**4,454.4**	4,149.3

Debt securities of £2.7 billion (2008 – £2.0 billion) are due in over one year.

14. DEBT SECURITIES (continued)

Group	Held at fair value through the income statement £m	Embedded Derivative £m	Available for sale £m	Held to maturity £m
Movements in debt securities during the year were:				
At 1st January 2009	**15.6**	**(45.5)**	**3,730.8**	**792.9**
Additions	**–**	**–**	**10,396.9**	**–**
Disposals and repayments	**–**	**–**	**(10,220.2)**	**(57.6)**
Exchange translation	**(1.5)**	**–**	**(61.8)**	**(23.8)**
Other changes in value	**3.0**	**4.5**	**28.5**	**0.4**
At 31st December 2009	**17.1**	**(41.0)**	**3,874.2**	**711.9**
Movements in debt securities during the year were:				
At 1st January 2008	40.3	(8.3)	3,498.2	–
Reclassified	–	–	(456.0)	456.0
Acquired on transfer of engagements	–	–	26.3	–
Additions	–	–	11,245.2	315.7
Disposals and repayments	(22.7)	–	(10,763.7)	(47.3)
Exchange translation	5.3	–	206.4	65.4
Other changes in value	(7.3)	(37.2)	(25.6)	3.1
At 31st December 2008	15.6	(45.5)	3,730.8	792.9

Society	Held at fair value through the income statement £m	Embedded Derivative £m	Available for sale £m	Held to maturity £m
Movements in debt securities during the year were:				
At 1st January 2009	**15.6**	**(45.5)**	**3,386.3**	**792.9**
Additions	**–**	**–**	**9,781.2**	**–**
Disposals and repayments	**–**	**–**	**(9,377.3)**	**(57.6)**
Exchange translation	**(1.5)**	**–**	**(61.8)**	**(23.8)**
Other changes in value	**3.0**	**4.5**	**38.0**	**0.4**
At 31st December 2009	**17.1**	**(41.0)**	**3,766.4**	**711.9**
Movements in debt securities during the year were:				
At 1st January 2008	40.3	(8.3)	3,152.5	–
Reclassified	–	–	(456.0)	456.0
Acquired on transfer of engagements	–	–	26.3	–
Additions	–	–	10,774.5	315.7
Disposals and repayments	(22.7)	–	(10,286.0)	(47.3)
Exchange translation	5.3	–	206.4	65.4
Other changes in value	(7.3)	(37.2)	(31.4)	3.1
At 31st December 2008	15.6	(45.5)	3,386.3	792.9

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

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

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

15. LOANS AND ADVANCES TO CUSTOMERS

	Group		Society	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Loans and advances to customers comprise:				
Loans fully secured on residential property	**14,700.3**	15,843.7	**8,550.7**	9,318.1
Other loans secured on residential property	**51.1**	55.4	**17.3**	18.4
Fair value hedging adjustments	**274.7**	429.5	**274.5**	429.6
Allowances for impairment	**(50.7)**	(41.4)	**(2.2)**	(0.7)
Loans secured on residential property	**14,975.4**	16,287.2	**8,840.3**	9,765.4
Loans fully secured on land	**4.0**	4.6	**4.0**	4.6

Loans and advances to customers are held at amortised cost, with interest and associated costs being recognised in the interest receivable and similar income line of the income statement on an effective interest rate basis. Amounts totalling £14.3 billion (2008 – £15.9 billion) are due in over one year.

Fair value hedging adjustments of £274.7 million (2008 – £429.5 million) have been made to certain fixed rate mortgages that are in fair value hedging relationships.

Covered Bonds

Loans and advances to customers include £5.1 billion (2008 – £5.4 billion) for both the Group and Society which have been transferred from the Society to Yorkshire Building Society Covered Bonds LLP, a Limited Liability Partnership which is consolidated by the Group. The loans secure £2.8 billion (2008 – £3.0 billion) of covered bonds issued by the Society. The covered bonds are included in debt securities in issue (see Note 24). The loans are retained on the Society's statement of financial position as the Society substantially retains the associated risks and rewards.

16. INTANGIBLE ASSETS

	Software £m	Other £m	Total £m
Group			
Cost			
At 1st January 2009	**41.1**	**2.1**	**43.2**
Additions	**5.8**	**–**	**5.8**
Disposals	**(0.3)**	**–**	**(0.3)**
Transfers	**0.1**	**–**	**0.1**
At 31st December 2009	**46.7**	**2.1**	**48.8**
Depreciation			
At 1st January 2009	**34.0**	**0.6**	**34.6**
Charged in year	**3.3**	**0.6**	**3.9**
Disposals	**(0.3)**	**–**	**(0.3)**
At 31st December 2009	**37.0**	**1.2**	**38.2**
Net book value			
At 31st December 2009	**9.7**	**0.9**	**10.6**
Cost			
At 1st January 2008	41.8	1.5	43.3
Additions	2.7	–	2.7
Disposals	(3.5)	–	(3.5)
Acquired on transfer of engagements	0.1	0.6	0.7
At 31st December 2008	41.1	2.1	43.2
Depreciation			
At 1st January 2008	34.9	0.3	35.2
Charged in year	2.6	0.3	2.9
Disposals	(3.5)	–	(3.5)
At 31st December 2008	34.0	0.6	34.6
Net book value			
At 31st December 2008	7.1	1.5	8.6

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

Other intangible assets include an amount paid for the transfer of the administration of a number of employee sharesave schemes to the Society, plus the fair value of the retail customers and income streams from renewable contracts, primarily property insurance, generated on transfer of engagements. Further details of these are contained in note 42.

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

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

16. INTANGIBLE ASSETS (continued)

	Software £m	Other £m	Total £m
Society			
Cost			
At 1st January 2009	**30.6**	**2.1**	**32.7**
Additions	**5.8**	**–**	**5.8**
Disposals	**(0.3)**	**–**	**(0.3)**
Transfers	**0.1**	**–**	**0.1**
At 31st December 2009	**36.2**	**2.1**	**38.3**
Depreciation			
At 1st January 2009	**24.0**	**0.6**	**24.6**
Charged in year	**3.2**	**0.6**	**3.8**
Disposals	**(0.3)**	**–**	**(0.3)**
At 31st December 2009	**26.9**	**1.2**	**28.1**
Net book value			
At 31st December 2009	**9.3**	**0.9**	**10.2**
Cost			
At 1st January 2008	27.9	1.5	29.4
Additions	2.7	–	2.7
Disposals	(0.1)	–	(0.1)
Acquired on transfer of engagements	0.1	0.6	0.7
At 31st December 2008	30.6	2.1	32.7
Depreciation			
At 1st January 2008	21.6	0.3	21.9
Charged in year	2.5	0.3	2.8
Disposals	(0.1)	–	(0.1)
At 31st December 2008	24.0	0.6	24.6
Net book value			
At 31st December 2008	6.6	1.5	8.1

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

17. INVESTMENT PROPERTIES	Group		Society	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Cost				
At 1st January	**9.7**	7.6	**9.5**	7.3
Additions	**–**	–	**–**	–
Disposals	**–**	(0.2)	**–**	(0.2)
Acquired on transfer of engagements	**–**	0.2	**–**	0.2
Transfers	**–**	2.1	**–**	2.2
At 31st December	**9.7**	9.7	**9.5**	9.5
Depreciation				
At 1st January	**2.5**	1.3	**2.5**	1.3
Charged in year	**0.1**	0.1	**0.1**	0.1
Impairment	**0.4**	0.5	**0.4**	0.5
Disposals	**–**	–	**–**	–
Transfers	**–**	0.6	**–**	0.6
At 31st December	**3.0**	2.5	**3.0**	2.5
Net book value				
At 31st December	**6.7**	7.2	**6.5**	7.0
Fair value				
At 31st December	**10.0**	10.5	**9.6**	10.1

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

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

Depreciation is provided by the Group to write off the cost less the estimated residual value of investment properties (excluding land) by equal instalments over their estimated useful economic life of 50 years.

Land is not depreciated. Any impairment in the value of properties is dealt with through the income statement as it arises.

The fair value of the Group's investment properties at 31st December 2009 has been arrived at on the basis of a valuation carried out by the Group's Estates Manager.

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

18. PROPERTY, PLANT AND EQUIPMENT

	Construction in progress £m	Land and Buildings £m	Equipment Fixtures, Fittings and Vehicles £m	Total £m
Group				
Cost				
At 1st January 2009	**2.4**	**81.7**	**76.5**	**160.6**
Additions	**2.6**	**0.5**	**1.9**	**5.0**
Disposals	**–**	**–**	**(0.5)**	**(0.5)**
Transfers	**(5.0)**	**2.3**	**2.6**	**(0.1)**
At 31st December 2009	**–**	**84.5**	**80.5**	**165.0**
Depreciation				
At 1st January 2009	**–**	**16.5**	**61.4**	**77.9**
Charged in year	**–**	**1.8**	**5.0**	**6.8**
Impairment	**–**	**0.2**	**–**	**0.2**
Disposals	**–**	**–**	**(0.5)**	**(0.5)**
Transfers	**–**	**–**	**–**	**–**
At 31st December 2009	**–**	**18.5**	**65.9**	**84.4**
Net book value				
At 31st December 2009	**–**	**66.0**	**14.6**	**80.6**
Cost				
At 1st January 2008	–	81.2	72.5	153.7
Additions	2.4	2.6	2.8	7.8
Disposals	–	(0.1)	(1.4)	(1.5)
Acquired on transfer of engagements	–	2.1	0.6	2.7
Transfers	–	(4.1)	2.0	(2.1)
At 31st December 2008	2.4	81.7	76.5	160.6
Depreciation				
At 1st January 2008	–	15.5	58.0	73.5
Charged in year	–	1.6	4.8	6.4
Disposals	–	–	(1.4)	(1.4)
Transfers	–	(0.6)	–	(0.6)
At 31st December 2008	–	16.5	61.4	77.9
Net book value				
At 31st December 2008	2.4	65.2	15.1	82.7

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

18. PROPERTY, PLANT AND EQUIPMENT (continued)

	Construction in progress £m	Land and Buildings £m	Equipment Fixtures, Fittings and Vehicles £m	Total £m
Society				
Cost				
At 1st January 2009	**2.4**	**59.6**	**31.3**	**93.3**
Additions	**2.6**	**0.3**	**1.9**	**4.8**
Disposals	**–**	**–**	**(0.5)**	**(0.5)**
Transfers	**(5.0)**	**2.3**	**2.6**	**(0.1)**
At 31st December 2009	**–**	**62.2**	**35.3**	**97.5**
Depreciation				
At 1st January 2009	**–**	**13.1**	**16.5**	**29.6**
Charged in year	**–**	**1.4**	**4.7**	**6.1**
Impairment	**–**	**0.2**	**–**	**0.2**
Disposals	**–**	**–**	**(0.5)**	**(0.5)**
Transfers	**–**	**–**	**–**	**–**
At 31st December 2009	**–**	**14.7**	**20.7**	**35.4**
Net book value				
At 31st December 2009	**–**	**47.5**	**14.6**	**62.1**
Cost				
At 1st January 2008	–	59.3	26.6	85.9
Additions	2.4	2.5	2.7	7.6
Disposals	–	(0.1)	(0.6)	(0.7)
Acquired on transfer of engagements	–	2.1	0.6	2.7
Transfers	–	(4.2)	2.0	(2.2)
At 31st December 2008	2.4	59.6	31.3	93.3
Depreciation				
At 1st January 2008	–	12.5	13.1	25.6
Charged in year	–	1.2	4.0	5.2
Disposals	–	–	(0.6)	(0.6)
Transfers	–	(0.6)	–	(0.6)
At 31st December 2008	–	13.1	16.5	29.6
Net book value				
At 31st December 2008	2.4	46.5	14.8	63.7

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

19. DEFERRED TAX ASSETS AND LIABILITIES

	Group		Society	
	2009	2008	**2009**	2008 Restated*
	£m	£m	**£m**	£m
The movement on the deferred tax liability/(asset) is as follows:				
At 1st January	**21.6**	33.9	**(17.2)**	3.7
Income statement (credit)/charge	**(29.1)**	(0.5)	**7.5**	(8.1)
Tax credit recognised directly in equity	**(17.9)**	(11.1)	**(17.0)**	(12.1)
Acquired on transfer of engagements	**–**	(0.7)	**–**	(0.7)
At 31st December	**(25.4)**	21.6	**(26.7)**	(17.2)
Deferred tax assets and liabilities are attributable to the following items:				
Deferred tax assets				
Provision for loan impairment	**1.0**	1.2	**0.7**	0.9
Other provisions	**0.8**	9.4	**0.8**	2.6
Other temporary differences	**0.1**	0.1	**0.1**	4.5
Accelerated tax depreciation	**0.5**	–	**0.8**	0.3
Tax value of losses carried forward	**10.2**	30.2	**10.2**	30.2
Transfer of engagements – Accelerated tax depreciation	**–**	0.2	**–**	0.2
Transfer of engagements – Pensions and other post retirement benefits	**–**	0.5	**–**	0.5
Pensions and other post retirement benefits	**3.6**	–	**3.6**	–
Cash flow hedging	**14.0**	–	**14.0**	–
	30.2	41.6	**30.2**	39.2
Deferred tax liabilities				
Pensions and other post retirement benefits	**–**	8.6	**–**	8.5
Accelerated tax depreciation	**–**	0.1	**–**	–
Implementation of IAS 39 – mortgages and hedging	**3.8**	13.9	**2.9**	12.9
Overseas operations	**0.3**	39.2	**–**	–
Other temporary differences	**0.7**	1.4	**0.6**	0.6
	4.8	63.2	**3.5**	22.0

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

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

	Group		Society	
	2009	2008	**2009**	2008 Restated*
	£m	£m	**£m**	£m
Accelerated tax depreciation	**(0.3)**	(1.3)	**(0.3)**	(1.3)
Tax value of losses carried forward	**11.1**	(11.1)	**11.1**	(11.1)
Pensions and other post retirement benefits	**0.6**	0.2	**0.6**	0.2
Other provisions	**8.4**	(4.3)	**1.7**	(0.3)
Overseas operations	**(42.3)**	8.2	**–**	–
Other temporary differences	**(6.6)**	7.8	**(5.6)**	4.4
	(29.1)	(0.5)	**7.5**	(8.1)

* The treatment of certain covered bond transactions has been changed, see note 44.

Following changes to the taxation of foreign dividends there are no longer any unrecognised deferred tax liabilities in respect of unremitted earnings of overseas subsidiaries (2008 – £110.5 million).

20. OTHER ASSETS

	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 £m
Prepayments and accrued income	**4.8**	4.8	**4.8**	4.7
Due from subsidiary undertakings	**–**	–	**34.1**	28.4
Other assets	**2.7**	7.9	**1.4**	3.9
	7.5	12.7	**40.3**	37.0

21. SHARES

	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 £m
Shares comprising balances held by individuals	**13,794.9**	13,683.1	**13,794.9**	13,683.1
Fair value adjustments	**(1.5)**	–	**(1.5)**	–
	13,793.4	13,683.1	**13,793.4**	13,683.1

22. AMOUNTS OWED TO CREDIT INSTITUTIONS

	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 £m
Amounts owed to:				
Banks	**377.3**	945.5	**103.4**	945.5
Group companies	**–**	–	**746.5**	740.1
Other credit institutions	**16.1**	144.8	**16.1**	144.8
Fair value adjustments	**–**	0.2	**–**	0.2
	393.4	1,090.5	**866.0**	1,830.6

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

23. OTHER DEPOSITS

	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 Restated* £m
Amounts owed to:				
Group companies	**–**	–	**2,955.1**	3,060.4
Other customers	**1,091.0**	1,762.0	**284.8**	944.9
	1,091.0	1,762.0	**3,239.9**	4,005.3

* The treatment of certain covered bond transactions has been changed, see note 44.

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

24. DEBT SECURITIES IN ISSUE

	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 £m
Certificates of deposit	**132.3**	395.2	**132.3**	395.2
Fixed rate notes	**4,738.7**	2,904.5	**4,738.7**	2,904.5
Floating rate notes	**757.7**	1,094.6	**757.7**	1,094.6
Fair value hedging adjustment	**70.0**	82.8	**70.0**	82.8
	5,698.7	4,477.1	**5,698.7**	4,477.1

Debt securities in issue include €3.0 billion, for both Group and Society, of covered bonds secured on certain loans and advances to customers. The Sterling equivalent value of these bonds is £2.8 billion (2008 – £3.0 billion).

25. RETIREMENT BENEFIT OBLIGATIONS

The Group operates one main employee benefit scheme (the Scheme), the costs of which are borne by the Society, with both defined benefit and defined contribution sections. With effect from 31st December 2008, the Society also operates an additional defined benefit employee benefit scheme (the Barnsley Scheme) in relation to the Society's transfer of engagements of Barnsley Building Society. The assumptions and figures below include the Barnsley scheme where appropriate.

In addition, the Group operates unfunded defined benefit pension schemes for certain current and former members of staff. The present value at 31st December 2009 of the defined benefit obligation in relation to these schemes was £5.3 million (2008 – £3.8 million) and the relevant disclosures have been aggregated with those of the main employee benefits scheme.

Defined contribution post-employment benefits
In addition to the defined benefit section (see below) the Group operates a defined contribution section of the main scheme for new employees and for existing employees who are not members of a defined benefit scheme. The expense recognised for the defined contribution section is £2.2 million (2008 – £2.0 million).

Defined benefit post-employment benefits
The Group operates a funded defined benefit scheme for certain employees, providing benefits based on final salary. The assets of the scheme are held in a separate trustee-administered fund. Contributions are assessed in accordance with the advice of an independent qualified actuary using the projected unit method. The defined benefit section was closed to new employees in 2000.

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

Summary of assumptions	**31st Dec 2009 %**	31st Dec 2008 %	31st Dec 2007 %	31st Dec 2006 %	31st Dec 2005 %
Inflation rate	**3.8**	3.2	3.4	3.0	2.8
Discount rate	**5.7**	6.4	5.8	5.1	4.7
Expected return on assets	**6.3**	5.9	6.4	7.0	6.7
Rate of increase in pay	**5.3**	4.7	4.9	4.5	4.3
Rate of increase of pensions in payment*					
subject to a min of 3% and a max of 5% each year	**4.0**	3.4	3.6	3.7	3.5
subject to a min of 0% and a max of 5% each year	**3.8**	3.2	3.4	3.0	2.8
Rate of increase for deferred pensioners*	**3.8**	3.1	3.4	3.0	2.8

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

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

The most significant non-financial assumption is the assumed rate of longevity. The assumptions made are equivalent to the following life expectancies for scheme members at age 60:

	2009 Years	2008 Years
For a current 60 year old male	**26.2**	26.0
For a current 60 year old female	**27.5**	27.4
For a current 45 year old male	**27.8**	27.7
For a current 45 year old female	**28.5**	28.5

Categories of assets	**31st Dec 2009 %**	31st Dec 2008 %	31st Dec 2007 %	31st Dec 2006 %	31st Dec 2005 %
Equities	**44**	42	44	66	66
Bonds	**55**	17	50	30	28
Cash and other	**1**	41	6	4	6
	100	100	100	100	100

25. RETIREMENT BENEFIT OBLIGATIONS (continued)

Reconciliation of funded status	**31st Dec 2009 £m**	31st Dec 2008 £m	31st Dec 2007 £m	31st Dec 2006 £m	31st Dec 2005 £m
Present value of defined benefit obligation*	**(317.3)**	(231.1)	(262.7)	(286.3)	(285.0)
Assets at fair value*	**313.0**	259.9	270.7	255.6	229.4
Funded status/Defined benefit (liability)/asset	**(4.3)**	28.8	8.0	(30.7)	(55.6)

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

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

Statement of comprehensive income (SCI)	**2009 £m**	2008 £m	2007 £m	2006 £m	2005 £m
Actuarial (loss)/ gain recognised in SCI	**(50.4)**	17.8	33.8	22.0	(21.4)
Cumulative actuarial gains/(losses) recognised at 1st January	**47.7**	29.9	(3.9)	(25.9)	(4.5)
Cumulative actuarial (losses)/ gains recognised at 31st December	**(2.7)**	47.7	29.9	(3.9)	(25.9)
Experience gain and losses					
(Loss)/gain on change of assumptions	**(80.0)**	45.2	37.0	15.3	(43.1)
Gain/(loss) on other experience	**4.0**	8.6	1.0	(0.7)	–
Experience gain/(loss) on assets	**25.6**	(36.0)	(4.2)	7.4	21.7
Actuarial (loss)/gain recognised in SCI	**(50.4)**	17.8	33.8	22.0	(21.4)

Components of pension expense as shown in the income statement	**2009 £m**	2008 £m
Service cost	**4.5**	5.6
Interest cost	**14.5**	15.0
Expected return on assets	**(15.4)**	(17.1)
Total pension expense	**3.6**	3.5

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

Reconciliation of present value of defined benefit obligation		
Present value of defined benefit obligation at 1st January	**231.1**	262.7
Acquired on transfer of engagements	**–**	8.0
Defined benefit service cost	**4.5**	5.6
Interest cost	**14.5**	15.0
Defined benefit employee contributions	**1.5**	1.5
Actuarial loss/(gain)	**76.0**	(53.8)
Defined benefit actual benefits paid	**(10.3)**	(7.9)
Present value of defined benefit obligation at 31st December	**317.3**	231.1

Movement in defined benefit fair value of assets		
Fair value of assets at 1st January	**259.9**	270.7
Acquired on transfer of engagements	**–**	6.1
Expected return on assets	**15.4**	17.1
Actuarial gain/(loss) on assets	**25.6**	(36.0)
Defined benefit actual company contributions	**20.9**	8.4
Defined benefit employee contributions	**1.5**	1.5
Defined benefit actual benefits paid	**(10.3)**	(7.9)
Fair value of plan assets at 31st December	**313.0**	259.9

None of the assets were invested in the Group's own financial instruments (2008 – £nil) or property (2008 – £nil).

25. RETIREMENT BENEFIT OBLIGATIONS (continued)

Estimated contributions in 2010

	2010 £m
Society contributions	**3.8**
Employee contributions	**1.5**
Total contributions	**5.3**

26. OTHER LIABILITIES

	Group		Society	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Accruals and deferred income	**27.5**	17.4	27.0	16.4
Income tax deducted at source	**18.9**	38.0	17.5	36.2
Other	**4.0**	3.2	4.0	0.2
	50.4	58.6	48.5	52.8

27. PROVISIONS

Movements in provisions during the year were as follows:

	FSCS Levy £m	Regulatory and Other £m	Total £m
Group			
At 1st January 2009	**14.8**	**2.3**	**17.1**
Amounts utilised during the year	**(5.4)**	**(0.4)**	**(5.8)**
Provision charge/(release) during the year	**2.7**	**(1.4)**	**1.3**
At 31st December 2009	**12.1**	**0.5**	**12.6**
At 1st January 2008	–	4.6	4.6
Acquired on transfer of engagements	0.1	–	0.1
Amounts utilised during the year	–	(1.3)	(1.3)
Provision charge/(release) during the year	14.7	(1.0)	13.7
At 31st December 2008	14.8	2.3	17.1
Society			
At 1st January 2009	**14.8**	**2.2**	**17.0**
Amounts utilised during the year	**(5.4)**	**(0.4)**	**(5.8)**
Provision charge/(release) during the year	**2.7**	**(1.4)**	**1.3**
At 31st December 2009	**12.1**	**0.4**	**12.5**
At 1st January 2008	–	4.3	4.3
Acquired on transfer of engagements	0.1	–	0.1
Amounts utilised during the year	–	(1.2)	(1.2)
Provision charge/(release) during the year	14.7	(0.9)	13.8
At 31st December 2008	14.8	2.2	17.0

Provisions for regulatory and other liabilities principally relate to previous sales of endowment policies.

Financial Services Compensation Scheme

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

The FSCS has borrowings of £20 billion in the form of loans from HM Treasury to cover compensation costs paid and payable in respect of the above defaults. The FSCS is liable to pay interest on the loans from HM Treasury and may have a further liability if there are insufficient funds available from the realisation of the assets of the banks/building society to fully repay the respective HM Treasury loans.

27. PROVISIONS (continued)

As a result of notifications received from the FSCS, the Society has recognised in this year's results a provision for a levy of £6.9 million for the scheme year 2010/11, calculated with reference to the protected deposits it held at 31st December 2009, and a release of £4.2 million for the scheme year 2009/10 due to interest rates being lower than the FSCS had anticipated. The amounts above do not take any account of any compensation levies which may arise from any ultimate payout on claims.

28. SUBORDINATED LIABILITIES

Group and Society	**2009**	2008
	£m	£m
6% Subordinated Bonds 2019	**25.8**	25.8
11⅜% Subordinated Bonds 2022	**25.3**	25.3
6⅜% Subordinated Bonds 2024	**51.6**	51.5
Fair value hedging adjustments	**9.0**	10.3
	111.7	112.9

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

- redemption of all (but not some only) of the 6% Notes at par on 7th May 2014 after giving not less than fifteen nor more than thirty days' notice to the holders. In the event the Society does not redeem the notes on 7th May 2014 the fixed rate of interest will become the aggregate of 2.03% and the then current five year benchmark Gilt rate; and
- redemption of all (but not some only) of the 11⅜% Notes at par on 27th November 2017 after giving not less than thirty nor more than sixty days' notice to the holders. In the event the Society does not redeem the notes on 27th November 2017 the fixed rate of interest will become the greater of 11⅜% and an aggregate of 3.10% and the then current five year benchmark Gilt rate.

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

29. SUBSCRIBED CAPITAL

Group and Society	**2009**	2008
	£m	£m
5.649% Permanent Interest Bearing Shares	**151.1**	151.0
Fair value hedging adjustments	**8.2**	16.2
	159.3	167.2

All Permanent Interest Bearing Shares (PIBS) are unsecured and denominated in Sterling. Interest is payable half yearly on 27th March and 27th September. PIBS are repayable at the option of the Society, in whole, in March 2019 or any interest payment date thereafter.

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

30. CAPITAL MANAGEMENT

More detail of capital management strategies can be found in the Risk Management Report on page 25.

	Group 2009 £m	Group 2008 £m
Tier 1		
General reserve	**975.6**	1,042.3
Subscribed capital	**159.3**	167.2
Pension fund adjustments*	**(0.6)**	(34.9)
Intangible fixed assets	**(10.6)**	(8.6)
Deductions from Tier 1 capital**	**(0.5)**	(61.9)
	1,123.2	1,104.1
Tier 2		
Subordinated liabilities	**111.7**	112.9
Collective allowances for impairment	**3.7**	5.8
Deductions from Tier 2 capital**	**(0.5)**	(61.9)
	114.9	56.8
Other items excluded	**(0.2)**	0.5
Total capital	**1,237.9**	1,161.4
Risk weighted assets	**7,926.6**	7,832.3
Tier 1 ratio (%)	**14.2%**	14.1%
Solvency ratio (%)	**15.6%**	14.8%

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

Throughout the year the Group Capital Committee has kept the Group's capital position under review as well as considering the current market conditions for capital issuance and has seen no benefit to the Group in issuing further capital in 2009.

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

** During 2009 the Group repatriated the majority of the capital of Yorksafe Insurance Company Limited, based in Guernsey, which previously was deducted from regulatory capital.

31. FINANCIAL COMMITMENTS

	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 £m
Committed undrawn standby facilities	**33.2**	3.5	**33.2**	3.5

The Society has an obligation under the Building Societies Act 1986 to discharge the liabilities incurred up to 11th June 1996 of all subsidiaries in so far as those subsidiaries are unable to discharge the liabilities out of their own assets. The Society has given undertakings whereby it has agreed to discharge the liabilities incurred after 11th June 1996 by certain of its subsidiaries, including Yorkshire Guernsey Ltd, in the event that these subsidiaries may be unable to discharge them out of their own assets. The Society accounts for these guarantees in accordance with 'IFRS 4 Insurance Contracts'.

Capital commitments contracted for at 31st December 2009, but for which no provision has been made in the accounts, amounted to £2.2 million (Society £2.0 million), (2008 – Group £2.2 million and Society £2.0 million).

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

Group	2009 Land and buildings £m	2009 Other £m	2008 Land and buildings £m	2008 Other £m
Within one year	**3.7**	**0.8**	3.8	1.0
Between one and five years	**12.4**	**0.5**	13.4	1.2
Over five years	**14.9**	**–**	17.2	–
	31.0	**1.3**	34.4	2.2

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

32. FINANCIAL INSTRUMENTS

The table below summarises the main financial instruments, their significant terms and conditions and the accounting treatment adopted.

Financial instrument	Significant terms and conditions	Accounting treatment
Cash in hand and balances with the Bank of England	Short-term cash balances in branches Statutory deposits, primarily non interest bearing	Amortised cost
Loans and advances to credit institutions	Short-term Fixed and variable interest rates	Amortised cost*
Debt securities	Short-term, medium-term and long-term Fixed and variable interest rates	Generally held at fair value as available for sale assets. Certain investments are held at fair value through the income statement or held to maturity at amortised cost. Detail is given in Note 14
Loans fully secured on residential property	Loan period is typically up to 25 years A variety of mortgage products offering fixed and variable interest rates	Amortised cost*
Derivative financial instruments	Primarily medium-term Value derived from underlying price, rate or index	Fair value through income statement
Intercompany deposit from Covered Bond Limited Liability Partnership	Long-term Fixed and variable interest rates	Fair value through income statement
Investments	Investment in subsidiary companies	Amortised cost
Shares	Deposits made by individuals Varying withdrawal notice periods Fixed and variable interest rates	Amortised cost*
Amounts owed to credit institutions and other customers	Primarily short-term Time Deposits Fixed and variable interest rates	Amortised cost*
Debt securities in issue	Short-term and medium-term Fixed and variable interest rates	Amortised cost*
Subordinated liabilities	Long-term Fixed and variable interest rates	Amortised cost*
Subscribed capital	Long-term Fixed interest rates	Amortised cost*

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

33. DERIVATIVE FINANCIAL INSTRUMENTS

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

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

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

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

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

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

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

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

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

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

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

33. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The following tables summarise the notional and fair value of all derivative financial instruments held at the year end and the hedging designations in place at that date.

Group

At 31st December 2009	**Contract/notional amount £m**	**Fair values Assets £m**	**Fair values Liabilities £m**
Interest rate swaps designated as fair value hedges	**6,515.5**	**25.4**	**307.9**
Interest rate swaps designated as cash flow hedges	**572.4**	**7.2**	**15.3**
Cross-currency interest swaps designated as fair value hedges	**2,664.9**	**755.2**	**–**
Derivatives not designated as hedges:			
Interest rate swaps	**8,367.8**	**69.9**	**95.0**
Cross-currency interest rate swaps	**530.2**	**9.0**	**11.1**
Equity linked interest rate swaps	**36.0**	**–**	**1.4**
Foreign exchange	**1,681.1**	**35.7**	**30.7**
Interest rate options	**213.0**	**2.0**	**–**
Interest rate futures	**750.0**	**–**	**6.7**
Forward rate agreements	**630.0**	**0.1**	**–**
Total derivatives held for hedging	**21,960.9**	**904.5**	**468.1**

Society

At 31st December 2009			
Interest rate swaps designated as fair value hedges	**6,515.5**	**25.4**	**307.9**
Interest rate swaps designated as cash flow hedges	**572.4**	**7.2**	**15.3**
Derivatives not designated as hedges:			
Interest rate swaps	**8,367.8**	**69.9**	**95.0**
Cross-currency interest rate swaps	**530.2**	**9.0**	**11.1**
Equity linked interest rate swaps	**36.0**	**–**	**1.4**
Foreign exchange	**1,681.1**	**35.7**	**30.7**
Interest rate options	**213.0**	**2.0**	**–**
Interest rate futures	**750.0**	**–**	**6.7**
Forward rate agreements	**630.0**	**0.1**	**–**
Total derivatives held for hedging	**19,296.0**	**149.3**	**468.1**

33. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Group
At 31st December 2008

	Contract/notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Interest rate swaps designated as fair value hedges	8,656.8	32.4	427.6
Interest rate swaps designated as cash flow hedges	2,587.8	47.6	65.1
Cross-currency interest swaps designated as fair value hedges	2,854.2	962.5	–
Derivatives not designated as hedges:			
Interest rate swaps	5,653.0	76.7	46.4
Cross-currency interest rate swaps	586.5	106.2	3.8
Equity linked interest rate swaps	4.3	1.2	–
Forward foreign exchange	541.8	–	120.9
Interest rate options	45.0	0.1	–
Interest rate futures	1,150.0	–	7.6
Forward rate agreements	100.0	–	0.8
Total derivatives held for hedging	22,179.4	1,226.7	672.2

Society
At 31st December 2008 restated*

	Contract/notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Interest rate swaps designated as fair value hedges	8,656.8	32.4	427.6
Interest rate swaps designated as cash flow hedges	2,587.8	47.6	65.1
Derivatives not designated as hedges:			
Interest rate swaps	5,653.0	76.7	46.4
Cross-currency interest rate swaps	586.5	106.2	3.8
Equity linked interest rate swaps	4.3	1.2	–
Forward foreign exchange	541.8	–	120.9
Interest rate options	45.0	0.1	–
Interest rate futures	1,150.0	–	7.6
Forward rate agreements	100.0	–	0.8
Total derivatives held for hedging	19,325.2	264.2	672.2

Society
At 31st December 2007 restated*

	Contract/notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Interest rate swaps designated as fair value hedges	8,766.8	50.5	49.6
Interest rate swaps designated as cash flow hedges	1,990.1	36.6	13.6
Derivatives not designated as hedges:			
Interest rate swaps	8,132.8	30.8	26.8
Cross-currency interest rate swaps	448.9	7.8	6.4
Equity linked interest rate swaps	6.7	4.1	–
Forward foreign exchange	424.7	–	16.8
Interest rate options	45.0	0.1	–
Collateral received	–	(9.0)	–
Collateral pledged	–	–	(19.2)
Total derivatives held for hedging	19,815.0	120.9	94.0

* The treatment of certain covered bond transactions has been changed, see note 44.

34. LIQUIDITY RISK

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

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

The Group's liquidity management is focused in three areas:

- limits are established by the board that govern the quantity, quality (counterparty creditworthiness) and marketability of and returns from the Group's portfolio of liquidity investments. The portfolio is managed by the Treasury function, monitored by the Risk function and overseen by the Group Asset and Liability Committee (GALCO) under a series of delegated authorities;
- the Group conducts a series of daily stress tests that are designed to ensure that its liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include ones caused by both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding. They are constructed on various timescales as far out as six months; and
- the Group has established its own method for rating counterparties with whom it invests its liquid assets. Each counterparty has a number of limits set for different types of exposure, and these are reviewed for each counterparty at least once a year. Reviews of limits, including suspension or withdrawal of limits, can be and are undertaken more frequently if conditions or events warrant it. The Group's Credit Committee meets at least monthly, and often more frequently, to review the overall wholesale credit risk profile of the Group, as well as reviewing individual limits either as a part of the rolling annual process or on an ad hoc basis.

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

- Society prudential liquidity – which provides an overall measure of the amount of the highest quality liquidity held by the Society. As at 31st December 2009 this ratio was 28.7% (31st December 2008: 20.6%);
- Group 8 day liquidity – which measures the amount of liquidity that is realisable (i.e. can be turned into cash) within eight working days. As at 31st December 2009 this ratio was 11.5% (31st December 2008: 10.1%); 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 that cover both retail and wholesale stresses and cover periods from two weeks to six months. The results of these stress tests are reviewed by Group Risk on a daily basis, and by GALCO on a monthly basis.

All liquidity risk in subsidiary companies, with the exception of other deposits, is eliminated by the use of appropriate inter-company loans and deposits. The tables below show contractual cash flows for all financial liabilities including interest payments. Further details of liquidity management are contained within the Risk Management Report on pages 23 to 30.

34. LIQUIDITY RISK (continued)

Group	Repayable on demand and up to one year £m	In more than one year but not more than five years £m	Over five years £m	Total £m
As at 31st December 2009				
Shares	**11,613.7**	**2,064.8**	**469.5**	**14,148.0**
Amounts owed to credit institutions	**313.5**	**78.6**	**3.2**	**395.3**
Other deposits				
Society	**283.2**	**2.1**	**–**	**285.3**
Subsidiaries	**733.4**	**78.7**	**–**	**812.1**
	1,016.6	**80.8**	**–**	**1,097.4**
Debt securities in issue	**2,123.4**	**3,705.9**	**–**	**5,829.3**
Subordinated liabilities	**7.5**	**30.1**	**162.1**	**199.7**
Subscribed capital*	**8.5**	**33.9**	**42.4**	**84.8**
Operating lease payments	**4.5**	**12.9**	**14.9**	**32.3**
Derivative financial liabilities	**340.6**	**327.9**	**72.0**	**740.5**
Total	**15,428.3**	**6,334.9**	**764.1**	**22,527.3**
Group				
As at 31st December 2008				
Shares	12,713.9	1,161.2	–	13,875.1
Amounts owed to credit institutions	1,047.2	3.4	48.5	1,099.1
Other deposits				
Society	931.5	–	–	931.5
Subsidiaries	786.0	64.5	–	850.5
	1,717.5	64.5	–	1,782.0
Debt securities in issue	1,056.9	3,633.1	3.7	4,693.7
Subordinated liabilities	7.5	30.1	169.7	207.3
Subscribed capital*	8.5	33.9	42.4	84.8
Operating lease payments	4.8	14.6	17.2	36.6
Derivative financial liabilities	379.2	353.8	66.1	799.1
Total	16,935.5	5,294.6	347.6	22,577.7

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

35. MARKET RISK

Value at Risk (VaR)
VaR is a risk management tool which evaluates the potential losses that may be incurred as a result of movements in market conditions over a specified holding period and to a given level of confidence. The model used is based on a 10 day holding period and a 99% confidence level.

The VaR model calculates potential movements in market prices by reference to market data from the last 90 days and incorporates underlying risk factors based on historic interest rate volatilities and correlations.

VaR for the Treasury portfolios is calculated and reported on a daily basis and for the Group statement of financial position on a monthly basis. A quarterly back test of the VaR model is performed to test the validity of the assumptions and parameters within the model.

A number of limitations should be considered in relation to the VaR model:

- historic data is not necessarily a good guide to future events;
- the model, by definition, does not capture potential losses outside the 99% confidence level, particularly those events that are extreme in nature; and
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

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

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

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

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

All market risk is managed in the Society on behalf of the Group, hence the tables below apply to both the Group and the Society.

2009	**Year-end £000**	**Average £000**	**Maximum £000**	**Minimum £000**
VaR	**6,852**	**11,247**	**17,451**	**5,199**
Basis risk	**75**	**266**	**439**	**75**
BP sensitivity	**(6)**	**34**	**230**	**(58)**

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

35. MARKET RISK (continued)

2008	Year-end £000	Average £000	Maximum £000	Minimum £000
VaR	9,644	9,585	15,461	5,724
Basis risk	305	226	334	173
BP sensitivity	84	9	140	(62)

	Greater than one year £m	Greater than five years £m	Greater than 10 years £m
Repricing gap	(100)	(93)	(27)

Detail of how the Group manages its interest rate risk is included in the Risk Management Report on pages 23 to 30.

36. CURRENCY RISK

Currency exchange risk is monitored daily and the Group seeks to minimise its net exposure to assets and liabilities denominated in currencies other than sterling. Maximum positions throughout the year represented less than 0.01% of total assets. More detail of this policy can be found in the Risk Management Report on page 27. Actual exposures were:

	2009 £m	2008 £m
Year-end	**0.1**	0.5
Maximum	**1.0**	5.8

37. WHOLESALE CREDIT RISK

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

	2009	2008
AAA	**51%**	46%
AA+ to AA-	**34%**	34%
A+ to A-	**8%**	17%
Other*	**7%**	3%
	100%	100%

* The Group has advanced £230 million, on commercial terms, to Chelsea Building Society prior to the proposed merger. More details of this transaction are set out in Note 40 on page 92.

The maximum exposure to any one country (other than the UK) is £298 million (2008 – £471 million), or 4.5% of total liquid assets.

99% of all wholesale exposures are to major industrial countries. The largest exposure to a single institution (other than the UK Government) is £740 million (2008 – £448 million), which is to a UK clearing bank in which the Government has a majority stake.

The Society uses an internal credit ratings model to help identify potential risks and this has resulted in the avoidance of exposure to counterparties such as Icelandic banks and Lehman Brothers.

37. WHOLESALE CREDIT RISK (continued)

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

	2009 £m	2008 £m
Cash in hand and balances with the Bank of England	**1,149.8**	291.9
Loans and advances to credit institutions	**988.4**	542.0
Debt securities	**4,562.2**	4,493.8
Derivative financial instruments	**904.5**	1,226.7
Investments (note a)	**2.1**	2.1
Total wholesale credit risk	**7,607.0**	6,556.5

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

UK Government securities	**1,421.6**	1,355.4
Medium-term notes issued by financial institutions	**1,389.2**	1,414.5
Certificates of deposit	**972.6**	869.3
Mortgage backed securities (note b)	**705.6**	785.6
Combination note (note c)	**10.9**	10.6
Synthetic collateralised debt obligations (note d)	**32.3**	27.0
Cash collateralised debt obligations (note e)	**30.0**	31.4
	4,562.2	4,493.8

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

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

(c) The combination note is an investment in a AAA rated capital protected vehicle that is structured to pay a return over and above its regular coupon.

(d) There are six investments in synthetic collateralised debt obligations. These contain embedded derivatives that have been separated with changes in fair value being taken directly to the income statement. In most cases fair values have risen in line with improved credit market conditions.

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

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

38. RETAIL CREDIT RISK

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

The measures considered include analysis of the movement of loans into arrears and between arrears bands by differing loan portfolios and loan characteristics (e.g. loan-to-value, behavioural scores) as well as monitoring of the overall characteristics of the loan portfolios (e.g. geographic, behavioural credit score, indexed loan-to-value concentrations, income multiples). In addition the Group undertakes a number of stress tests that subject the portfolios to different levels of default, house price deflation and other factors to identify the potential loan losses under the different economic conditions represented by those stress tests.

Retail credit risk within the Group is predominantly related to mortgage lending of £8.8 billion (2008 – £9.8 billion) conducted through the branch network and mortgage lending of £6.2 billion (2008 – £6.5 billion) conducted through professional intermediaries.

The maximum exposure to retail credit risk is £15.0 billion (2008 – £16.3 billion).

Geographic distribution of mortgage balances	**2009**	2008
	%	%
Scotland	**11**	12
North East	**6**	6
Yorkshire & Humberside	**17**	17
North West	**14**	14
Midlands	**12**	11
East Anglia	**3**	3
South West	**5**	5
Greater London	**11**	11
South East	**15**	15
Wales & Northern Ireland	**6**	6
	100	100

Loan-to-Value distribution	**Book**		**New Lending**	
	2009	2008	**2009**	2008
Loan-to-Value	**%**	%	**%**	%
Greater than 90%	**27**	23	**–**	6
75% to 90%	**19**	19	**25**	30
50% to 75%	**26**	27	**56**	46
Less than 50%	**28**	31	**19**	18
	100	100	**100**	100

The Group's average indexed loan-to-value is 51.95% (2008 – 50.14%). The proportion of the Group's loan books that are over 90% loan-to-value has risen slightly to 27% as at 31st December 2009. At the same time the Group has materially reduced the loan-to-values it permits on new lending.

Customer type	**Book**		**New Lending**	
	2009	2008	**2009**	2008
	%	%	**%**	%
First time buyer	**19**	19	**9**	10
Other buyers i.e. movers	**47**	47	**51**	31
Remortgage	**34**	34	**40**	59
	100	100	**100**	100

38. RETAIL CREDIT RISK (continued)

Arrears statistics

	Group		Society	
	2009	2008	**2009**	2008
Arrears outstanding as a percentage of debt	**%**	%	**%**	%
No arrears	**92.95**	92.54	**97.53**	97.22
Less than 3 months	**4.16**	5.01	**1.75**	2.11
3 to 6 months	**1.50**	1.36	**0.45**	0.42
6 to 12 months	**0.79**	0.62	**0.17**	0.14
Over 12 months	**0.22**	0.09	**0.03**	0.03
Property in possession	**0.38**	0.38	**0.07**	0.08
	100.00	100.00	**100.00**	100.00
Number of properties in possession at the year end	**380**	410	**52**	57

The Group's arrears levels have increased during 2009, in line with the market as a whole, reflecting the challenging economic environment. Nevertheless, the Group's arrears ratios remain healthy compared to industry standards, and where they relate to higher risk lending our pricing approach looks to ensure that the Group is adequately rewarded for the additional risks taken. Arrears on more recent lending are minimal, reflecting the de-risking measures undertaken during 2008 and 2009.

Loans and advances

	Group		Society	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Not impaired:				
Neither past due nor impaired	**13,665.8**	14,660.5	**8,350.3**	9,071.9
Past due but not impaired	**420.6**	567.5	**115.3**	147.1
Impaired	**669.0**	675.7	**106.4**	122.1
Total loans and advances	**14,755.4**	15,903.7	**8,572.0**	9,341.1

Group and Society

	Loans and advances		Fair value of collateral	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Collectively assessed for impairment	**14,167.9**	15,328.1	**14,164.2**	15,322.3
Individually assessed for impairment	**587.5**	575.6	**540.5**	540.0
Total loans and advances	**14,755.4**	15,903.7	**14,704.7**	15,862.3

The Group has assisted borrowers who have had financial difficulties by rearranging the terms of their loans. The total of such loans is £204.3 million (2008 – £157.9 million).

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

39. FAIR VALUES

The tables below are a comparison of book and fair values of the Group's financial instruments by category as at the statement of financial position date. Where external market prices are available they have been used to determine fair value. Otherwise, internal pricing models using external market data have been used.

	2009		2008	
	Book Value	**Fair Value**	Book Value	Fair Value
Group	**£m**	**£m**	£m	£m
Assets				
Cash in hand and balances with the Bank of England	**1,149.8**	**1,149.8**	291.9	291.9
Loans and advances to credit institutions	**988.4**	**988.4**	542.0	542.0
Debt securities – fair value	**17.1**	**17.1**	15.6	15.6
Debt securities – embedded derivative	**(41.0)**	**(41.0)**	(45.5)	(45.5)
Debt securities – available for sale	**3,874.2**	**3,874.2**	3,730.8	3,730.8
Debt securities – held to maturity	**711.9**	**670.8**	792.9	676.6
Loans and advances to customers	**14,979.4**	**15,160.2**	16,291.8	15,946.1
Investments	**2.1**	**2.1**	2.1	2.1
Liabilities				
Shares	**13,793.4**	**13,793.4**	13,683.1	13,683.1
Amounts due to credit institutions	**393.4**	**393.4**	1,090.5	1,090.5
Other deposits	**1,091.0**	**1,091.0**	1,762.0	1,762.0
Debt securities in issue	**5,698.7**	**5,650.8**	4,477.1	4,471.0
Subordinated liabilities	**111.7**	**95.9**	112.9	86.5
Subscribed capital	**159.3**	**85.2**	167.2	75.5

	2009		2008 Restated*	
	Book Value	**Fair Value**	Book Value	Fair Value
Society	**£m**	**£m**	£m	£m
Assets				
Cash in hand and balances with the Bank of England	**1,149.8**	**1,149.8**	291.9	291.9
Loans and advances to credit institutions	**570.3**	**570.3**	486.9	486.9
Debt securities – fair value	**17.1**	**17.1**	15.6	15.6
Debt securities – embedded derivative	**(41.0)**	**(41.0)**	(45.5)	(45.5)
Debt securities – available for sale	**3,766.4**	**3,766.4**	3,386.3	3,386.3
Debt securities – held to maturity	**711.9**	**670.8**	792.9	676.6
Loans and advances to customers	**8,844.3**	**8,838.9**	9,770.0	9,382.0
Investments	**9,876.3**	**9,876.3**	10,607.0	10,607.0
Liabilities				
Shares	**13,793.4**	**13,793.4**	13,683.1	13,683.1
Amounts due to credit institutions	**866.0**	**866.0**	1,830.6	1,830.6
Other deposits	**3,239.9**	**3,239.9**	4,005.3	4,005.3
Debt securities in issue	**5,698.7**	**5,650.8**	4,477.1	4,471.0
Subordinated liabilities	**111.7**	**95.9**	112.9	86.5
Subscribed capital	**159.3**	**85.2**	167.2	75.5

* The treatment of certain covered bond transactions has been changed, see note 44.

39. FAIR VALUES (continued)

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

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

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

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

The table below classifies all financial instruments held at fair value according to the method used to establish the fair value.

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Investments classified as Level 3 are unquoted equity investments related to the operation of cash machines (see Note 10).

Group	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
As at 31st December 2009				
Debt Securities	**6.2**	**10.9**	**–**	**17.1**
Embedded derivatives	**–**	**(41.0)**	**–**	**(41.0)**
Investments	**–**	**–**	**2.1**	**2.1**
Derivative assets	**–**	**904.5**	**–**	**904.5**
Derivative liabilities	**–**	**(468.1)**	**–**	**(468.1)**
Certificates of deposit	**–**	**972.6**	**–**	**972.6**
Available for sale securities	**2,825.2**	**76.4**	**–**	**2,901.6**
	2,831.4	**1,455.3**	**2.1**	**4,288.8**

40. RELATED PARTIES

Identity of related parties
The Group and Society have related party relationships with their subsidiaries, joint venture, the pension scheme and key management personnel. The Group considers its key management personnel to be its directors.

Contributions to the pension scheme
The Society paid contributions of £23.0 million to the pension scheme (2008 – £10.3 million).

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

	No. of key management personnel	**2009 £000**	No. of key management personnel	2008 £000
Short-term employee benefits		**1,600**		1,432
Post employment benefits		**64**		72
Total key management personnel compensation	**11**	**1,664**	12	1,504

40. RELATED PARTIES (continued)

Transactions with key management personnel

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

	No. of key management personnel 2009	**Amounts in respect of key management personnel and their close family members 2009 £000**	No. of key management personnel 2008	Amounts in respect of key management personnel and their close family members 2008 £000
Mortgage loans				
At 1st January		**627**		699
Net movements in the year		**(76)**		(72)
At 31st December	**2**	**551**	2	627
Deposit accounts and investments				
At 1st January		**1,193**		1,193
Net movements in the year		**174**		–
At 31st December	**11**	**1,367**	11	1,193

Mortgage loans made to key management personnel and their close family members were granted in the ordinary course of business and are subject to repayment under normal lending terms. The maximum outstanding balances during the year were £626,932.

Amounts deposited by key management personnel and their close family members earn interest at the same rates offered to the public.

Key management personnel and their close family members paid interest totalling £17,901 (2008 – £25,974), received interest totalling £64,635 (2008 – £34,238), and paid no fees and commissions during the year. Interest paid reflects amounts relating to 'offset' mortgages where savings balances are used to reduce the interest bearing balance of mortgage loans.

Transactions with subsidiaries

The Society enters into a number of transactions with its subsidiaries in the normal course of business. These include loans and shares. The value of related party transactions, outstanding balances at the year end and related income and expense for the financial year are as follows:

	2009 £m	2008 Restated* £m	2007 Restated* £m
Shares in subsidiaries			
At 1st January	**241.8**	294.1	294.1
Net movements	**(29.9)**	(52.3)	–
At 31st December	**211.9**	241.8	294.1
Loans to subsidiaries			
At 1st January	**10,362.9**	8,134.9	5,532.3
Net movements	**(700.8)**	2,228.0	2,602.6
At 31st December	**9,662.1**	10,362.9	8,134.9
Deposits from subsidiaries			
At 1st January	**3,798.1**	3,204.7	2,614.7
Net movements	**(92.2)**	593.4	590.0
At 31st December	**3,705.9**	3,798.1	3,204.7
Interest receivable on loans	**400.3**	462.0	348.4
Interest payable on deposits	**(220.8)**	(175.0)	(145.4)
Fees and expenses receivable	**15.0**	15.9	16.4
Fees and expenses payable	**(2.6)**	(2.5)	(2.6)

* The treatment of certain covered bond transactions has been changed, see note 44.

40. RELATED PARTIES (continued)

Transactions with joint ventures
The Society holds 50% of the share capital of MutualPlus Ltd, a branch sharing company. The outstanding balances at 31st December 2009 and 31st December 2008 are less than £0.1 million.

Chelsea Building Society
As part of transactional arrangements prior to the proposed merger, on 30th December 2009 £230 million has been advanced to Chelsea Building Society, on commercial terms, as a reverse repo transaction secured by a covered bond issued by that society. This amount is included in loans and advances to credit institutions, see note 13.

On 2nd February 2010, a further £520 million was advanced to Chelsea Building Society, on commercial terms, as a reverse repo transaction secured by a covered bond issued by that society.

41. CASH FLOWS FROM OTHER OPERATING ACTIVITIES

	Group		Society	
	2009	2008	2009	2008 Restated*
	£m	£m	£m	£m
Working capital adjustments:				
Depreciation and amortisation	**11.4**	9.8	**10.6**	8.6
Profit on sale of assets	**–**	(0.2)	**–**	(0.2)
Interest on subordinated liabilities and subscribed capital	**16.2**	16.2	**16.2**	16.2
Provisions	**61.2**	38.7	**9.2**	12.9
Gain attributable to transfer of engagements	**–**	(3.2)	**–**	(3.2)
Fair value of subordinated liabilities and subscribed capital	**(9.1)**	29.1	**(9.1)**	29.1
Loss on realisation of debt securities	**(11.5)**	1.0	**(10.8)**	0.9
Increase in other assets	**(10.4)**	(8.7)	**(18.9)**	(21.3)
Decrease in other liabilities	**(11.6)**	(22.8)	**(7.7)**	(0.7)
Working capital adjustments	**46.2**	59.9	**(10.5)**	42.3
Decrease/(increase) in operating assets:				
Loans and advances to credit institutions	**–**	46.2	**–**	46.2
Loans and advances to customers	**1,253.4**	(635.7)	**918.7**	(147.2)
Investments	**–**	–	**730.7**	(2,175.8)
Derivative financial instruments	**(203.0)**	623.4	**(410.3)**	1,411.9
Net decrease/(increase) in operating assets	**1,050.4**	33.9	**1,239.1**	(864.9)
(Decrease)/increase in operating liabilities:				
Shares	**110.3**	924.9	**110.3**	924.9
Amounts owed to credit institutions	**(697.1)**	810.9	**(964.6)**	390.4
Other deposits	**(671.0)**	(676.3)	**(765.4)**	687.4
Net (decrease)/increase in operating liabilities	**(1,257.8)**	1,059.5	**(1,619.7)**	2,002.7

* The treatment of certain covered bond transactions has been changed, see note 44.

42. TRANSFER OF ENGAGEMENTS

On 31st December 2008 the Society acquired the business of the Barnsley Building Society (the Barnsley) under section 42B(3)(b) of the Building Societies Act on the basis of a board resolution of the Barnsley as permitted by a direction given by the Financial Services Authority.

The Barnsley had identified exposures to two Icelandic banks that would require a write-off of up to £10 million. This sum could have been fully absorbed by the general reserves of the Barnsley but its board determined that the long-term interests of its members would best be served by a transfer of engagements to the Society.

The assets and liabilities acquired and the associated accounting adjustments are set out below:

Assets	Notes	Cessation Accounts £m	Reclassi-fications £m	Adjustments £m	Take on balances £m
Cash in hand and balances with the Bank of England		0.5	–	–	0.5
Loans and advances to credit institutions	c	46.2	–	0.1	46.3
Debt securities	c	26.1	–	0.2	26.3
Loans fully secured on residential properties	d	292.1	–	0.6	292.7
Other loans		1.4	–	–	1.4
Tangible fixed assets	e	3.7	(0.3)	(0.7)	2.7
Investment properties	e	–	0.2	–	0.2
Intangible assets	f	–	0.1	0.6	0.7
Deferred tax	g	0.3	0.5	(0.1)	0.7
Current tax		1.0	–	–	1.0
Prepayments and accrued income		0.2	–	–	0.2
Total assets		371.5	0.5	0.7	372.7
Liabilities					
Shares		310.0	–	–	310.0
Amounts owed to credit institutions	c	30.0	–	0.2	30.2
Amounts owed to other customers		14.8	–	–	14.8
Derivative financial instruments	h	–	–	2.1	2.1
Accruals and deferred income		0.4	–	–	0.4
Provision for liabilities		0.1	–	–	0.1
Deferred tax		(0.5)	0.5	–	–
Net pension liability		1.9	–	–	1.9
Other liabilities		1.2	–	–	1.2
Total liabilities		357.9	0.5	2.3	360.7
General reserves		13.6	–	(1.6)	12.0
Total reserves and liabilities		371.5	0.5	0.7	372.7
Goodwill					
Fair value of net assets					12.0
Purchase consideration	i				(8.8)
Negative goodwill	j				3.2

The board has considered whether any adjustment is required to the provisional value of the net assets acquired, or of the purchase consideration, based on events that have occurred since the acquisition date. Given that the board remains committed that all subsequent amounts that are received on the previously written off exposure to the two Icelandic banks will be returned, net of costs, to the former members of the Barnsley, no adjustment is required. In addition, no other matters have been noted.

42. TRANSFER OF ENGAGEMENTS (continued)

Notes and adjustments

a The results of the Group do not include any material amounts of income or expense relating to the business acquired on 31st December 2008. The income and expenditure account for the Barnsley for the period to 30th December 2008 is reported in the table below for information only.

b The cessation accounts of the Barnsley have been prepared in accordance with UK Generally Accepted Accounting Principles. Certain reclassifications have been made to comply with IFRS and balances have been adjusted in accordance with 'IFRS 3 Business Combinations'.

c Money market instruments have been adjusted to fair value by applying appropriate market interest rates and prices.

d Mortgage balances have been adjusted to fair value by comparing them with the Society's current product range.

e Properties ancillary to branches and not used by the business have been reclassified as Investment Properties. Properties have been adjusted to their current fair value. Computer software has been reclassified as intangible assets.

f Identifiable intangible assets relate to the intrinsic value of a retail savings book and income streams from renewable contracts, primarily property insurance. They will be amortised over their useful lives of between three and five years.

g Deferred taxation relating to mortgage provisions has been written off.

h Derivative financial instruments have been recognised at their fair value.

i The combination of the two societies did not result in any transfer of consideration. The deemed purchase price has been calculated by measuring the fair value of the Barnsley business. This calculation has been based on a forward projection of cash flows generated by the business assuming modest growth in business assets and a saving in management expenses due to synergies. These projections have been discounted at a rate of 12% which approximates to the estimated cost of long-term unsecured funding.

j Negative goodwill results from the transaction, this gain has been recognised in the Income statement in Negative goodwill.

Income and expenditure account of the Barnsley Building Society
For the period 1st January 2008 to 30th December 2008

	£m
Net interest income	**5.0**
Net fee and commission income	**0.4**
Administrative expenses	**(4.4)**
Depreciation and amortisation	**(0.7)**
Other operating expenses	**(0.2)**
Impairment charge	**(10.0)**
Taxation	**1.1**
Net loss for the period*	**(8.8)**

* The above Income and Expenditure relates to the cessation accounts of the Barnsley and these amounts have not been included in the Income Statements of the Society or the Group. They are reported here for information only.

43. EVENTS AFTER THE REPORTING PERIOD

At special general meetings on 22nd January 2010 and 26th January 2010 respectively, the members of Chelsea Building Society and Yorkshire Building Society approved the proposed merger of the two societies. Subject to confirmation by the Financial Services Authority the merger will take effect on 1st April 2010.

44. PRIOR YEAR RESTATEMENT

During the year the directors have re-considered the accounting policy adopted in respect of certain covered bond transactions to better reflect the substance of the underlying transaction. The change has no impact on the consolidated financial statements.

Previously, where mortgages pledged as collateral in relation to a bond issue had a value in excess of the value of the related bonds, the over-collateralisation was accounted for within the statement of financial position of the Society as a capital contribution, whilst an equal and opposite loan was recognised in the statement of financial position of Yorkshire Building Society Covered Bonds LLP, a fellow group entity and the vehicle used for the covered bond programme.

The revision of the accounting policy has resulted in the statement of financial position of the Society including only the value of the mortgages, thereby removing the over-collateralisation asset, with an equal and opposite reduction in the amount due to the LLP. The income statement has been restated to remove the impact of the fair value of the interest rate swap and the over-collateralisation.

Statement of financial position	**Society**			
	2008 as reported	Fair value adjustment	Netting adjustment	2008 Restated
ASSETS	£m	£m	£m	£m
Liquid assets				
Cash in hand and balances with the Bank of England	291.9	–	–	291.9
Loans and advances to credit institutions	486.9	–	–	486.9
Debt securities	4,149.3	–	–	4,149.3
Loans and advances to customers				
Loans secured on residential property	9,765.4	–	–	9,765.4
Other loans	4.6	–	–	4.6
Derivative financial instruments	466.2	(202.0)	–	264.2
Investments	12,800.0	–	(2,193.0)	10,607.0
Intangible assets	8.1	–	–	8.1
Investment properties	7.0	–	–	7.0
Property, plant and equipment	63.7	–	–	63.7
Deferred tax assets	46.3	(7.1)	–	39.2
Retirement benefit surplus	30.7	–	–	30.7
Other assets	37.0	–	–	37.0
Total assets	28,157.1	(209.1)	(2,193.0)	25,755.0
LIABILITIES				
Shares	13,683.1	–	–	13,683.1
Amounts owed to credit institutions	1,830.6	–	–	1,830.6
Other deposits	6,425.3	(227.0)	(2,193.0)	4,005.3
Debt securities in issue	4,477.1	–	–	4,477.1
Derivative financial instruments	672.2	–	–	672.2
Current tax liabilities	11.3	–	–	11.3
Deferred tax liabilities	22.0	–	–	22.0
Retirement benefit obligations	1.9	–	–	1.9
Other liabilities	52.8	–	–	52.8
Provisions	17.0	–	–	17.0
Subordinated liabilities	112.9	–	–	112.9
Subscribed capital	167.2	–	–	167.2
	27,473.4	(227.0)	(2,193.0)	25,053.4
Total equity attributable to members	683.7	17.9	–	701.6
Total liabilities	28,157.1	(209.1)	(2,193.0)	25,755.0

44. PRIOR YEAR RESTATEMENT (continued)

Statement of financial position

	Society 2007 as reported £m	Fair value adjustment £m	Netting adjustment £m	2007 Restated £m
ASSETS				
Liquid assets				
Cash in hand and balances with the Bank of England	434.9	–	–	434.9
Loans and advances to credit institutions	732.2	–	–	732.2
Debt securities	3,184.5	–	–	3,184.5
Loans and advances to customers				
Loans secured on residential property	9,324.5	–	–	9,324.5
Other loans	4.2	–	–	4.2
Derivative financial instruments	132.3	(11.4)	–	120.9
Investments	9,217.9	–	(786.7)	8,431.2
Intangible assets	7.5	–	–	7.5
Investment properties	6.0	–	–	6.0
Property, plant and equipment	60.3	–	–	60.3
Deferred tax assets	4.8	(0.8)	–	4.0
Retirement benefit surplus	8.0	–	–	8.0
Other assets	19.8	–	–	19.8
Total assets	23,136.9	(12.2)	(786.7)	22,338.0
LIABILITIES				
Shares	12,448.2	–	–	12,448.2
Amounts owed to credit institutions	1,410.0	–	–	1,410.0
Other deposits	4,103.8	(14.0)	(786.7)	3,303.1
Debt securities in issue	3,967.4	–	–	3,967.4
Derivative financial instruments	94.0	–	–	94.0
Current tax liabilities	10.6	–	–	10.6
Deferred tax liabilities	7.7	–	–	7.7
Retirement benefit obligations	–	–	–	–
Other liabilities	51.3	–	–	51.3
Provisions	4.3	–	–	4.3
Subordinated liabilities	105.0	–	–	105.0
Subscribed capital	146.0	–	–	146.0
	22,348.3	(14.0)	(786.7)	21,547.6
Total equity attributable to members	788.6	1.8	–	790.4
Total liabilities	23,136.9	(12.2)	(786.7)	22,338.0

Income Statement

	Society 2008 as reported £m	Fair value adjustment £m	2008 Restated £m
(Loss)/profit before tax	(69.4)	22.4	(47.0)
Tax credit/(expense)	20.1	(6.3)	13.8
Net (loss)/profit	(49.3)	16.1	(33.2)

Annual business statement

1. STATUTORY PERCENTAGES

	2009 %	Statutory Limit %
Lending Limit	**6.3**	25.0
Funding Limit	**32.5**	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986.

The Lending Limit measures the proportion of business assets not in the form of loans fully secured on residential property.

The Funding Limit measures the proportion of shares and borrowings (excluding offshore deposits held by individuals) not in the form of shares.

The statutory limits are as laid down under the Building Societies Act 1986 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

2. OTHER PERCENTAGES

	2009 %	2008 %
As a percentage of shares and borrowings:		
Gross capital	**5.58**	5.66
Free capital	**5.13**	5.22
Liquid assets	**31.94**	25.35
(Loss)/profit for the financial year as a percentage of mean total assets	**(0.01)**	0.04
Management expenses as a percentage of mean total assets	**0.57**	0.56

The above percentages have been prepared from the Group accounts and in particular:

- 'Shares and borrowings' represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue;
- 'Gross capital' represents the aggregate of general reserve, hedging reserve, available for sale reserve, subordinated liabilities and subscribed capital;
- 'Free capital' represents the aggregate of gross capital and collective impairment provision less property, plant and equipment, intangible assets and investment properties;
- 'Liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets;
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year; and
- 'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

3. INFORMATION RELATING TO THE DIRECTORS AND OTHER OFFICERS AT 31ST DECEMBER 2009

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
E. J. S. Anderson, BSc, CPFA 22nd December 1950	Company Director	19th May 2003	Airport Operators Association Ltd Leeds, York and North Yorkshire Chamber of Commerce and Industry Leeds International Pianoforte Competition Leeds Trinity University College Mid Yorkshire Hospitals NHS Trust St. Gemma's Hospice University of Leeds
I. J. Bullock, BSc, FIA 7th November 1960	Building Society Sales and Marketing Director	12th April 2007	Accord Mortgages Ltd MutualPlus Ltd
A. M. Caton, BA 27th July 1963	Building Society Corporate Development Director	1st July 2004	YBS Investments (No. 1) Ltd YBS Investments (No. 2) Ltd Yorksafe Insurance Company Ltd Yorkshire Guernsey Ltd Yorkshire Investment Services Ltd Yorkshire Key Services Ltd Yorkshire Key Services (No. 2) Ltd
Mrs L. F. Charlesworth, BA, MBA 24th August 1956	Company Director	31st December 2006	St. James Investments Ltd St. James Investment Company UK No. 3 Ltd
I. C. A. Cornish, BSc 11th November 1960	Building Society Chief Executive	1st July 2003	Accord Mortgages Ltd Yorkshire Investment Services Ltd Yorkshire Key Services Ltd Yorkshire Key Services (No. 2) Ltd
R. H. Davey, BA 22nd July 1948	Company Director	27th September 2005	Amlin Plc London Capital Group Holdings Plc Severn Trent Plc Severn Trent Water Ltd
A. T. Gosling, MA, FCA 1st June 1955	Building Society Finance Director	1st May 2001	Barnsley Property Services Ltd YBS Investments (No. 1) Ltd YBS Investments (No. 2) Ltd YBS Properties Ltd YBS Properties (Edinburgh) Ltd YBS Properties (York) Ltd Yorksafe Insurance Company Ltd Yorkshire Building Society Estate Agents Ltd Yorkshire Computer Services Ltd Yorkshire Guernsey Ltd Yorkshire Investment Services Ltd
P. R. Johnson, FCA 12th October 1946	Chartered Accountant	1st June 2007	Cheadle Hulme School Member of the board of Addleshaw Goddard LLP

3. INFORMATION RELATING TO THE DIRECTORS AND OTHER OFFICERS AT 31ST DECEMBER 2009 (continued)

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
D. V. Paige, BSc, FCA 3rd July 1951	Company Director	31st December 2006	Aegon UK Plc Aegon Direct Marketing Services Europe Ltd Cornerstone International Holdings Ltd Edgecumbe Consulting Group Ltd Guardian Assurance Plc Guardian Linked Life Assurance Ltd Guardian Pensions Management Ltd Scottish Equitable Plc Scottish Equitable (Managed Funds) Ltd Stonebridge International Insurance Ltd
Ms I. Thambiah, BSc, MBA 16th February 1968	Independent Retail Adviser	1st May 2008	Thambiah Consulting Ltd
S. Turner, BSc 29th November 1951	Company Director	13th October 2005	SCM Microsystems Inc Netretail Holding BV

Mr A.M. Caton, Mr I.C.A. Cornish, Mr A.T. Gosling and Mr I. J. Bullock entered into renegotiated contracts during 2009, which are terminable by the Society or the director on one year's notice.

Documents may be served on the above-named directors: Ref. "Yorkshire Building Society" c/o Deloitte LLP at the following address: 1 City Square, Leeds LS1 2AL.

Officer	Business Occupation	Directorships
R. J. Churchouse, MA, ACA	General Manager Risk and Planning	None
Mrs R. D. Court, BA	General Manager Human Resources and Customer Service	Yorkshire Guernsey Ltd Prism (England) Ltd
Mrs A. L. FitzPatrick, LLB	Group Secretary	None
D. N. Henderson, BSc	Chief Information Officer	Yorkshire Key Services Ltd Yorkshire Key Services (No. 2) Ltd

Principal Office:
Yorkshire House, Yorkshire Drive, Bradford BD5 8LJ.
www.ybs.co.uk

Auditors:
Deloitte LLP, 1 City Square, Leeds LS1 2AL.

Report and Accounts 2009

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