

Annual Report & Accounts 2012

Leeds
Leeds
Building Society

Financial Highlights

For the year ended 31 December 2012

£10.3 billion

TOTAL ASSETS

£52.4 million

PRE-TAX PROFITS

£7.7 billion

MEMBER SAVINGS BALANCES

£1.65 billion

NEW MORTGAGE LENDING

£614 million

CAPITAL AND RESERVES

Leeds

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Board of Directors

Robin A. Smith, TD, LLB, DL
(Chairman)

Robert W. Stott
(Vice Chairman)

Peter A. Hill, ACIB
(Chief Executive)

Robin J. Ashton, BA, ACA

Philippa A. Brown

David Fisher

Philip A. Jenks

Robin S.P. Litten, BA (Hons), ACMA
(Finance Director)

Leslie M. Platts, BA, FCA

Abhai Rajguru, BSc (Hons),
FCMA, CGMA

Kim L. Rebecchi, BA (Hons), FCIB
(Sales and Marketing Director)

Ian Robertson, CA, CCMI

Karen R. Wint, ACIB
(Operations Director)

Chief Risk Officer & Secretary

Andrew J. Greenwood, LLB



Chairman's Statement

For the year ended 31 December 2012

In my final year as Chairman, I am proud to report that Leeds Building Society has delivered another very strong set of financial results. Despite the demanding market conditions, which have prevailed since the onset of the financial crisis in 2007, we have achieved an excellent performance in our core markets, increased capital and reserves, and total assets now exceed £10bn.

Whilst we do not expect the economic environment to improve significantly over the short to medium term, our resilient profitability, strong funding, liquidity, and cost control mean that we are confident the Society will continue to deliver good results for its current and future members throughout 2013 and beyond.

ECONOMIC BACKGROUND

Economic conditions remain challenging. In the early part of 2012, the eurozone was in difficulties and, whilst European sentiment improved in the second half of the year, the underlying issues are not yet fully resolved. This is undoubtedly impacting confidence and, as Europe is also the UK's largest export market, it is making the rebalancing of the UK economy harder to achieve. Inflation has fallen sharply in the year, but still remains above earnings growth, maintaining the pressure on household budgets. That the recovery has failed to materialise means the Government's attempts to bring the deficit under control, through austerity measures, look set to continue into the next parliament.

As a result of the weak economic environment, Bank Base Rate remains at an historic low. House prices have remained flat, as have commercial real estate values, although recent press comment suggests house prices may be about to improve. Notwithstanding this, changes in the savings and mortgage market were of benefit to the Society. Data from the Bank of England shows that household savings balances, including capitalised interest, increased by around £46.6bn this year, compared to £30.4bn in 2011, whilst gross mortgage lending increased by £1.7bn, to £142.6bn. However, net lending reduced to only £7.4bn compared to £9.5bn a year earlier.

STRATEGIC DIRECTION

To ensure we continue to thrive, your Board believes that the Society must have a compelling vision underpinned by a clear and distinct strategy.

Since Peter Hill was appointed Chief Executive in 2011, we have defined that vision and built our strategy around it.

This is explained more fully in the Chief Executive's Review on page 4.

The Society's vision is "to be Britain's most successful building society".

Most successful means:

- Delivering the **best value for members**,
- Achieving the **best business** and financial results and,
- Creating the **best environment for our colleagues**.

The members of the Executive team have been challenged to achieve these goals and their rewards are directly linked to the level of success.

REGULATION AND INDUSTRY DEVELOPMENTS

In April this year, the Financial Services Authority (FSA) will split into the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA), and we will be regulated by both bodies. The FCA will focus on consumer protection and the PRA on financial stability.

The Society has made a number of changes to meet the requirements of the FSA's Retail Distribution Review (RDR), which relates to the sale of regulated investment products. I am delighted the Society has partnered with Legal & General, which will ensure that members are able to continue to benefit from regulated advice on investments and retirement planning through our branches.

In October 2012, the FSA issued its Policy Statement on the Mortgage Market Review (MMR), with the recommendations becoming effective from April 2014. We anticipated many of the key outcomes and have already implemented the majority of proposals, such as changing the way we assess affordability.

The UK Government conducted its own review into the banking sector through the Independent Commission on Banking and recently undertook a consultation to determine if any changes were needed to the regulatory framework for the building society sector. We actively contributed to the 'Future of Building Societies' discussion and welcome the commitment



“...we have achieved an excellent performance in our core markets, increased capital and reserves, and total assets now exceed 10bn.”

made by the Government to ensure that mutuals are able to thrive.

The Bank of England introduced the 'Funding for Lending' scheme to stimulate lending to consumers and businesses, and we were one of the first institutions to sign up. Whilst this initiative supported our mortgage volume aspirations, retail savings remain the core of our funding requirements, and will continue to be so, as we grow the business over the coming years.

We continue to maintain strong relationships with all of our key stakeholders, including our members, regulators, the Bank of England, media and industry trade bodies. The credit ratings agencies, Moody's and Fitch, both continued to assign long term 'A' ratings to the Society citing our resilient profitability, driven by a good interest margin and strong cost control.

BOARD COMPOSITION AND CORPORATE GOVERNANCE

This will be my last Chairman's statement, as I will retire at the Annual General Meeting (AGM) in March. In line with best practice, recommended by the UK Corporate Governance Code, we maintain a high level of skill and expertise on the Board. Succession planning is key to our ongoing prosperity and it is proposed that Robin Ashton, who joined the Board in April 2011, will follow me as Chairman.

To fill Board vacancies, we have engaged recruitment consultants, advertised nationally and considered a wide range of candidates, both internal and external, to ensure that we are able to meet the challenges and opportunities facing the Society both now and in the future.

Robin Litten was appointed Finance Director in January 2012. Robin has significant experience in the building society sector, having held senior positions with both Skipton and Scarborough building societies. He is a qualified accountant who has also worked in both banking and retail.

In December 2012, Karen Wint was appointed Operations Director. Karen first joined the Society in 1983 and has been a member of the senior management team for five years as General Manager, with responsibility for Customer Services. Karen is a member of Leeds City Council's Housing and Regeneration Board and an Associate of the Chartered Institute of Bankers. She is the sister of Kim Rebecchi.

Last year, two non-executive Directors retired. I am pleased to report that we appointed David Fisher and Phil Jenks as non-executive Directors in March 2012. David is currently the Chairman of the Business and Oversight Board, and Chairman of the Remuneration Committee of the Law Society, and former Chief Executive of Sainsbury's Bank. Phil is a specialist adviser to the Housing Finance Select Committee, having

previously held the role of Chief Operating Officer, Mortgages, at HBOS Plc.

In January this year, we appointed Philippa Brown as a non-executive Director. She is currently Chief Executive Officer of Omnicom Media Group UK. Her previous roles include that of Managing Director of IPC Media, part of the Time Warner Group, and Media Director of Bartle Bogle Hegarty.

These new Directors are all subject to election at this year's AGM, to be held on 26 March, 2013, and a summary of their details, and those of Peter Hill and Kim Rebecchi, who are subject to re-election, can be found on pages 22 and 23. All these Directors bring a range of knowledge, skill and experience to the Board that will help ensure our continued success and I ask you to support their nominations.

Executive pay and performance continue to be closely scrutinised and objectives are aligned with our Corporate Plan, recognising short, medium and long term goals. The very strong results this year mean that performance-related awards have been made to the senior executives and the majority of our colleagues. Details are contained in the Directors' Remuneration report on pages 30 to 34.

SUMMARY

I am able to step down as Chairman in the confidence that the Society is in an extremely strong position. Assets exceed £10bn, we have achieved good levels of profitability and increased capital and reserves to record levels. My thanks go to my professional and dedicated colleagues who have worked tirelessly over many years to deliver these excellent results and a superior service to our members.

I would like to extend my best wishes to my proposed successor, Robin Ashton, and know that the Society's Senior Management Team, led by our Chief Executive, Peter Hill, has all the attributes needed to ensure that your Society continues to be successful.

Finally, I would like to thank you, our members, for all your support and commitment. Leeds Building Society would not exist without you and I have been privileged to serve you as Chairman for the last six years. I am delighted that you choose to be part of such a successful and independent institution.



Robin Smith
Chairman
18 February 2013



Chief Executive's Review

For the year ended 31 December 2012

2012 Business Highlights:

- New mortgage lending increased by 35% to £1.65bn (£1.23bn 2011) which is significantly above our market share
- Net residential lending of £737m (£300m 2011) is our best ever performance
- Savings balances grew by £384m (£329m 2011) to £7.74bn, the highest level in our history
- Assets increased by 5% to a record £10.32bn (£9.86bn 2011)
- 61,000 new members were attracted, taking total membership to a record 696,000
- Pre-tax profit rose by 4% to £52.4m (£50.2m 2011)
- Capital and reserves increased by 7% to a record £614m (£572m 2011)

Leeds Building Society has performed very strongly in 2012 and delivered a record performance in both our mortgage and savings markets. Residential mortgage completions increased by 35% to £1.65bn, net lending was almost two and half times higher than 2011, at £737m, and retail savings balances grew by £384m, a rise of 5%. I am also delighted that assets and membership numbers are the highest in our history and capital and reserves are at record levels.

This has been achieved in the context of continuing challenges for the financial services sector and the UK economy as a whole, combined with a mortgage market that has seen very little growth in recent years.

SOCIETY'S STRATEGY

Following my appointment as Chief Executive, I stated that my approach would be evolutionary, not revolutionary. Building on solid foundations, we have now developed a strategy to

deliver the Society's vision, "to be Britain's most successful building society", outlined by the Chairman, Robin Smith, on page 2.

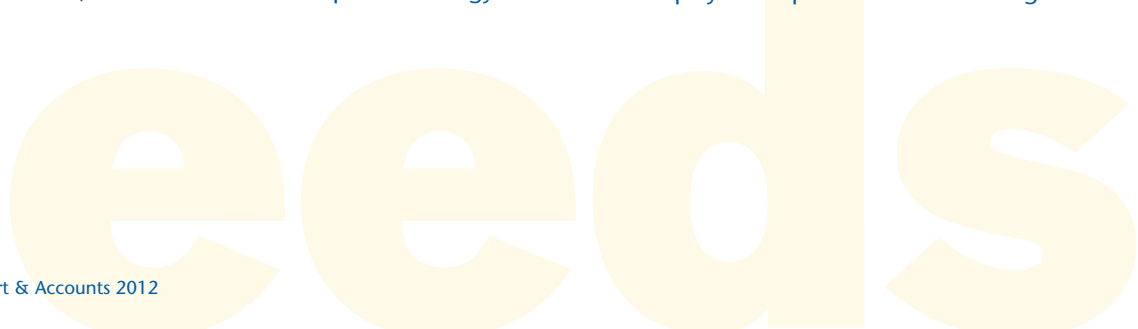
The strategy is built on four pillars:

1. To generate strong levels of profit, which are retained in the business to build a solid platform for growth and continuing financial security.
2. To support the aspirations of a wide range of borrowers and savers, in particular those who are not well served by the wider market.
3. To deliver outstanding personal service to all our members.
4. To continue to reinvest in the business to improve efficiency, whilst being intolerant of waste.

In addition to developing the vision, your Society has made excellent progress in 2012 to implement the strategy.

BUSINESS PERFORMANCE

Retail savings continue to play an important role in our funding strategy. The Society attracted over £2.4bn of deposits in 2012, and total balances increased to a record £7.74bn. Our net savings grew by £212m (excluding capitalised interest) in a market that contracted for building societies and 39,000 new savings members were attracted by the security and value we provide. The Member Loyalty Bond was once again very popular and I am pleased that we are offering another exclusive product this year. Our branches play an important role in serving our members and



“Leeds Building Society has performed very strongly in 2012 and delivered a record performance in both our mortgage and savings markets.”

this was endorsed when we won in the ‘Best Regional Branch Network’ category at the 2012 Your Money Direct Awards.

The Retail Distribution Review (RDR) represents a fundamental change from the current position on the high street. The Board held the view that, at a time when many other high street institutions are turning their backs on this type of service, with some focusing solely on high net worth customers, Leeds Building Society should continue to offer an advice service that complements our traditional building society savings accounts. We considered a range of possible partners, and decided to work with Legal & General, who have become the Society’s main provider of advice to our members on investment and protection products.

Our ability to attract both retail and wholesale funding has enabled us to grow our lending further in 2012. New residential loans increased by 35% to £1.65bn, compared to £1.23bn a year earlier, and this represents almost double our market share. We have particular expertise in the Shared Ownership market, which is very popular with first time buyers, and we have also developed a number of Local Authority Mortgage Schemes (LAMS). These provide 95% loan-to-value loans to people who can afford the mortgage repayments, but are unable to provide a large deposit.

We believe that providing mortgages designed specifically for first time buyers plays an important role in supporting home ownership, the housing market and the wider economy and I am delighted that £497m of our new lending, almost 30%, has helped 5,700 first-time-buyers onto the housing ladder. Including these mortgages, the average loan-to-value on all new lending in 2012 was still only 56% (51% 2011).

A large proportion of our new mortgages came through intermediaries and our strong market proposition was recognised at the Legal & General Mortgage Club Awards, where we won the title of ‘Best Regional Lender’. We also work hard to ensure that our processes are efficient and this was acknowledged when we won the Mortgage Finance Gazette ‘Best Use of Technology Award for Lenders’. Through the capability of our colleagues, we were able to reduce costs, enhance communication and improve the efficiency of our mortgage offer process, resulting in all documentation being sent to solicitors by secure e-mail and instant delivery, rather than by post.

We continue to reinvest in the long-term prosperity of the Society as we develop a solid platform for growth, and I am

delighted that we have been able to create over 30 new roles in 2012. As a result, our cost income ratio increased slightly to 33%, from 31% a year earlier, as did our cost asset ratio, from 48p per £100 of assets to 49p as at 31 December 2012. These ratios remain amongst the best in the building society sector.

Economic conditions remain challenging, maintaining the pressure on household budgets. We work closely with those borrowers experiencing financial difficulty and offer a range of forbearance options. Despite these headwinds, residential arrears (1.5% or more of outstanding mortgage balances) reduced from 3.23% in 2011 to 2.89%.

The charge for impairment losses reduced by £6.6m, to £41.9m, in 2012. As a result, the total residential and commercial balance sheet provisions are £80m (£85m 2011), leaving the Society well covered for losses.

We no longer have any Treasury or Sovereign debt exposure to the so-called ‘peripheral’ Eurozone countries of Portugal, Italy, Ireland, Greece or Spain.

We have again delivered a strong pre-tax profit performance of £52.4m (£50.2m 2011), which has enabled us to further increase the security of our members’ savings as capital and reserves increased by 7%, to £614m (£572m 2011). Only 4.2% of this is in the form of borrowed capital, the lowest ratio of the larger building societies. Our Core Tier 1 capital ratio strengthened to 14.3% from 13.8% in 2011, and total assets rose to £10.32bn (£9.86bn 2011), including liquid assets of £1.75bn, representing 18.5% of total funds.

Whilst there are many aspects to delivering a performance that is ‘Best for Business’ and ‘Best for Members’, I believe that our ability to provide competitive savings accounts, help people onto the housing ladder, and deliver sector leading efficiency are the key components of our success in 2012.

MEMBER ENGAGEMENT

As an independent mutual owned by our members, I am particularly pleased that, during my first full year as Chief Executive, we have attracted 61,000 new members, and total membership is at a record high of 696,000.

We carry out regular independent member surveys and satisfaction scores remain consistently high, at an average of 95% in 2012. It is also pleasing to know that 93% of those surveyed would recommend Leeds Building Society to their family and friends. We also use the industry standard metric of

Chief Executive's Review *continued*

For the year ended 31 December 2012

Net Promoter Score (NPS), which measures the likelihood of a customer recommending a product or service. Our NPS of +54 benchmarks very well against the industry.

This research provides insight into how we are perceived as an organisation. However, we are not complacent and encourage feedback from all of our key stakeholders, and especially our members, on both positive and negative experiences. Our success has been built on listening and adapting quickly, we take corrective action where necessary, ensuring that any issues are eradicated and enhancements made where possible.

Our 'Nominate a Star' scheme encourages customers to recommend a colleague or a team that has delivered outstanding customer service. I am very proud to report that there has been a superb response in 2012 and we received 460 nominations from members providing excellent feedback about colleagues across the business.

All of the Society's members also have an opportunity to comment and have their say on the Society's performance and direction at our Annual General Meeting (AGM). As a mutual, we operate a 'one member, one vote' system and members can cast their vote in a variety of ways, including at their local branch, online or by post. We encourage all our members to use their vote and I would urge you to do so at this year's AGM.

PEOPLE

Our colleagues play a vital role in our success and I am, therefore, delighted that our status as an 'Investor in People' was re-affirmed last year. There were many highlights in the report. Colleagues have a high degree of understanding around our vision, feel truly engaged and proud to be working for the Society, and welcome our very open and honest approach to leadership and management.

Each year we seek feedback from all our colleagues and the 2012 survey maintained high engagement levels, which benchmark well against the average for our industry. The average length of service for our colleagues is almost eight years. Over half have been with the Society for more than five years. Indeed, we have 100 colleagues with over 20 years' service and a further nine with over 40.

All of our colleagues benefit from a structured personal development plan and regular training to support career progression. As part of the work undertaken to deliver our ten-

year vision, we will focus on recruiting and retaining the best talent and being 'Best for Colleagues'.

CORPORATE CITIZENSHIP

It is important that we take a responsible approach to everything we do and deliver value, security and sustainability to all our current and future stakeholders. We conduct our business in an ethical way, balance the interests of all our key stakeholders, including the wider community, and are a responsible corporate citizen. We published our first Corporate Responsibility report in January last year and have continued to develop our approach. We focus on four main areas of impact; community, members, colleagues and the environment.

As the UK's 5th largest building society, we have a national presence and our network of branches, and processing centres, play an important role in their local community. Therefore, we have developed our charity and community giving to provide a sustainable contribution to large national charities and local community causes.

Our partner charities are Age UK, Marie Curie Cancer Care, Variety – the Children's Charity and Leeds Building Society Charitable Foundation. They benefit from our Caring Saver Account, which pays 1% of the average balances held over the year, and our 'Your interest... in theirs' scheme, where members donate the pence amount of any interest they earn on their savings. We also make a donation for each vote cast at our AGM, and you can choose from the British Heart Foundation, WWF-UK (World Wide Fund for Nature), Help for Heroes, St. George's Crypt and our own Foundation, to receive the funds from your vote.

Our Heads of Department once again undertook a number of fund raising activities throughout 2012 for St. Gemma's Hospice, Tiny Lives and Martin House Children's Hospice. Our 'Matched Funding' scheme, which looks to support everyone at the Society with their charitable fundraising, has also been very successful. Through all of these initiatives, worthy causes have received £133,000 during the year, of which we are very proud.

We are aware that we can always do more to help and have launched the 'Lending a Hand' scheme, which enables all of our colleagues to spend a day volunteering in the community. The first to benefit from this was St. George's Crypt, when we held a food collection day in December. Over 1,500 tins and



“I am also delighted that assets and membership numbers are the highest in our history...”

packets of dried food were donated and these were distributed to people in Leeds who desperately needed it.

Since its inception, the Leeds Building Society Charitable Foundation has donated almost £1.25m to charities located within fifteen miles of our branches and offices. Each donation looks to support community based projects which aim to provide relief from suffering, hardship or poverty, or their direct consequences.

We continue to focus on minimising our impact on the environment. During the branch refurbishments and upgrades carried out this year we have, wherever possible, incorporated energy efficient technologies. We have an active recycling and waste management policy, which has enabled us to recycle more than ever and reduce landfill, and we work in partnership with our suppliers to minimise carbon emissions.

We have also maintained our sporting affinities and agreed a new three-year sponsorship of Leeds Rhinos for the 2013, 2014 and 2015 seasons, as this is a very effective way of raising awareness of the Society. The new deal is the third successive three-year sponsorship agreed between us and, during the first six years, Leeds Rhinos have won eight major trophies, which is an outstanding achievement.

OUTLOOK

The challenging economic environment looks set to remain, with most forecasters predicting little or no improvement in the economy. This means the mortgage and savings markets are unlikely to improve materially in 2013, and the Bank of England Base Rate is likely to remain at its historic low for the foreseeable future.

Uncertainty continues in the eurozone, as the UK struggles to rebalance the economy and bring the deficit under control. Inflation looks set to continue to fall slowly and is likely to remain above wage growth. Household budgets will continue to experience pressures as the austerity measures look likely to continue for longer.

The regulatory environment continues to change. We have already successfully implemented our Retail Distribution Review strategy and look forward to working with the Financial Conduct Authority and Prudential Regulation Authority when they come into effect on 1 April this year. The new rules from the Mortgage Market Review will also be effective from April 2014.

Notwithstanding this, we are extremely well placed to continue our outstanding performance, providing our members with good value for money savings products and helping people to buy their own homes. Leeds Building Society is a profitable, well capitalised business and this gives us the opportunity to achieve our growth aspirations in 2013 and beyond.

It has been a pleasure to present my first full year's results which have been achieved in difficult economic conditions, and I would like to thank the Board of Directors and my dedicated and talented colleagues for their contribution.

We are committed to remaining independent and you, our members, remain at the heart of everything we do. I would like to thank you for your continued support as we look forward to further success together in 2013.



Peter Hill
Chief Executive
18 February 2013

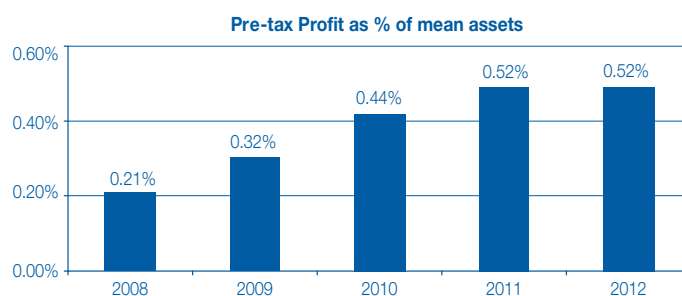
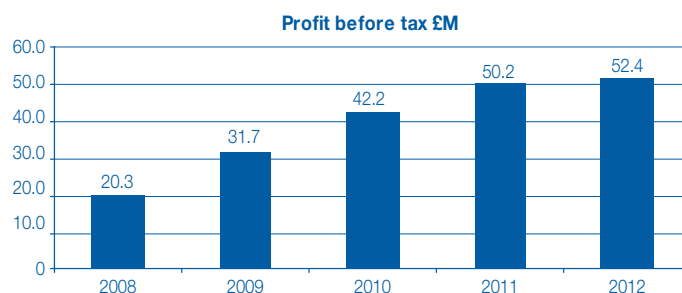
Business Review

For the year ended 31 December 2012

This section provides a detailed review of the Society's performance in 2012 in the context of its key performance indicators. The business review should be read in conjunction with the information provided in the Chairman and Chief Executive Statements, the Directors' Report, Income Statements and the Statements of Financial Position.

The Society's criteria for continued success include generating strong levels of profit, underpinned by sustainable growth and superior efficiency. This creates a secure platform which enables the Society to meet the aspirations of a wide range of borrowers and savers, and deliver outstanding personal service to its members. The Society's performance against key performance indicators which support these aims is summarised in the table below.

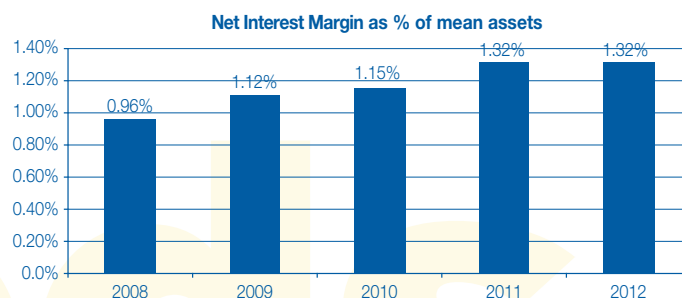
Pre-tax profit	Increased by 4% to £52.4m
Capital	Increased by 7% to £614m
Efficiency	Cost to Income ratio of 33% (expected to the lowest of any major Building Society)
Residential arrears	Reduced to 2.89% from 3.23%
Mortgage losses	Reduced by £6.6m
Commercial real estate total exposure	Reduced by £67m to just 4% of total assets
New residential lending	Increased by 35% to £1.65bn
Share balances	Increased by 5% to £7.7bn
Wholesale funding	Raised £375m of long term secured funding
Credit rating	Retained a long term A credit rating from both Moodys and Fitch
Customer satisfaction	95% of those responding to our survey expressed satisfaction
Membership	Total members increased to 696,000



The increase in pre-tax profit in 2012 was achieved as cost increases, including the FSCS levy, and lower other income were covered by improvement in net interest income and lower impairment charges. The key components of pre-tax profit are discussed in more detail below.

Net Interest Margin

The net interest margin for the year remained at 1.32% generating £133.2m net interest income (2011 £127.6m). The Society's objective is to achieve a net interest margin that balances the requirements of both mortgage and savings members whilst ensuring that sufficient profits are generated to maintain a strong capital position.



INCOME STATEMENT OVERVIEW

Pre-tax Profit

Profit is the main source of capital for a building society and is essential in ensuring the long term security of the Society for its members.

The key performance indicators monitored by the Society in respect of profitability include, profit before tax and its relationship to mean assets, net interest margin, other income, administrative expenses and impairment provisions.

The Society's pre-tax profit for 2012 increased 4% to £52.4m from £50.2m in 2011. Pre-tax profit as a percentage of mean assets remained at 0.52%. The level of pre-tax profit generated by the Society is sufficient to support its on-going capital requirements.

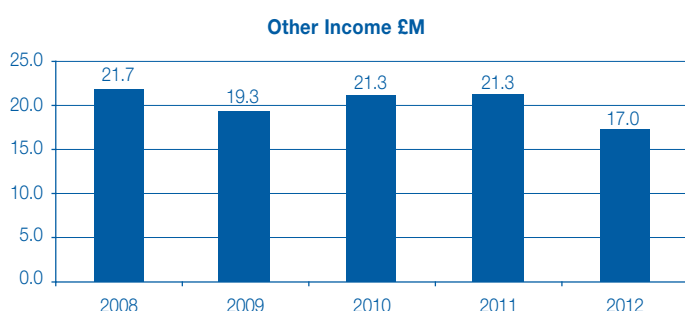
“Pre-tax profit is the main source of capital for a building society and is essential in ensuring the long-term security of the Society for its members...”

The increase in interest income in 2012 of £5.6m is principally due to the improvement in earnings from mortgages, which has been partially offset by the higher cost of both retail (member) savings and funds from the wholesale market. Earnings from mortgages have improved mainly due to the level of new mortgage lending in 2012. The Society increased the amount of new lending in 2012 to £1.65bn from £1.23bn in 2011. Notwithstanding the competitive positioning of mortgage products throughout the year, the margin on new lending was higher than on the lending that matured during 2012 and this contributed to the overall improvement in earnings from mortgages. The Society was successful in raising further secured long term funding of £375m in the year (2011 £393m). However, long term funding is more expensive than short term unsecured funding and the extra cost associated with these funds has reduced the improvement in the overall interest margin. Competition for retail savings remained strong for most of the year, which has meant that the Society has paid higher rates to attract new funds and this too has reduced the improvement in the interest margin.

In October 2012, the Bank of England introduced the Funding for Lending Scheme (FLS) to encourage banks and building societies to increase the amount of funds available for new lending. Latest indications are that the FLS is contributing to both a reduction in the cost of new mortgages and the cost of new retail savings. In the second half of the year, the Society accessed £200m through FLS compared to net residential lending of £402m.

Other Income (Non-interest Income)

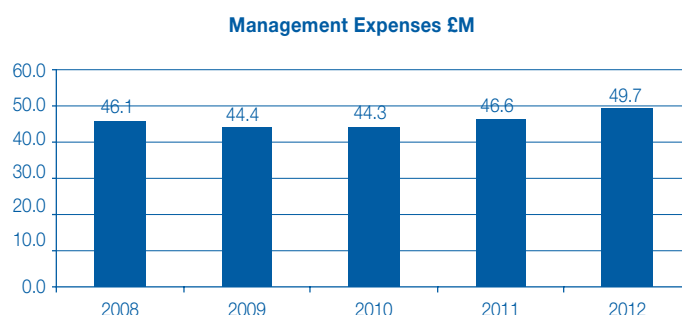
Other income encompasses income from the sale of mortgage related insurance products and other investment products (provided by Aviva and Credit Suisse), rental income and other ancillary fees/income. Other income reduced to £17.0m from £21.3m in 2011 and this was due to lower earnings from the sale of investment products. These sales have been impacted by the market conditions in the latter part of 2012, which has meant that it has been difficult for the Society to launch structured savings products that offer value for money compared to more traditional savings products. In addition, in response to the implications of the Retail Distribution Review, which become effective from January 2013, the Society has moved to an introducer only proposition with Legal & General thus ending its relationship with Aviva and Credit Suisse. The preparatory work required to ensure a smooth transition to Legal & General impacted on the level of sales in the final months of the year.



Administrative Expenses

Managing expenses and optimising efficiency remain a key focus of the Society. Key performance indicators monitored by the Society to demonstrate this include the cost to income ratio and the cost to mean assets ratio. Total administrative expenses, including depreciation, increased in 2012 by 7% to £49.7m (2011 £46.6m). The increase includes higher staff costs (£2.0m) as the Society continued to invest in its capability, particularly in the areas of risk and compliance as well as lending capacity. In addition, a further £0.7m was invested in infrastructure projects including the preparatory work for the change in the provider of the Society's core IT services during 2013. As a result of these investments, the Society's cost to income ratio increased to 33% from 31% in 2011 though it is still expected to be the lowest of any major building society. The cost to mean assets ratio also remains one of the lowest in the sector, having increased modestly in 2012 to 0.49% from 0.48%. These ratios demonstrate the Society's continuing focus in delivering quality customer service to its members as efficiently as possible.

The trend in the Society's overall costs is shown in the following table.



Fair Value Gains Less Losses from Derivative Financial Instruments

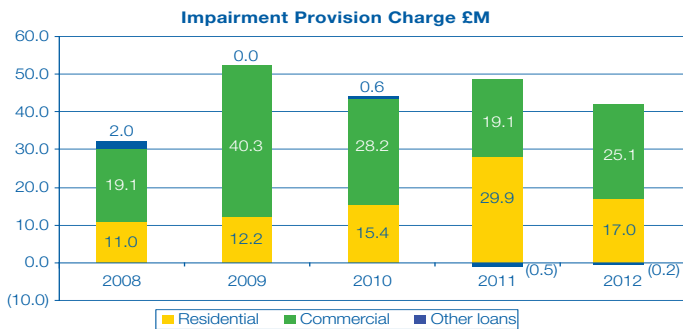
Fair value movements are changes in the value of certain assets and liabilities, mainly derivatives, to reflect their current market value. The movements are primarily due to timing differences which will trend to zero as the asset or liability reaches maturity. Fair value changes in 2012 resulted in a gain of £0.7m compared to gains of £0.1m in 2011.

Impairment Provisions

The Group's impairment charge on loans and advances reduced in 2012 by £6.6m to £41.9m (2011 £48.5m). Overall, balance sheet provisions represent 31% (2011: 33%) of impaired loan balances (where 1.5% or more of the balance is in arrears or the loan is in possession/LPA receivership) leaving the Society well covered. The charge, split between residential, commercial and other loans is shown overleaf.

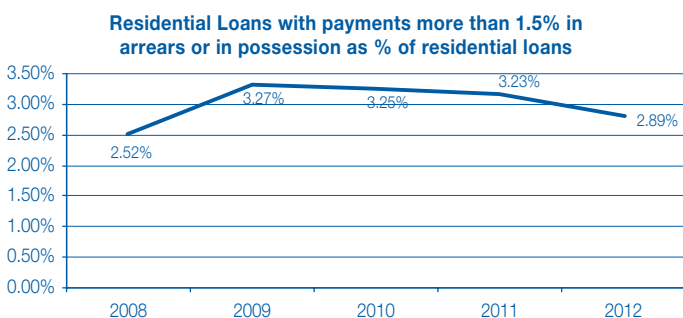
Business Review *continued*

For the year ended 31 December 2012



The arrears ratio indicates how borrowers, both residential and commercial, are coping with maintaining their mortgage payments and provide an indication of the Society's exposure to future loan defaults and loan losses.

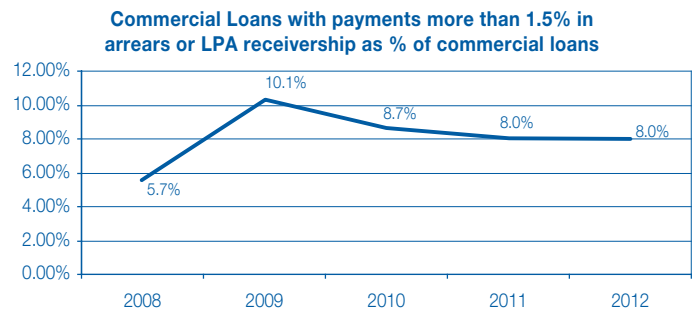
The level of arrears in the residential portfolio is shown in the following table.



The total level of residential arrears, including possessions, reduced to 2.89% at the end of 2012 (2011 3.23%). The Society's arrears ratio on the UK portfolio, which excludes the higher arrears experienced on the overseas lending was lower at 2.52% (2011 2.91%).

The residential impairment charge reduced to £17.0m from £29.9m as the charge in 2011 included an increase in the specific provision for Southern Ireland arrears cases and collective provision for those cases which were not in arrears but had experienced payment difficulties in the previous twelve months, particularly in Southern Ireland where the Society took a cautious approach in view of the very difficult economic conditions in that country. The Society has balance sheet loan loss provisions against residential mortgages of £44.4m (2011: £45.3m).

The level of arrears in the commercial loan portfolio is shown in the following table.



The level of reported arrears on the commercial loan portfolio, which also includes those loans not in arrears but where an LPA receiver has been appointed, was 8% at 31 December 2012. The ratio excluding these LPA receiver cases is just 2.7%.

The commercial loan charge has increased by £6.0m to £25.1m from £19.1m in 2011 and this reflects the mix of defaulted cases in 2012 and a further decline in commercial property values. The Society has balance sheet loan loss provisions against commercial mortgages of £36.0m (2011: £39.4m).

The Society's investment property, a discount retail park in Hornsea, was revalued at the end of 2012 and as a result of the deterioration in the market for this type of property and an increase in the level of vacant units, the value has reduced by £1.1m in 2012 to £5.6m.

Other Provisions

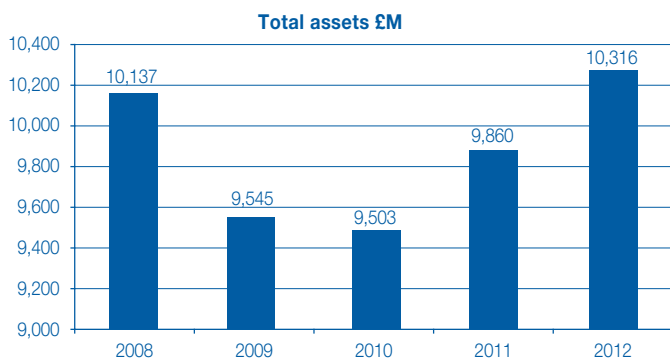
As a regulated deposit taker the Society is a member of the Financial Services Compensation Scheme (FSCS), which compensates savers and investors for losses incurred when other institutions fail. As Building Societies raise a higher proportion of funding from retail deposits they pay a disproportionate share of the cost of bailing out failed financial institutions. In 2012, the FSCS increased its levy, including capital repayments to £5.2m (2011 £3.4m).

Unlike some other financial institutions, the Society has no systemic mis-selling issues and so has not had to make any significant provisions in respect of the mis-sale of payment protection policies, although the Society has provided a further £0.6m to cover the increased volume of speculative cases and costs involved in dealing with them.

“Maintaining the appropriate level and quality of liquidity ensures that the Society can meet its obligations as they fall due.”

BALANCE SHEET OVERVIEW

The Society's balance sheet total assets grew by 4.6% in 2012. The change in total assets over the last five years is shown in the following table.

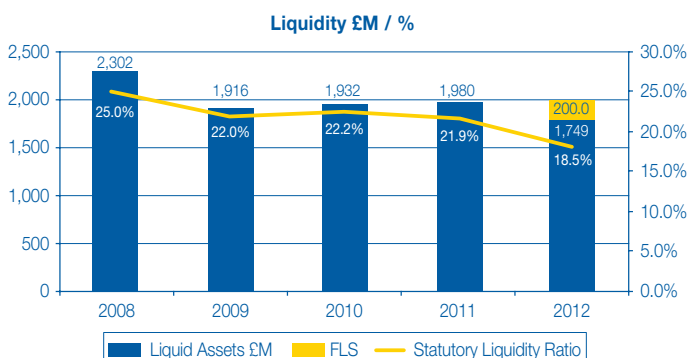


The main components of the Society's assets and liabilities are discussed in more detail below.

Liquid Assets

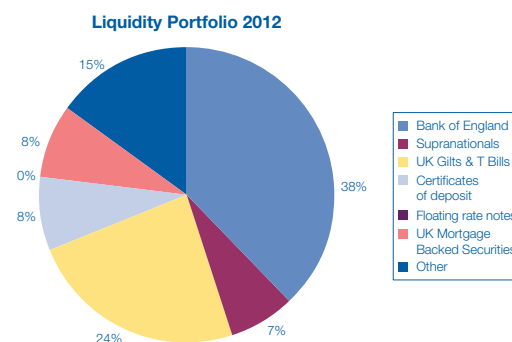
Maintaining the appropriate level and quality of liquidity ensures that the Society can meet its financial obligations as they fall due. The key performance indicators monitored by the Society to ensure this include the liquidity ratio and the level of buffer assets. Buffer assets are considered to be the highest quality investment instruments, readily realisable as cash when required.

The Society continued to maintain a strong liquidity position ending 2012 with liquidity of £1.75bn representing 18.5% of share and deposit liabilities (SDLs) compared to 21.9% at the end of 2011. The Society was able to reduce the liquidity ratio in 2012 as the quality of the portfolio has continued to improve with a higher volume and proportion of buffer assets. The lengthening of the residual maturity profile of the wholesale funding portfolio and the reduction in short term funding also contributed to a lower liquidity requirement. The Society also has access to the Funding for Lending Scheme which as at 31 December 2012 provided a further £200m of buffer assets not shown on the Balance Sheet. This liquidity is provided by the Bank of England in the form of Treasury bills and when added to "on Balance Sheet" liquidity increases the ratio to 20.2%.



Within total liquidity of £1.95bn, including the £200m through the FLS, £1.1bn is classified as buffer assets as defined by the FSA. This is significantly in excess of the amount required on an ongoing basis, ensuring that the Society is able to meet its obligations as they fall due under stressed conditions.

A breakdown of the liquid assets is shown in the following table.



As at 31 December 2012 the Society's portfolio of buffer assets represented 12% of SDLs (2011 10%). This calculation is made net of any buffer assets that are subject to repo arrangements.

The Society has continued to manage the liquid asset portfolio to increase the quality and liquidity of the assets with over 57% held in buffer assets (2011 42%). 96% of the liquid asset portfolio is rated 'A' or better with 82% rated 'AAA' (2011 96% rated 'A' or better, 74% rated 'AAA').

There is no direct sovereign exposure to the so-called 'peripheral' Eurozone countries (Portugal, Ireland, Italy, Greece and Spain) in the liquid asset portfolio, nor is there any exposure to market counterparties in those countries.

Loans and Advances to Customers

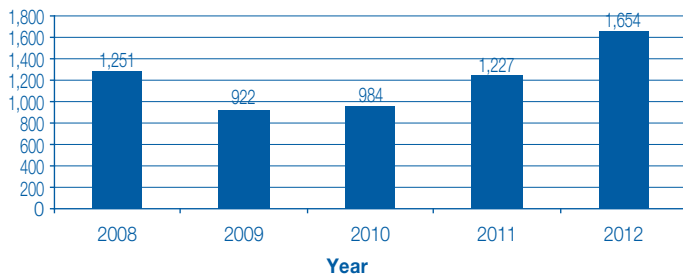
The change in loans and advances to customers demonstrates the Society's ability to grow the business through offering a competitive product range to attract or retain borrowers. The key performance indicators monitored by the Society include the level of net lending, the arrears ratio (see impairment section) and the portfolio mix.

The Society's loans and advances to customers of £8.3bn include £7.6bn of residential mortgages, £0.4bn of commercial loans and £0.3bn of other loans. The Society's gross and net mortgage lending increased in 2012. Gross residential lending increased by £427m to £1.65bn whilst total net lending, including commercial loan redemptions, increased to £667m following an increase in 2011 of £259m. The changes in gross and net lending reflect the Society's current strategic objective of increasing the size of the Society's mortgage book taking advantage of the Society's funding capacity and strong capital position to further strengthen its proposition to current and future members.

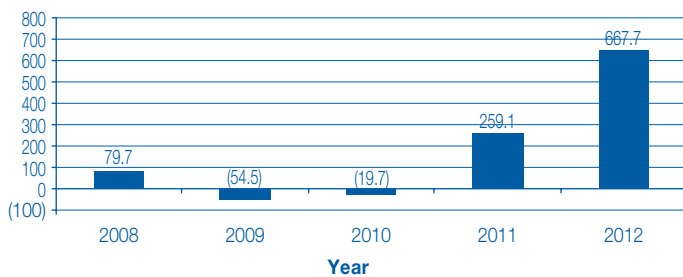
Business Review *continued*

For the year ended 31 December 2012

Gross Residential Lending £M



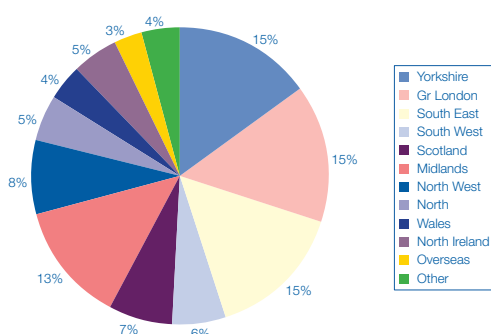
Net Lending £M



Both the Society's gross and net residential lending in 2012 are above its market share (based on the mortgage data from the Council of Mortgage Lenders – CML). Gross lending was £0.8bn above our market share, whilst net lending was £0.7bn above.

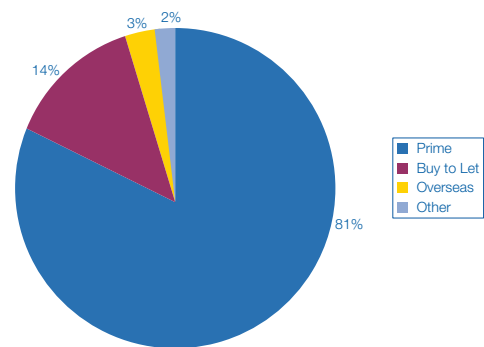
The Society's residential lending is well diversified and the split of the year end balances by region, product type and loan to value (LTV) percentage are shown in the following charts.

2012 Balances by Region



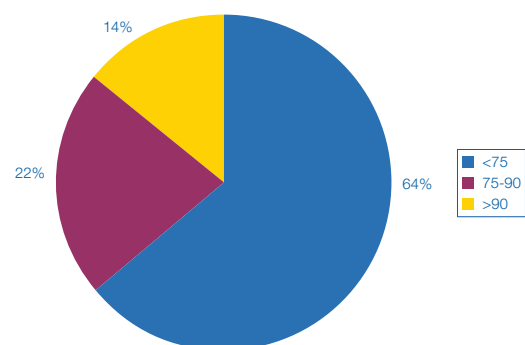
The Society's lending portfolio is geographically diverse with the largest exposures being in Yorkshire, the South East and Greater London reflecting the concentration of activities in Yorkshire and the higher property values in the South East and London.

2012 Mortgage Balances by Type



The Society concentrates predominantly on the prime residential mortgage market, including shared ownership, but also lends to buy to let landlords. The Society is no longer active in overseas lending, which historically relates to Southern Ireland and lending to UK residents in Spain.

2012 Balances by Indexed LTV



The overall indexed LTV on the mortgage portfolio at the end of 2012 remained at 51%, reflecting the Society's conservative lending policy and the absence of house price growth in the current environment.

The Society withdrew from the commercial lending market in 2008 and since then the portfolio has reduced from a peak of £626m in 2008 to £438m at the end of 2012 and now represents less than 6% of total loans and advances to customers.

Investment Property

In 2009, the Group purchased the freehold of a retail park, Hornsea Freeport, to protect its interests over the medium to long term horizon. The site was originally the security against a commercial loan held with the Society, which could no longer be serviced by its owners. The Group considers the running of an investment property to be outside its core business activities, and has employed an experienced firm of property managers to deal with the day to day running of the shopping complex. The latest valuation has resulted in a reduction in the fair value by £1.1m to £5.6m.

“The Society’s residential lending is well diversified and the split of the 2012 lending and year end balances by region, product type and loan to value are shown...”

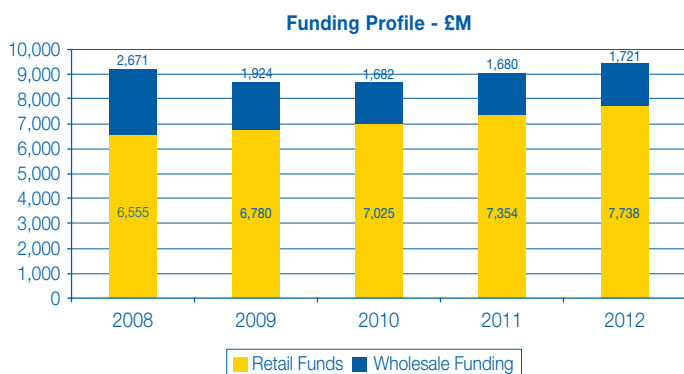
Fixed assets

Fixed assets, which represent land and buildings and office and computer equipment, were £28.5m at the end of 2012 compared to £27.5m at the end of 2011. The Society spent £1.8m in 2012 investing in the branch network and infrastructure projects.

Retail and Wholesale Funding

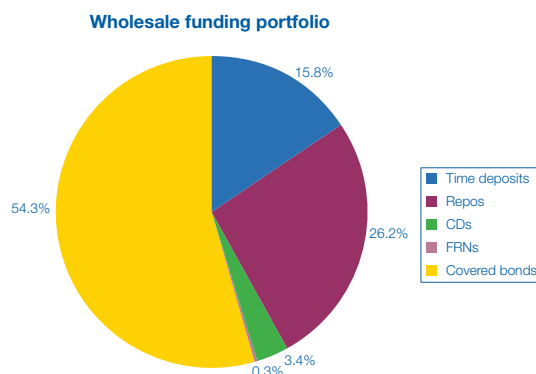
Achieving an appropriate level, mix and duration of funding is essential in providing the Society with the financial resources to meet its growth aspirations. The key performance indicators monitored by the Society to demonstrate this include the change in retail (members) funds and the wholesale (non-retail) funding ratio.

As a mutual building society, the Society is required to obtain the majority of its funding through retail funds from its members, with the balance of funds from the wholesale markets. The graph below shows the funding mix of the Group between retail and wholesale balances.



The Society continued to maintain a high level of retail savings in 2012, despite the very competitive environment. The Society’s net retail receipts of £212m were £262m above its market share of the mutual sector net retail savings as published by the Building Societies Association.

During 2012 the Society remained active in the long term wholesale funding markets raising a total of £375m sterling equivalent. In February, the Society utilised the Long Term Refinancing Operation provided by the ECB to raise €150m of funding with a maturity of up to three years. A £250m three-year floating rate covered bond was issued in March which attracted a diverse range of new investors to the Society. The Society’s non retail portfolio at the end of the year is as follows:



The wholesale funding ratio reduced to 18.8% from 19.2% at the end of 2011.

The Society’s Treasury Department also prepared the Society for its debut securitisation in 2012, issuing £397m of residential mortgage backed securities and retaining them for use as collateral in the Funding for Lending Scheme. The Society raised £200m through this scheme in 2012.

The Society has reduced the amount of short term funding it holds to £202m (2011 £637m) whilst maintaining a consistent presence in the short term money markets throughout the year. The Society has maintained the residual maturity profile of its wholesale funding portfolio at 3.0 years (2011 3.1 years) and the proportion of funding which is categorised as long term (with more than 1 year remaining to maturity) has remained broadly stable at 62% (2011 59%).

Maintaining strong ratings with the Credit Rating Agencies is important to support the Society’s wholesale funding activities. The Society’s short and long term credit ratings from FitchRatings and Moody’s Investor Services as at 31 December 2012 are as follows:

	Long Term	Short Term	Outlook
Moody’s	A3	P-2	Stable
Fitch	A-	F2	Stable

Capital

Maintaining a strong capital position is essential in ensuring the long term security of the Society for its members. The key performance indicators monitored by the Society include the core tier 1 ratio, solvency ratio and level of the capital buffer.

Business Review *continued*

For the year ended 31 December 2012

The amount of the Society's capital and its capital ratios improved further in 2012 as a result of the strong underlying profit generated in the year and lower growth in the value of its risk weighted assets (RWA).

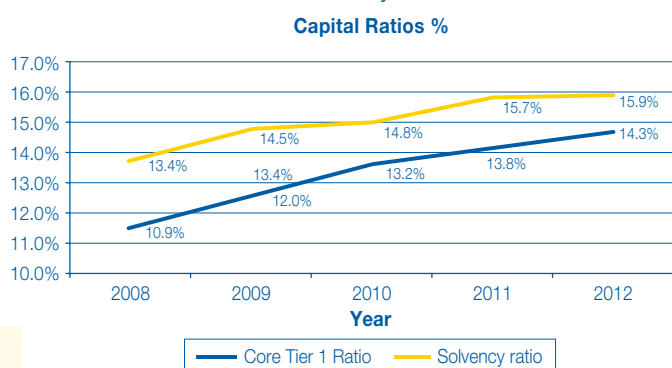
Core tier 1 capital is the strongest form of capital and, in the most part, represents the Society's accumulated post-tax profit (general reserves) built up over time. The ratio compares the core tier 1 capital to its RWA (which is the sum of its assets modified to incorporate the level of risks inherent in those assets).

The solvency ratio is the level of total capital, which is the sum of core tier 1 capital and other forms of capital (Permanent Interest Bearing shares, subordinated debt, revaluation reserve and collective loan loss provisions), as a percentage of RWA.

The Society's capital and associated ratios are shown in the following table.

	2008	2009	2010	2011	2012
Core Tier 1 Capital (£'M)	448.0	469.8	501.4	537.0	575.1
Core Tier 1 Ratio	10.9%	12.0%	13.2%	13.8%	14.3%
Total balance Sheet Capital	526.9	543.1	531.1	572.4	613.8
Add/(Less):					
Collective mortgage loss provisions	18.6	15.4	19.9	34.7	24.3
Cash flow/Available for sale reserve	4.4	8.6	9.4	3.7	0.4
Fair value adjustment for subordinated liabilities	(1.4)	-	-	-	-
Total Regulatory Capital (£'M)	548.5	567.1	560.4	610.8	638.5
Solvency ratio	13.4%	14.5%	14.8%	15.7%	15.9%

The graph below shows the relationship between the Society's core tier 1 ratio and its total solvency ratio.



The FSA also sets minimum capital requirements based on their assessment of the Society's risk profile of its assets and business activities. Throughout 2012, the Society's actual regulatory capital was significantly in excess of this minimum requirement.

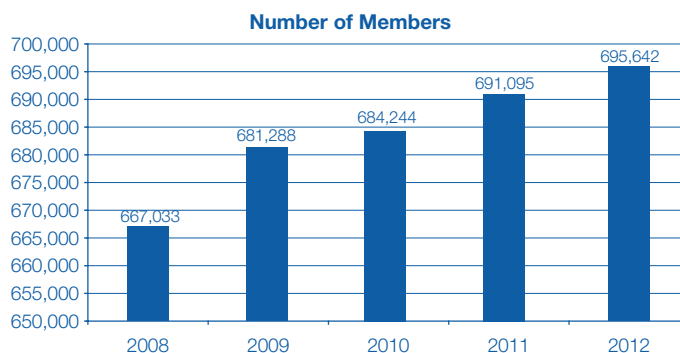
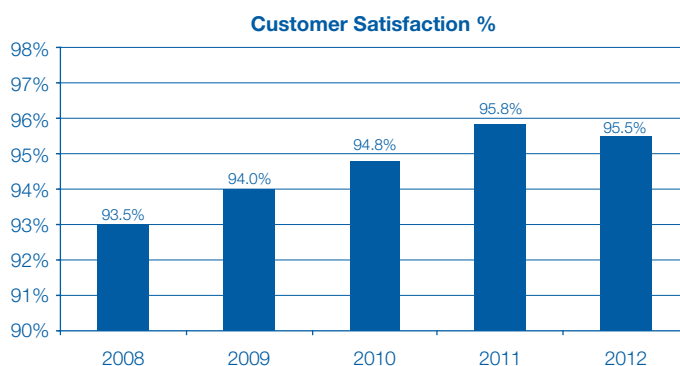
NON-FINANCIAL PERFORMANCE OVERVIEW

Delivering outstanding customer service and maintaining or improving the Society's relationship with members and colleagues (external and internal stakeholders) is important to the overall success of the Society. The key performance indicators monitored by the Society include the number of members, as well as member and colleague satisfaction.

Members and Satisfaction

Member satisfaction is measured through an independent survey which is carried out quarterly. As well as providing an overall measure of satisfaction, the survey also provides a comparison of the Society's performance against other financial institutions. The Society also measures the total number of members, as a growing membership base is also a reflection of member satisfaction and the Society's success in delivering quality customer service and competitive products.

The Society has achieved combined scores of over 90% since the creation of the member survey and they remained at over 95% in 2012.



“Customer satisfaction has remained at over 95% in 2012.”

Colleague Satisfaction

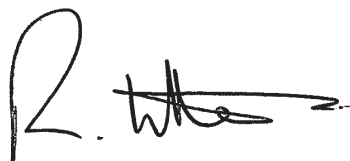
Colleague satisfaction is monitored through an annual colleague survey and monthly through the level of colleague turnover. In the 2012 survey, colleagues who were either satisfied or very satisfied, was 76% and colleague turnover was 17%.

The Society has maintained a high level of colleague satisfaction and an acceptable turnover rate, based on the Society's own internal targets.

Outlook

During 2012, the Society has further improved its underlying profitability and financial strength. The economic outlook for the UK and wider Eurozone economies continues to be uncertain and against that backdrop, the Society's aim is to maintain its strong financial position ensuring that it continues to be able to withstand the challenges and stresses which may present themselves, whilst continuing to provide value and security to its members.

Within this context, the Society plans to continue to deliver an increase in net residential lending significantly above its market share, funded through a combination of growing retail savings balances and further long term wholesale funding, including FLS. The continued growth in the Society's business is expected to reinforce the continuing financial strength of the Society.



Robin S. P. Litten
Finance Director
18 February 2013

Risk Management Report

For the year ended 31 December 2012

Purpose

The purpose of this report is to:

- Explain the Society's risk management framework;
- Highlight the risk governance arrangements; and
- Set out the principal risks and uncertainties facing the Society.

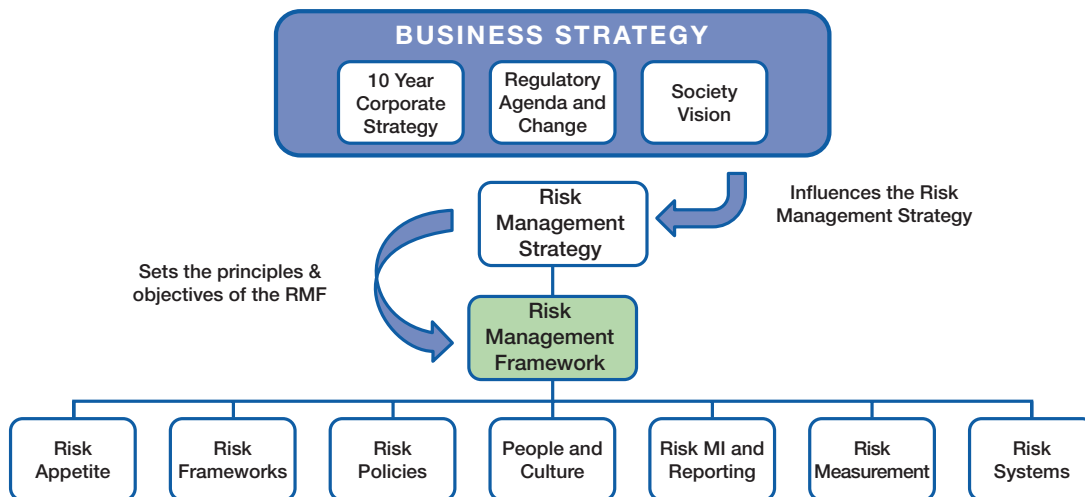
Risk Management Framework

The Society has developed a Risk Management Strategy ("RMS"), which sets out the vision and principles for risk management within the organisation, in the context of the Society's Corporate Plan.

The Risk Function seeks to support the sustainable achievement of the Society's long term strategy and comprises specialist teams that provide in depth fundamental analysis and oversight of each of the constituent risks faced by the Society. These areas comprise Credit, ALM and Treasury Risk, Operational and Conduct Oversight Risk (including Compliance) teams.

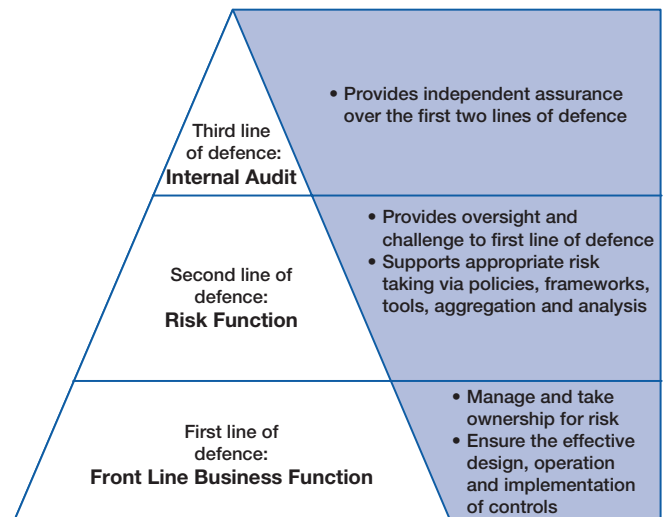
In order for the RMF to operate effectively, it is critical that:

- Risk is owned by line management and integrated within business processes;
- Appropriate supporting arrangements exist to ensure independent risk expertise and assurances are available; and
- Risk management is a partnership between the Risk Function and frontline business functions.



The RMS is supported by a detailed Risk Management Framework ("RMF"), which provides a structured approach to risk management and takes an integrated and holistic view of risks across the Society. The approach set out in this report has been embedded within the Society, in order to achieve a consistent approach to the aggregation and management of all risks and has been integrated into business management and decision making, at both strategic and operational levels. The RMF is underpinned by a number of core supporting components. The inter-relationship between the Business Strategy, RMS, RMF and its supporting components is shown above.

To effect these principles, the Society operates a "3 lines of defence" model:



Both the RMS and RMF are maintained by the Society's Chief Risk Officer ("CRO") and are subject to an annual appraisal by the Group Risk Committee, on behalf of the Board. The CRO leads the independent, integrated Risk Function and reports directly to the Society's Chief Executive. In addition, the CRO is also accountable to the Chairman of the Group Risk Committee.

“The Risk Function seeks to support the sustainable achievement of the Society’s long-term strategy...”

Risk Governance Arrangements

A high level summary of the Society’s governance controls and committee structure is set out below.

Governance Controls

The governance infrastructure is supported by three tiers, with the following controls underpinning each level:

Tier	Controls
Tier 1 Board Governance Infrastructure	<ul style="list-style-type: none"> Board Procedures Manual Board level committee Terms of Reference (ToR) for: <ul style="list-style-type: none"> Group Risk Committee; Audit Committee; Assets & Liabilities Committee; Board Credit Committee; Conduct Risk Committee; Remuneration Committee; and Nominations Committee.
Tier 2 Executive Management Governance Infrastructure	<ul style="list-style-type: none"> Control manual for Executives List of Board delegated authorities Executive Management level committee ToR for: <ul style="list-style-type: none"> Executive Committee; Management Risk Committee; Management Credit Committee; and Management Assets and Liabilities Committee.
Tier 3 Risk Management Infrastructure	<ul style="list-style-type: none"> Risk Management Frameworks Risk Policies Risk Appetite Internal Capital Adequacy Assessment Process, Individual Liquidity Assessment Process, Contingency Funding Plan and Recovery and Resolution Plan.

Further details of the activities of the GRC, BCC, ALCO and CRC are set out in the Corporate Governance Report on pages 27 to 28.

Committees with dotted lines into the Board are not directly tasked with risk oversight. However, aspects of their responsibilities relate to risk management within the Society.

Principal Risks and Uncertainties

The principal risks and uncertainties facing the Society, which are managed by the RMF are outlined below.

Credit Risk

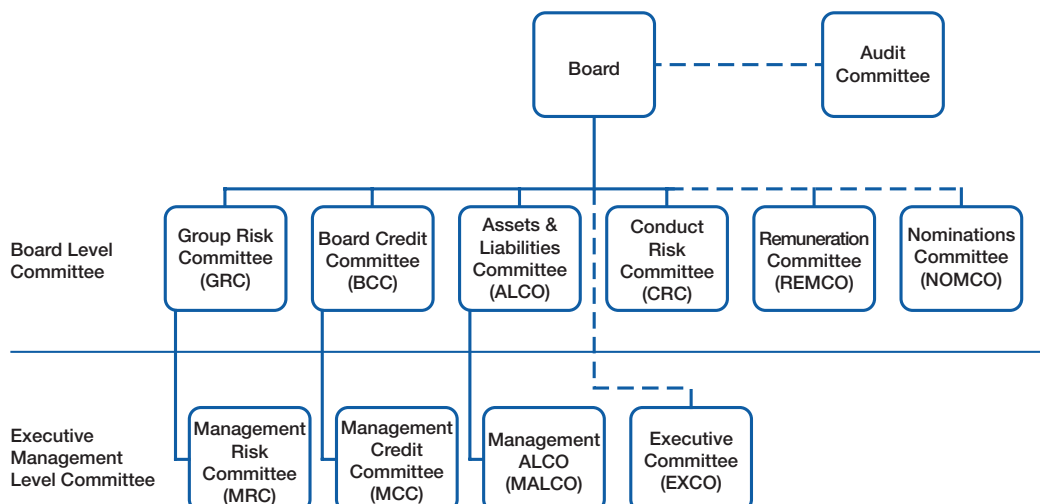
Credit risk represents the risk that customers or counterparties will not meet their financial obligations as they fall due. The Society faces this risk from its lending operations to retail mortgage customers, commercial lending customers and wholesale counterparties through Treasury operations for liquidity purposes. Under each category heading below is an explanation of how the Society mitigates each of these risks.

Market Background and Uncertainties

The key driver of credit risk within the Society is the performance of the UK economy. At present, the outlook for 2013 is for low economic growth as a result of further austerity measures in the UK and overseas, which will reduce demand for goods and services. It is also expected that inflation will continue to erode household income, UK house prices will remain relatively flat and the resilience of the UK labour market in 2012 could start to diminish. These factors, which influence the level of residential arrears and impairment losses, are offset, to an extent, by the continued low interest rate environment. As a consequence, the Society does not envisage a significant increase in the level of residential arrears or impairments in 2013.

Committee Structure

The structure of management and Board Committees is set out below.



Risk Management Report *continued*

For the year ended 31 December 2012

The economic environment outlined above will also affect the performance of the Society's commercial loan portfolio. Reductions in demand for goods and services lead to a heightened risk of insolvencies, which could result in borrowers being unable to meet their obligations as tenants default. The Society stopped underwriting new commercial loans in 2008 and is in the process of further reducing its exposure to this asset class.

The Eurozone crisis continued during 2012 with Spain and Cyprus requesting financial assistance from the EU. It is envisaged that the periphery Eurozone sovereigns will continue to experience difficulties in 2013, as further austerity measures are deployed in order to reduce their deficits. The Society has no direct exposure to these periphery sovereigns, but remains vigilant to second order effects.

Residential Risk Mitigation

This risk is managed by a specialist retail credit risk function, reporting to the Chief Risk Officer and, in turn, to the BCC.

The Society's Credit Policy is approved annually by the Board and is reviewed on an ongoing basis by the BCC. This document details the current limit structures in respect of mortgage lending and reflects the Society's current risk appetite. The BCC also receives monthly management information, highlighting the performance of the Society's mortgage portfolio.

With regard to new lending, residential credit risk is managed using the following tools:

- Credit scorecard assessment.
- Affordability assessment based on income and expenditure.
- Access to credit data, which reviews the credit history of an individual.
- Independent expert appraisal of the suitability and value of a property.
- Underwriting systems, which are a hybrid of computer systems and people.

The Society's retail credit risk function monitors the performance of the portfolio, including stress testing, on an ongoing basis. This identifies trends and facilitates an understanding of the portfolio, which is used to assess whether the current risk appetite remains appropriate.

If a borrower's financial situation starts to deteriorate, the Society has established procedures to respond appropriately. The Society has a dedicated Collections function that seeks to engage with customers, at an early stage, to discuss potential financial difficulties. Forbearance options are determined on a case by case basis, with the aim of working with the borrower to clear their arrears. The Society is able to offer customers a range of options including extension of the mortgage term, a temporary change to interest only, deferral of interest, reduced monthly repayments, transfer to an alternative product or special interest rate (subject to meeting the criteria). If a borrower's financial situation has deteriorated significantly the Society may take possession of the mortgaged property.

The analysis of the Society's residential portfolio and forbearance measures feed into the Society's provisioning policy. This ensures that the Society properly recognises losses in accordance with its accounting policies.

Commercial Risk Mitigation

The Society closed its commercial lending operations to new business in 2008, and since this time has managed down the portfolio from £626m to £430m as at 31 December 2012. During this time, the Society has retained a team of appropriately skilled staff, who are responsible for administering the portfolio and maximising recovery levels. In addition, the Risk function provides second line oversight of the performance of the portfolio.

The performance of the portfolio is monitored closely, and overseen by BCC with monthly reporting to the Board. All loans are assessed on a case by case basis using a broad range of potential impairment indicators. If a loan is deemed impaired then the Society uses a combination of formal recovery action and appropriate forbearance, through loan extensions, restructures, and where suitable, enforced external refinancing to reduce the size of the loan book and minimise losses.

Similar to residential credit exposures, analysis of the commercial portfolio and forbearance measures feed into the Society's provisioning policy. Over recent years the Society has made significant provisions against its commercial portfolio, which has ensured the Society has recognised losses on impaired cases in accordance with its accounting policies.

Wholesale Credit Risk Mitigation

Since the onset of the financial crisis, the Society has maintained a very low risk appetite for wholesale credit risk. In 2011, the continued turbulence within the Eurozone resulted in the Society aligning its wholesale counterparty credit lines to UK entities only, with the exception of several highly rated counterparties domiciled in Europe, North America and Asia. As at the end of 2012, 90% of the Society's Treasury investments were located within the UK. These exposures were diversified through holdings of UK Government, financial institution and asset backed securities, along with deposits with the Bank of England. The Society has no wholesale credit exposure to Ireland, Portugal, Spain, Greece, Italy or Cyprus.

All credit limits are subject to ALCO review on a regular basis. This ensures that counterparty exposures remain compliant with the Board approved wholesale credit policy. Established credit lines are based on a combination of internal assessment, external credit ratings, credit default swap spreads, the jurisdiction in which the counterparty is domiciled and other market intelligence.

Operationally, a dedicated Treasury Risk function monitors the Society's exposures on a daily basis and escalates market developments, as appropriate. ALCO receives regular updates on wholesale credit risk exposures.

“Since the onset of the financial crisis, the Group has maintained a very low risk appetite for wholesale credit risk.”

Liquidity Risk

Liquidity risk represents the risk that the Society is unable to meet its financial obligations as they fall due or can only do so at excessive cost.

Market Background and Uncertainties

During 2012, the wholesale funding markets showed signs of improvement but remained susceptible to events such as the continuing difficulties within the Eurozone. In the UK, the Bank of England implemented the Funding for Lending Scheme (“FLS”), which has had a significant effect on the cost of secured and unsecured wholesale funding. The Society considers that, during 2013, the wholesale markets will potentially remain volatile due to further uncertainty. The introduction of Basel III will require the Society to be compliant with new liquidity standards. These new measures include a liquidity coverage ratio and a net stable funding ratio, which focus on the quality and quantity of liquidity under stressed conditions and the stability of the Society’s funding profile. Implementation of these indicators will be phased in between 2015 and 2018. The Society considers that it is currently well positioned to meet such requirements.

Liquidity Risk Mitigation

This risk is managed through Board approved limits and policy, which determine the overall level, composition and maturity of liquidity and funding balances. Operationally, the Group’s Treasury function is responsible for the day-to-day management of Group liquidity and wholesale funding. Daily compliance with limits is monitored by the Finance and Risk functions and is reported to ALCO and the Board on a monthly basis.

One of the main approaches used by the Society to determine the adequacy of its liquidity, is to conduct an annual Individual Liquidity Adequacy Assessment (“ILAA”). This process, which is subject to FSA review, determines a minimum level of liquid assets required, in order to ensure adequate liquidity, under multiple stressed market environments. These liquid assets, known as ‘buffer assets’, are of a very high credit quality, such as UK Government securities or deposits held with the Bank of England, which ensures they can be readily and easily converted to cash as liabilities fall due. The Board approved the most recent ILAA in September 2012 and concluded that the Society’s liquid asset buffer holdings comfortably met the effects of a prolonged severe stress. As at the end of December 2012, the Society’s liquid buffer eligible assets totalled £1.0bn and accounted for 55% of total liquidity.

The Society also manages liquidity risk through the use of sale and repurchase arrangements (“repo”). Certain treasury assets are encumbered through repo and stock lending programmes, which ensures that these assets remain liquid and readily realisable.

Whilst the core source of the Society’s funding emanates from retail depositors (83%), the Society has remained active in the international wholesale markets. During 2012 the Society lengthened the maturity profile of its wholesale funding, through the issuance of a £250m sterling covered bond and repo arrangements.

Market Risk

Market risk is the risk that the value of, or income emanating from, the Society’s assets and liabilities changes adversely, as a consequence of movements in interest rates and foreign currency rates.

Market Background and Uncertainties

During 2012, the interest rate environment in the UK fell further due to a double dip recession and the introduction of the FLS. With regard to currencies, Sterling strengthened against both the Euro and the Dollar in 2012.

Interest Rate Risk Mitigation

The Society is susceptible to interest rate risk due to the differing interest rate characteristics and maturity profile of its mortgage and savings products. Predominantly, this is due to the provision of fixed rate mortgage and fixed rate savings products. In the event of an upward movement in interest rates the Society could be susceptible to reduced net interest income, as its liabilities become more expensive, whilst net interest income remain constant.

Basis risk, an additional source of interest risk, arises as a consequence of changes in the relationship between interest rates, which have similar but not identical characteristics e.g. LIBOR and the Bank of England Base Rate.

These risks are managed through the use of conservative Board limits, offsetting assets and liabilities and the use of financial derivative instruments, such as interest rate and basis swaps. Board limits are reviewed on an annual basis and ALCO receives management information on interest rate and basis risk exposures. Operationally, Treasury is responsible for managing the Society’s interest rate and basis risk exposures and this is overseen by an ALM and Treasury Risk function.

Through the transaction of interest rate derivatives, the Society converts cashflows into a variable rate basis and hence these cashflows follow the general movements in interest rates, reducing the risk exposure. The Society only transacts the aforementioned contracts for hedging purposes and not for trading or speculative purposes.

Foreign Currency Risk Mitigation

Currency risk is the risk of loss emanating from movements in foreign exchange rates. Here, the Society would be susceptible to the appreciation in the value of foreign currency denominated liabilities or the depreciation in foreign currency denominated assets. Whilst the Society’s assets and liabilities are mainly denominated in Sterling, the Society is exposed to foreign exchange movements through its wholesale funding operations and legacy residential portfolios located in Ireland and Spain.

Similar to interest rate risk, foreign currency risk is managed through Board limits, offsetting assets and liabilities and the use of financial derivative instruments such as foreign exchange swaps. Again, from an operational perspective, Treasury is responsible for managing the Society’s foreign currency risk exposures, with oversight provided by the ALM and Treasury Risk function.

Risk Management Report *continued*

For the year ended 31 December 2012

A subset of foreign currency risk is redenomination risk. This is risk of loss as a result of a reduction in the value of foreign currency denominated assets, which is not matched by a reduction in the value of foreign currency liabilities, for instance if a jurisdiction were to leave the Euro and alter its currency. The Society is exposed to this risk through its legacy lending operations in Ireland (2% of total balances). This risk in Ireland has been substantively mitigated through raising funds under the same governing law as that of the assets. ALCO is responsible for managing this risk, which is also subject to oversight from GRC.

Operational Risk

Operational risk is the risk of financial or reputational loss as a result of inadequate or failed processes, people and systems or from external events.

Market Background and Uncertainties

The Society recognises its increased exposure to operational risk. In 2012 an increasingly litigious social environment, prolonged economic challenges and a period of regulatory change, saw the probability of a range of events increasing. In 2013, the Society will continue to focus on core business activities and does not anticipate any significant changes to the type of operational risks to which it is exposed.

In 2012, the Board agreed to move forward with an outsourcing contract for the provision of the Society's IT core system and ecommerce platform to replace current arrangements with Yorkshire Key Services, a subsidiary of Yorkshire Building Society. The Board acknowledges the significance of this project and has engaged external advisors to provide management support and an appropriate contract that will protect the Society over a ten year term.

The project will run throughout 2013 and into 2014, and it is recognised that successful delivery is crucial in protecting the Society's member interests. Accordingly, a weekly Project Executive Group has been established, to provide close scrutiny of progress and an escalation point for key issues. The Society's Operations Director is performing the role of Project Director and provides updates to each Board Meeting and GRC. Whilst Management has identified the project as one of its top risks, it is confident that it has established a structure to mitigate effectively any matters which may arise.

Operational Risk Mitigation

Management accepts that, in the delivery of its strategy and annual objectives, it will be exposed to operational risk and has assessed a range of possible events and their likely impacts. The risk assessments are used to create a range of tolerances linked to specific events, which form the basis of the Society's Operational Risk Appetite. The Risk Appetite Statement is reviewed and approved by the Board on an annual basis.

The approach to the management of operational risk is embedded into the RMS and the RMF with business areas responsible for the 'first line' of defence control of operational risks. Within the Risk function, a specialist team monitors and reports through to management meetings, the GRC or the Board, on the adequacy of the control environment.

The Society's key exposures to operational risk relate to regulation, information technology & security, financial crime, people and third party relationships. Operational risk losses in 2012 were not material and within the Board's appetite. A review of the profile of 2012 losses did not identify any systemic concerns, with most losses arising out of isolated events with no single loss considered to be significant.

Conduct Risk

Conduct risk, which is a sub-set of operational risk, is considered by the Society to be the risk that actual or potential customer detriment arises, or may arise, from the way the Society conducts its business.

Market Background and Uncertainties

During 2012, the FSA published its final rules on its Mortgage Market Review, outlining the proposed approach to reforming the mortgage market to ensure it is sustainable and works better for customers. The majority of the changes will come into effect in 2014, which will see, amongst other things, most interactive sales (e.g. face to face or telephone) being provided on an advised basis and a requirement, for all mortgage advisors to hold a relevant mortgage qualification. In addition, lenders will be fully responsible for assessing whether the customer can afford the loan and, whilst interest only loans can continue to be granted, there must be a credible strategy in place for repaying the capital. Although the Society will have to refine existing processes in preparation for implementation, it is not anticipated, at this stage, that this will have a significant effect on either lending policy or the current customer experience.

Conduct Risk Mitigation

Overall, the Society has no tolerance for significant conduct risk events and a low tolerance for other conduct risk events. The Society restricts its activities to areas where appropriate expertise is in place. Any potential exposures are proportionate to the size and scale of the Society's operations and do not exceed those quantified within its operational risk appetite.

The Society ensures independent assessment of conduct risk through a dedicated Conduct Oversight function. To continue to support the Society in achieving its objectives and responsibilities in relation to mitigating and managing conduct risk, the CRC became a Board Sub-Committee in March 2012. The CRC continues to meet bi-monthly, with regular updates provided to the Board.

Business Risk

Business Risk represents the risk of changes in the external environment that have the potential to affect negatively the Society's business model. Examples of business risk are the major regulatory changes impacting liquidity, capital or the conduct of business.

Business Risk Mitigation

The Society addresses business risks within its Corporate Plan, which is reviewed annually by the Board. In addition, the Board is provided with updates on the Society's key strategies to ensure these are consistent with the Society's risk appetite.

“Overall, the Group has a low tolerance for conduct risk events and restricts its activities to areas where appropriate expertise is in place.”

Pension Obligation Risk

The Society has funding obligations for a defined benefit pension scheme which was closed to new entrants on 31 December 1999. Pension risk is the risk that the value of the scheme's assets, supplemented by additional member contributions, will be insufficient to cover obligations over the remaining life of the scheme. The return on the scheme's assets will vary, depending on the movement in equity markets and interest rates, whilst the projection of the scheme's liabilities is based on estimates of mortality, inflation and future salary increases. In practice, the actual outcome may differ to the estimates and any shortfall will be borne by the Society.

Pension Obligation Risk Mitigation

This risk is managed through regular meetings of the Pension Trustee Board and an Investment Sub-Committee that was established in 2012. These committees receive quarterly investment monitoring updates, prepared by the scheme's independent advisors and annual actuarial updates, which may lead to a course of appropriate action, such as altering asset allocations. The Pension Trustee Board liaises with Society management as appropriate.

Capital Management

The Society assesses its capital adequacy through an Internal Capital Adequacy Assessment Process ("ICAAP") at least annually. This process is used to determine the level of capital required to support the Society's current and future risks of its business activities. The ICAAP ensures that the Society meets regulatory capital requirements under business as usual and multiple stressed environments, over a five year time horizon.

Following Board approval, the ICAAP is reviewed by the FSA as part of its Supervisory Review and Evaluation Process. This process is used to determine an Individual Capital Guidance ("ICG") requirement for the Society. The Board receives management information on the capital position of the Group compared to the ICG.

The expected implementation of Basel III in 2013 introduces stricter definitions of the components of capital. Current instruments which do not meet the stricter definitions, principally the Society's £25m Permanent Interest Bearing Shares (4% of total capital), will be gradually derecognised for capital purposes, over a ten year period, starting in 2013. Basel III had no effect in 2012, and the Society has considered the impact of the introduction of these rules on future levels of capitalisation, including under stress testing. The Directors consider that the Society will continue to remain well capitalised and there is no foreseeable requirement to issue additional capital instruments.

The Society remained strongly capitalised in 2012, significantly above the ICG and Basel II transitional floors. The Society expects its capital position to remain strong in 2013.



Abhai Rajguru

Chairman of the Group
Risk Committee
18 February 2013

Board of Directors



ROBIN SMITH (70)

I became the Society's Chairman in 2007. I am proud of the Society's Board commitment to mutual status and how its Executive Team has responded to the market challenges of recent years. I practised as a solicitor, ultimately becoming senior partner of my firm (now DLA Piper). I am a non-executive director of Bartlett Group (Holdings) Ltd, Yorkshire County Cricket Club and maintain my links with the Territorial Army. I am also involved with a number of local and national charities.



PETER HILL (51)

I joined the Society in 2001 as a Senior Manager and was appointed to the Board, as Operations Director, in 2006. I became Chief Executive in 2011. My vision is to create Britain's most successful building society, which means providing members with the best products and service, having the best working environment for colleagues and delivering the best financial performance. I am an active contributor to the Leeds and Yorkshire business community and a member of the Council of Mortgage Lenders Executive Committee. I am married with two sons at secondary school.



ROBIN ASHTON (55)

I joined the Board as a non-executive director in April 2011. I am a member of the Group Risk, Assets & Liabilities and Nominations Committees as well as chairing the Board Credit Committee. I am a Chartered Accountant and spent my executive career in retail financial services. I am also a non-executive director of Shawbrook Bank Ltd and Albemarle & Bond Holdings

Plc. I am married with three children and my interests include reading and motorsports.



PHILIPPA BROWN (46)

I joined the Board as a non-executive Director in January 2013 and bring a strong consumer and marketing perspective to the role. I am also a member of the Group Risk Committee. Putting the interests of the members at the heart of the business provides a strong point of difference and one of the reasons why the Society has been so successful. I have been employed in marketing and advertising

for 25 years and am Chief Executive Officer of a UK leading media agency, Omnicom Media Group UK. Outside of work I enjoy swimming and have two children. I also support Breakthrough Breast Cancer and Childline.



DAVID FISHER (54)

I joined the Board in March 2012. I am a member of the Assets and Liabilities Committee, Remuneration Committee and a Pension Scheme Trustee. I started my Financial Services career with Halifax Building Society 23 years ago. Prior to joining the Leeds I was Chief Executive of Sainsbury's Bank. I am delighted to have been given the opportunity to return

to my mutual roots and to join a board totally committed to mutual status. I hold a number of other directorships and advisory roles. Outside of work, I am married with two daughters. I am a keen runner and completed my first marathon in 2012.



PHIL JENKS (62)

I joined the Board in March 2012 and am a member of the Society's Credit, Risk and Conduct Committees. I have almost 40 year's experience in financial services and have extensive knowledge, particularly of mortgages and savings. I am a Non Executive Director at Charter Court Financial Services Group and work as a consultant for a number of organisations including the Government

on housing related projects. I fully appreciate the importance of mutuals and am proud to be a director where the focus is on getting things right for customers. I am married with three children and outside of work I enjoy walking, going to the theatre and watching sport.



“In my final year as Chairman, I am proud to report that Leeds Building Society has delivered another very strong set of financial results for 2012.”



ROBIN LITTEN (49)

I am delighted to have joined the Society in January 2012. I have spent my career in retail and financial services and joined the Society from Skipton Building Society where I was Chief Commercial Officer. My previous roles include Deputy Finance Director at Barclaycard, Finance Director at Barclays Private Banking, Group Finance Director and Chief Executive at Scarborough Building Society. Outside

work, I enjoy spending time with my family, playing squash and cycling.



LES PLATTS (59)

I joined the Board in 2010 and I am Chair of the Remuneration Committee and a member of the Audit and Conduct Risk Committees. I am a Chartered Accountant and was the Senior Partner for Deloitte in their Leeds office. The Society, with its proud history and firm commitment to mutuality, is a very strong part of the Leeds business community. I am also a director of an investment administration

business. I am married with two children and outside of work I support the NSPCC. I am also a keen follower of cricket, football and rugby.



ABHAI RAJGURU (47)

I joined the Board in 2008 having spent my career in the financial services sector. I hold a number of directorships including a private equity firm and a hospital trust. I serve on the Society's Audit, Assets & Liabilities and Group Risk Committees. I am proud to be a member of the Board of the Society, which, as a mutual, has remained focussed on delivering value to its members. Much of my time outside

work is taken up by my young son, and I also enjoy music, films and motorsports.



KIM REBECCHI (46)

I am a Chartered Banker and joined the Board in 2009, having worked for the Society since 1988. I have executive responsibility for distribution, product development, marketing and am also Chairman of Headrow Commercial Property Services. As an active Rotarian, I am involved with a number of Leeds-based charities and sit on Cancer Research UK's Advisory Board. Having grown up in

Leeds, I am proud to be on the Board of the only mutually owned financial services organisation with its Head Office in Leeds. I enjoy spending time with my family and friends and have a love of the great outdoors.



IAN ROBERTSON (65)

I joined the Board in 2008 and am a member of the Audit, Group Risk and Credit Committees. I am proud to work with such a highly regarded local institution and to help further enhance its reputation as a leading example of the benefits of mutuality. I was President of the Institute of Chartered Accountants of Scotland in 2004/5 and I am Chairman of the Advisory Audit Board of the Scottish

Parliament Corporate Body and a Director of the Homes and Communities Agency for England. Outside work I am a keen reader and love music.



BOB STOTT (69)

I joined the Board in 2008, following my retirement as a director of Wm Morrison Supermarkets plc and was appointed Vice Chairman in 2011. I am a member of the Society's Remuneration and Nomination Committees and I chair the Trustee Board of the Staff Pension Scheme. I hold five other directorships and I am also a Trustee of the YCCC Charitable Youth Trust. Mutuality for me means that our

endeavours can be focused entirely on our members. I enjoy spending time with my family and I follow most team sports.



KAREN WINT (47)

I was very proud to be appointed to the Board in December 2012 as Operations Director, having first joined the Society when I left school almost 30 years ago. I am delighted that our passion to deliver great service and value for our customers has remained strong. In my role I drive our continuous improvement culture through our people strategy and am responsible for business systems and

customer service. I sit on Leeds City Council's Housing & Regeneration Board and am a Chartered Banker. I enjoy walking and spending time in the Yorkshire Dales.

Directors' Report

For the year ended 31 December 2012

Business Objectives and Future Developments

The Group's main objective is to provide existing and new members with residential mortgages and retail savings products. In support of the main objective, the Group seeks to deliver quality customer service, cost efficiency and competitive products, returning value to members whilst preserving financial strength.

The Group's business and future plans are reviewed in more detail by the Chairman and Chief Executive on pages 2 to 7 and in the Business Review on pages 8 to 15. The Business Review identifies and explains the Group's Key Performance Indicators and how it has performed against them during 2012.

Principal risks and uncertainties

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 16 to 21.

Profit and Capital Position

The pre-tax profit of the Group increased by 4% to £52.4m compared with £50.2m in 2011. At 31 December 2012, gross capital, represented by general and other reserves, revaluation reserves, subordinated liabilities and subscribed capital, amounted to £614m and this was 6.5% (2011 6.4%) of shares and borrowings. Free capital, represented by gross capital together with the collective loss provision, less tangible fixed assets and investment properties, amounted to £604m, 6.4% (2011 6.4%) of shares and borrowings. One of the Group's other key measures of capital strength is the core tier 1 ratio which increased to 14.3% in 2012 compared to 13.8% in 2011. Overall, the capital ratios reflect the continued financial strength of the Group.

Mortgage Arrears

At 31 December 2012, there were 471 (2011 504) mortgage accounts 12 months or more in arrears. The total mortgage arrears in these cases was £8.2m (2011: £6.6m) and the total of principal loans outstanding was £79.2m (2011 £73.2m).

Basel II – Pillar 3

The disclosures required under Basel II – Pillar 3 are published on the Society's website within four months of the end of the financial year.

Going Concern

The current economic conditions present increased risks and uncertainties for all businesses. In response to such conditions, the Directors have carefully considered these risks and uncertainties and the extent to which they might affect the preparation of the Financial Statements on a going concern basis. The directors consider that:

- the Group maintains an appropriate level of liquidity, sufficient to meet both the normal demands of the business and the requirements which might arise in stressed circumstances;
- the availability and quality of liquid assets are structured so as to ensure funds are available to repay any maturing wholesale funds and exceptional demand from retail investors. These

assets are principally invested with banks and building societies which meet the requirements of the Group Financial Risk Management Policy. The Policy is regularly reviewed and updated to take into account changes to the credit risk assessment of each counterparty;

- the Group's other assets are primarily in the form of mortgages on residential property. Regular assessment of the recoverability of all mortgage assets is undertaken and provision made where appropriate. The Directors consider that the Group is not exposed to losses on these assets which would affect their decision to adopt the going concern basis; and
- reasonable profits have been generated in order to keep gross capital at a suitable level to meet regulatory requirements. In the current environment, profitability is affected by the low interest environment and increased impairment losses on loans and advances to customers. Having reviewed its plans and forecasts for the coming period, the Directors consider that the Group is able to generate adequate profits to enhance the capital of the Society, and to improve its solvency in the future.

The Directors, therefore, consider that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and Accounts.

Directors

The following persons served as Directors of the Society during the year:

Mr R. A. Smith (*Chairman*)

Mr R. W. Stott (*Vice Chairman*)

Mr P. A. Hill (*Chief Executive*)

Mr J. N. Anderson (resigned 27 March 2012)

Mr R. J. Ashton

Mr D. Fisher (appointed 27 March 2012)

Mr P. A. Jenks (appointed 27 March 2012)

Mrs C. M. Kavanagh (resigned 27 March 2012)

Mr R. S. P. Litten (*Finance Director* – appointed 10 January 2012)

Mr L. M. Platts

Mr A. Rajguru

Ms K. L. Rebecchi (*Sales and Marketing Director*)

Mr I. Robertson

Mrs K. R. Wint (*Operations Director* – appointed 1 December 2012)

Details of the Directors of the Society at 31 December 2012 and who continue in office are shown on pages 22 and 23. In accordance with the Rules, Mr R. S. P. Litten, Mrs K. R. Wint, Mr D. Fisher, Mr P. A. Jenks offer themselves for election and Mr P. A. Hill and Ms K. L. Rebecchi offer themselves for re-election by the members at the Annual General Meeting. Mrs P. A. Brown who was appointed as a director in January 2013 also offers herself for election.

“...the Group seeks to deliver quality customer service, cost efficiency and competitive products...”

None of the Directors holds any beneficial interest in shares in, or debentures of, any subsidiary undertakings of the Society.

Corporate Governance

Statements on Corporate Governance and Directors' Responsibilities are set out on pages 26 to 29 and 35 respectively.

Auditor

The auditor, Deloitte LLP, has expressed its willingness to continue in office and in accordance with Section 77 of the Building Societies Act 1986, a resolution for their reappointment as auditor will be proposed at the Annual General Meeting.

Charitable and Political Donations

The Group made a donation of £90,000 to the Leeds Building Society Charitable Foundation. Our Caring Saver Account enabled further donations of £29,000 to be made to charities. Other charitable donations in the year amounted to £15,000. No contributions were made for political purposes. Further details are included in the Chief Executive's Review.

Environmental Policy

The Society recognises that it has a responsibility to protect the environment for its members and the community and appreciates that its activities may sometimes have an impact on the environment. The Society has, therefore, an agreed policy, which seeks to identify and sympathetically consider environmental issues in all activities and areas of business. In the course of premises upgrades, and refurbishments, improvements are designed to incorporate energy efficient technologies. The Society has an active recycling waste management policy, which has resulted in a significant increase in the amount of waste paper, cardboard and plastic that is recycled. Under new consolidated waste management arrangements there has been the introduction of dry mixed recycling at all Society locations and a move towards the elimination of waste destined for landfill. The Society now also uses entirely renewable 'Green' energy and actively works in partnership with its suppliers to manage and minimise carbon emissions. In addition to mitigating the Society's impact as a "polluter" there is a growing appreciation of the Society's role and responsibility to act as an "innovator" and "influential stakeholder" in the drive towards sustainability – socially and environmentally, as well as politically.

Communication with Members

As a member-owned business, the Society recognises the importance of effective communication with its members. Each month, the Society uses an independent market research company to consult with members, and the outcome is reported quarterly to the Board. In addition, senior management undertakes a regular programme of branch visits to meet both staff and customers. A formal framework also exists for written communications with members. The Society encourages all eligible members to participate in the AGM, either by attending in person or voting by proxy. In order to encourage voting at the 2013 AGM, members

will, once again, be able to vote online using the internet, and a charitable donation is being made for each vote cast. In this regard, a choice of charitable recipients is being offered. In 2012, 17.2% of members who voted used the internet. All voting members receive a copy of the 'Highlights' magazine which provides information and updates on the Society's activities, together with the Summary Financial Statement.

Colleagues

The Society has maintained and developed systems during the year for effective communication with our colleagues. The provision of information continues through the Intranet, e-mail, circulars, colleague magazine, meetings, presentations and team briefings to ensure colleagues are aware of the Society's performance and objectives and the business environment in which it operates. There is a Staff Association, through which colleagues make their views known on matters that affect their employment and, in addition, there is also a regular employee survey. It is the Society's policy to consider employment applications, provide access to training, career development and promotion opportunities to all regardless of their gender, sexual orientation, marital or civil partner status, gender re-assignment, race, religion or belief, colour, nationality, ethnic or national origin, disability or age, pregnancy, trade union membership, or part-time or fixed term status. Wherever possible, colleagues who develop a disability continue their employment with appropriate training or redeployment where necessary and reasonable adjustments are accommodated.

Creditor Payment Policy

The Group's policy is to agree terms and conditions with suppliers, under which business is to be transacted, to ensure that suppliers are aware of the terms of payment and to pay in accordance with its contractual and other legal obligations. The creditor days stood at 10 days at 31 December 2012 (2011: 14 days).

Post Balance Sheet Event

The Directors consider that no events have occurred since the year end to the date of this Report that are likely to have a material effect on the financial position of the Group as disclosed in the Annual Accounts.

Andrew J. Greenwood

Andrew J. Greenwood
Chief Risk Officer & Secretary
18 February 2013

Corporate Governance Report

For the year ended 31 December 2012

Introduction

Leeds Building Society voluntarily has regard to best practice, as recommended by the UK Corporate Governance Code, (the Code) formerly the Combined Code on Corporate Governance, issued by the Financial Reporting Council (FRC), which applies to listed companies. The Code sets out principles for ensuring the effectiveness of non-executive directors. The Code was launched in July 2010 for accounting periods beginning on or after 29 June 2010 and was revised in September 2012; the new provisions apply to accounting periods beginning on or after 1 October 2012. The Society will be working towards implementing the new provisions in time for the 2013 results. The FRC also publishes, under the Code, guidance in relation to audit committees, and model terms of reference for audit, nominations, remuneration, and risk committees. This report explains the Society's approach to corporate governance, and sets out details of the principal Board Committees, together with attendance records for those Committees.

The Board

At 31 December, 2012, the Board comprised four executive and eight non-executive Directors. The offices of Chairman and Chief Executive are distinct and held by different individuals. The Chairman is principally responsible for leading the Board and is not involved in the day to day management of the Society. The Chief Executive's responsibilities are focused on running the Society and implementing strategy.

In accordance with relevant provisions in the Code, the Board considers that all non-executive Directors are free of any relationship which could materially interfere with the exercise of their independent judgment. On 1 December 2012 Mrs K. Wint was appointed as Operations Director after a rigorous selection procedure. Mrs Wint was formerly General Manager Mortgage Operations and has worked for the Society for 15 years. Mrs Wint was selected by the Board from a number of internal and external candidates based on her knowledge and experience of the Building Society sector. Mrs Wint is the sister of Ms K. Rebecchi the Sales & Marketing Director and the board gave careful consideration to the risk of any real or perceived conflict of interests that could develop in making this appointment. Despite the belief that both individuals are independently minded the Board accepted recommendations from the Nominations Committee and has put in place safeguards to mitigate any such risk. Mrs Wint will be offering herself for election at the 2013 Annual General Meeting. All Directors have access to the advice of the Secretary and, if necessary, are able to take independent professional advice at the Society's expense. A brief biography of each Director is set out on pages 22 and 23. The Board considers that the Directors' skills and expertise complement each other to provide the appropriate balance, in terms of protecting members' interests and addressing the requirements of the business. The Board considers that diversity amongst Board members is of great value but that diversity is a far wider subject than just gender. Careful consideration is given

to issues of overall Board balance and diversity in making new appointments to the Board. The Society has thirteen Board Members in total, four of which are executive. Female directors constitute 23% of the Board's composition. The role of Senior Independent Director under the Code, insofar as it applies to the Society, is undertaken by the Vice-Chairman. The Chairman consults with the Vice-Chairman, the Society Secretary and other members of the Nominations Committee on any Board matters relating to the Code.

The Board operates through meetings of the full Board, as often as necessary for the proper conduct of business, normally 10 times a year and through its main committees which are detailed on pages 27 to 28. At least annually, the non-executive Directors meet without the executive Directors being present. The Board's focus is on the formulation of strategy, the monitoring and control of business performance, and ensuring the necessary financial and human resources are in place to meet its objectives. A framework of delegated authorities is in place, which extends to the Society's officers, management and various management committees. This was reviewed and updated during the year.

The appointment of new Directors is considered by the Nominations Committee, which makes recommendations to the full Board. Members of the Society are also entitled to nominate candidates for election to the Board. Each Director must meet the tests of fitness and propriety prescribed by the Financial Services Authority (FSA) and must receive approval from the FSA, as an Approved Person. All Directors are required to submit themselves for election by the Society's members at the first opportunity after their appointment and for re-election every three years. Non-executive Directors are not usually expected to serve for more than three full three year terms, following first election to the Board.

The Code includes a provision that all Directors should stand for re-election each year. This was originally recommended by Sir David Walker as a measure for FTSE 100 companies. However, as stated above, the Society's Rules require that Directors should stand for election at the Annual General Meeting following their appointment and every three years thereafter. Members also have the opportunity to vote on the Board as a whole, by virtue of the Resolution to receive the Directors' Report, the Annual Report & Accounts, and Annual Business Statement, as well as the resolution to receive the Summary Directors' Remuneration Report. In all the circumstances, the Board considers there is a need for experienced management familiar with the business, and that the current voting arrangements are appropriate. It will, therefore, not propose that all Directors are subject to re-election on an annual basis. However, the Nominations Committee, which also considers matters of Corporate Governance, will keep this under review. The Board believes that in all other respects it complies with the provision of the code.

The Board and its committees are supplied with full and timely information. Ordinarily, papers are sent out one week prior to Board and Board Committee Meetings.

Board and Board Committee Membership attendance record

(The number in brackets is the maximum number of scheduled meetings that the Director was eligible to attend)

Director	Board	Audit Committee	Remuneration Committee	Nominations Committee	Credit	ALCO	Conduct Risk	Group Risk
R. A. Smith (<i>Chairman</i>)	10(10)			7(7)				
R. W. Stott (<i>Vice Chairman</i>)	10(10)		5(5)	7(7)				
P. A. Hill (<i>Chief Executive</i>)	10(10)			7(7)	5 (6)	11(12)		5(6)
J. N. Anderson, Director until 27 March 2012	3(3)		1(1)					
R. J Ashton	10(10)			4(4)	6(6)	11(12)		6(6)
D. Fisher (appointed 27 March 2012)	7(7)		4(4)			8(9)		
P. A. Jenks (appointed 27 March 2012)	6(7)				4(4)		4(4)	
C. M. Kavanagh, Director until 27 March 2012	3 (3)		1(1)					
R. S. P. Litten (<i>Finance Director</i>) (appointed 10 January 2012)	10(10)				6(6)	11(12)		6(6)
L. M. Platts	10(10)	6(6)	5(5)		3(3)		2(3)	
A. Rajguru	10(10)	5(6)				11(12)		6(6)
K. L. Rebecchi (<i>Sales and Marketing Director</i>)	10(10)				3(5)	10(12)	6(6)	
I. Robertson	10(10)	6(6)			6(6)			6(6)
K. R. Wint (<i>Operations Director</i>) (appointed 1 December 2012)	1(1)				1(1)			

Internal Control

The Board is responsible for defining the Society's risk appetite, and for determining the framework and strategies for control and risk management. Senior management is responsible for designing, operating and monitoring robust and effective internal control and risk management processes. The Audit Committee, on behalf of the Board, regularly receives reports on the adequacy and effectiveness of these processes from the objective and independent Internal Audit function. This has operated throughout the year.

Through its meetings, the Audit Committee has reviewed the effectiveness of the Society's systems of internal control for the year to 31 December 2012, on behalf of the Board, and has taken account of any material developments that may have taken place since the year end. These systems of control are designed to manage, rather than eliminate, the risk of failure to achieve business objectives and to provide reasonable assurance as to the safeguards protecting the business against the risk of material error, loss or fraud. A report setting out the work of the Audit Committee is provided to the Board on an annual basis.

Audit Committee

The Audit Committee, which meets at least five times a year, is a sub-committee of the Board and makes recommendations to it. Its Terms of Reference reflect the guidance on Audit Committees, published as part of the Code. Its principal role is to:

- monitor the integrity of the financial statements of the Society and any formal announcements relating to the Society's financial performance, reviewing significant financial judgements contained in them;

- ensure the Society's internal financial and business control and risk management systems have operated as defined in control documentation and comply with policies, procedures, laws, regulations and other relevant requirements;
- monitor and review the effectiveness of the Society's Internal Audit function;
- make recommendations to the Board in relation to the appointment and remuneration of the external auditor and to monitor and review the external auditor's independence, objectivity and effectiveness, taking into consideration relevant United Kingdom professional and regulatory requirements;
- develop and implement the policy on the engagement of the external auditor to supply non – audit related services; and
- review how the Society complies with best practice in regard to corporate governance and to report annually thereon to the Board.

As part of its regular agenda, the Audit Committee reviewed and challenged relevant accounting policies and significant financial judgements regarding the level of residential and commercial lending impairment provisions including forbearance, provisions for the FSCS and MPP1 liabilities and adoption of the Going Concern assumption. All significant financial judgements are outlined in note 2.

During the year, the Chairman of the Committee was Mr I. Robertson. The other members of the committee were Mr L. M. Platts and Mr A. Rajguru. The Committee invites the presence of internal and external auditors and members of management when considered helpful for the conduct of its Terms of Reference. The Audit Committee usually meets with the external auditor

Corporate Governance Report *continued*

For the year ended 31 December 2012

without executive management being present, at the beginning of each meeting. The Board is satisfied that the composition of the Committee provides recent and relevant financial experience.

Group Risk Committee

The Group Risk Committee, a sub-committee of the Board, met six times in 2012, to review the Group's exposure to risk, and the appropriateness of the risk framework in place. On an annual basis, the Committee oversees the calculation and allocation of the Group's capital requirements, and recommends to the Board the Society's Internal Capital Adequacy Assessment Process (ICAAP). Throughout the year, the Committee monitors the impact of changes in the profile of risk on the ICAAP requirements, and the Board's stated Risk Appetite. Additionally, standing reports are received on the Society's Corporate Risk Register, external risk indicators, and updates on Management actions.

The Chairman of the Committee was Mr A. Rajguru, other Board members of the Committee during all or part of the year, were, Mr P. A. Hill, Ms K. L. Rebecchi, Mr R. J. Ashton, Mr P. A. Jenks, Mr R. S. P. Litten, Mr I. Robertson and Mrs K. R. Wint.

Details of the types of risk faced by the Society, together with details of how these risks are managed, are set out in the Directors' Report and the Notes to the Accounts.

Assets and Liabilities Committee

The Assets and Liabilities Committee, which met monthly during 2012, is a sub-committee of the Board and oversees treasury policy, in line with the Board approved Financial Risk Management Policy. In particular, the Committee oversees wholesale funding and liquidity investment strategies, hedging, interest rate risk management and counterparty credit criteria. It also considers and recommends to the Board, the Society's Individual Liquidity Adequacy Assessment. The current chairman of the Committee is Mr R. S. P. Litten. The other Board members of the Committee during all or part of the year, were, Mr P. A. Hill, Ms K. L. Rebecchi, Mr R. J. Ashton, Mr A. Rajguru, and Mr D. Fisher.

Nominations Committee

The Nominations Committee is a sub-committee of the Board and makes recommendations to it. During the year, the Chairman was Mr R. A. Smith. The other members of the Committee during the year, were, Mr P. A. Hill, Mr R. W. Stott and Mr R. J. Ashton. Its main responsibility is to make recommendations on appointments to the Board, so that it comprises sufficient Directors who are fit and proper and can meet the collective and individual responsibilities of Board members, both efficiently and effectively. It considers succession planning, taking account of the challenges and opportunities facing the Society and what skills and expertise are, therefore, needed on the Board in the future. In considering appointments, the Committee will take account of the requirements under the Building Societies Act, the Society's Rules and the UK Corporate Governance Code.

Before any recommendations on appointment are made to the Board, the Committee will formally assess the aptitude, qualifications and experience of individual candidates. All appointments to the Board are made on merit and against objective criteria.

During the year, the Nominations Committee met on seven occasions. In addition to the appointment of an Operations Director referred to above, following a formal selection process, two new non-executive directors were appointed during the year, Mr D. Fisher and Mr P. A. Jenks were both appointed to the board on 27 March 2012 and will offer themselves for election by the members at the AGM. Mrs P. Brown was appointed on 15 January 2013 and will also be offering herself for election by the members at the 2013 AGM.

Credit Committee

The Credit Committee is a sub-committee of the Board, and in 2012 met on six occasions. Its Terms of Reference relate to the formulation of policy pertaining to asset quality and credit risk within the Society, controlling credit risk, and monitoring its management, (including residential, commercial, lifetime, and unsecured credit risks) for approval by the Board. The Chairman of the Committee was Mr R. J. Ashton, other Board members of the Committee were, Mr P. A. Hill, Mr L. M. Platts, Mr I. Robertson, Mr R. S. P. Litten, Ms K. L. Rebecchi, Mr P. A. Jenks and Mrs K. R. Wint.

Remuneration Committee

Detailed information on the work and composition of the Remuneration Committee is set out in the Directors' Remuneration Report at pages 30 and 34.

Conduct Risk Committee

With the impending implementation of the Financial Services Bill and the change from regulation by the Financial Service Authority to two regulatory bodies, the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA), the Society decided that it was appropriate to have a new Board sub Committee focusing solely on Conduct Risk to provide oversight of Conduct Risk across the business and to ensure fairness principles are promoted across all levels of the Society's operations. The Committee meets bi-monthly and also reviews and approves new types of products offered to members to ensure they meet the required regulatory standards, the Society's risk appetite and are suitable for their target audience. The Chairman of the Committee is Ms K. L. Rebecchi; other Board members are Mr P. A. Jenks, Mr L. M. Platts and Mrs K. R. Wint.

Auditor

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, undertook a number of non-audit related assignments during 2012 and these were conducted in accordance with the policy and are considered to be consistent with the professional and ethical standards expected of the external auditor, and in the Society's best interests. Details of the fees paid to the external auditor for audit and non-audit services are set out in Note 8 to these Accounts.

Directors' Development and Performance Evaluation

The Society's Chairman, on behalf of the Nominations Committee, conducts a formal documented evaluation of the non-executive Directors, on an annual basis.

Following the completion by all non-executive Directors of a questionnaire, and with the benefit of feedback from the executive Directors, the Chairman reviews the performance of each non-executive Director individually, the effectiveness of each Board Committee, and the Board, as a whole. In addition, each Board Committee reviews its own performance, and the outcome is fed back to the Chairman, which then forms part of the process for evaluating the effectiveness of each of those Committees. The Chairman's performance is reviewed, in his absence, by the Board as a whole. Feedback is given to him by the Vice-Chairman. Ongoing training and development requirements for non-executive Directors are identified through relevant sub-committee work plans and the performance evaluation process. All newly appointed non-executive Directors undertake a comprehensive, tailored induction programme. Executive Directors are evaluated within the performance evaluation framework for employees generally and by the Remuneration Committee, with regard to their remuneration.

Terms of Reference

Copies of the Terms of Reference for the Audit, Group Risk, Conduct Risk, Assets and Liabilities, Nominations, Remuneration and Credit Committees are available on the Society's website, or on written request from the Society's Secretary. Where appropriate, they have been updated in light of FRC guidance.



Andrew J. Greenwood
Chief Risk Officer & Secretary
18 February 2013

Directors' Remuneration Report

For the year ended 31 December 2012

Personal introduction from Leslie Platts, Chairman of the Remuneration Committee

In the Chief Executive's statement, you will have read the positive comments he has made regarding the Society's strong performance in 2012. Total assets reached a record £10.3bn, profits grew to £52.4m, mortgage balances grew by 9% to £8.3bn and our net savings balances grew by 5% to £7.7bn. At the same time, we have continued to strengthen the Society's balance sheet and we have seen very strong customer and colleague satisfaction levels.

It is in this context that the Remuneration Committee has determined the payments to Executive Directors and senior managers for 2012. In summary; the Chief Executive's basic pay increased by 8.3%, reflecting a successful first full year in post and a benchmarking of his position versus other "in post" Chief Executives. Other executive directors' pay and that of the Chairman increased on average by 2.6% compared with 3.12% on average for all other employees. The 2012 Executive Director bonus scheme has generated awards of between 61% and 63% of salary, reflecting between 82% and 83% of the total opportunity.

The Remuneration Committee pays close attention to the Regulatory environment in respect of Remuneration matters as well as general developments in Corporate Governance.

The Committee is also very focussed on ensuring we set our remuneration policy so we can (i) attract and retain the Society's most senior executives, (ii) reward performance in line with the Society's annual business plan and our ten year vision and (iii) recognise our commitment to providing value for money for our members.

As we explain below, we amended our incentive plans for 2012 following external benchmarking and in response to emerging best practice. As we move through 2013 and subsequent years, the Committee will continue to keep these schemes under review. We will be undertaking a detailed review of pay and benefits in the coming year, but have no plans to change our policy in 2013.



Leslie M. Platts

Chairman of the Remuneration Committee

18 February 2013

Purpose of this Report

This report provides information about the Society's policies on remunerating directors and senior executives and discloses the remuneration of the directors. The report considers all the areas set out in the UK Corporate Governance Code relating to remuneration, in so far as they are considered relevant to building societies, the FSA Remuneration Code (the Code), and the disclosure requirements arising under the third EU Capital Requirements Directive. A summary of this report will be sent to all members eligible to vote at the Annual General Meeting, who will have the opportunity to participate in an advisory vote on the report. The 2011 Directors Remuneration Report received a 90.3% positive vote (excluding abstentions) from voting members.

Composition and Scope of the Remuneration Committee

The Remuneration Committee, under delegated authority from the Board, is responsible for ensuring that the Society's Remuneration Policy follows best practice, and meets regulatory disclosure requirements.

The Committee comprises solely non-executive directors who do not have any day-to-day involvement in the operations of the Society and no personal financial interest in the recommendations. None of the Committee has any personal interest (other than as ordinary members), conflicts of interest arising from cross-directorships or day-to-day involvement in the business.

During the year, the Chairman of the Committee was Mr L. M. Platts. The other members of the Committee were Mr J. N. Anderson and Mrs C. M. Kavanagh (who both retired on 27 March 2013), Mr R. W. Stott, and Mr D. Fisher who joined the Society on 27 March 2013. No executive directors or other Society employees are members of the Remuneration Committee. Executive directors and other members of senior management are invited to attend by the Committee, as appropriate. Ms Becky Hewitt, Head of Human Resources, acts as Secretary to the Committee.

The Committee reports to the Board on the remuneration and terms of engagement of executive directors, other members of senior management, and Code Staff (basically, Senior Management and other key managers in areas such as Compliance, Risk, Human Resources and Internal Audit), together with wider aspects of remuneration policy for all members of staff and the fees for the Society's Chairman. All recommendations are considered by the full Board, but no Director participates in discussions when decisions relating to his or her own remuneration are made.

The Committee's terms of reference were last reviewed in December 2012. The full terms of reference are available on the Society's website.

During the year, the Committee met five times and activities included:

- Reviewing the outcome of performance in 2011 and the level of awards paid in 2012.
- Reviewing basic salaries.
- Revising the structure of our executive incentive plans for 2012 and 2013.
- Agreeing the performance objectives for the annual bonus schemes for 2012 and 2013.
- Considering the requirements of the FSA Remuneration Code and how this best applies to the Society.

The Remuneration Committee seeks the advice of independent, external consultants, as required. During the year, PriceWaterhouseCoopers LLP was engaged, in a consortium with several other building societies, to assist the Society in the appropriate application of the Remuneration Code.

Remuneration Policy

As a mutual organisation, and in support of the Society's aim to be 'Best for Members, Best for Business, Best for Colleagues', the Society's Remuneration Policy is designed to help attract, retain, reward and motivate our leadership team to enable the delivery of business objectives, whilst providing value for members.

In delivering this Policy, the following principles are observed:

- Our remuneration policy is clearly linked to our business strategy and the long term interests, and security, of the Society.
- We will ensure our pay policies meet regulatory requirements and Corporate Governance best practice.
- We will use a balance of fixed and variable remuneration to create an acceptable relationship between risk and reward.
- Basic Pay and total remuneration is set at a competitive level to attract and retain people of the required calibre.

The table below summarises the principal components of the executive directors' total remuneration. The remainder of the report provides all the supporting detail.

	Purpose	Operation	Performance Metrics
Basic Pay	Reflects level of accountability	Once set, any future increases are linked to personal performance and market benchmarking	Execution of the role, as defined in the role profile
Performance related pay	Rewards performance against a range of financial and business objectives	Maximum 75% of basic pay with 40% of the award deferred over three years	Delivery of corporate, personal and peer group performance objectives
Pension/Benefits	Provides market competitive remuneration	Based on membership of either the Society's defined benefit or defined contribution pension scheme	Not applicable

Remuneration Outcomes for 2012

1. Basic Pay

The salary levels for the executive directors and other senior executives are recommended to the Board based on assessments of individual performance and by comparisons with roles carrying similar responsibilities, in comparable financial organisations, with a similar level of complexity and diversity to the Society.

In 2012, the Chief Executive's basic pay increased by 8.3%, reflecting the successful completion of his first year in this role and considering benchmark data. Other executive directors' fixed pay and that of the Chairman was increased on average by 2.6%, which was broadly in line with the pay settlement to all other employees which was 3.12% on average.

2. Performance Related Pay

In 2012, we revised the structure of our executive bonus plans. The purpose of the review was to create a single scheme, which measures performance, as follows:

- The performance objectives are aligned with our Corporate Plan, recognising short, medium and long term goals. The maximum opportunity has increased from 60% to 75% of basic salary, as a result of benchmarking.
- The performance of the executives is assessed against a scorecard of measures, to ensure significant reward cannot be achieved by the delivery of high performance in one area, to the detriment of another.

Directors' Remuneration Report *continued*

For the year ended 31 December 2012

Executive Scorecard

- Strategic measures, including achievement of profit, growth, risk and business development objectives.
- Delivery of annual personal performance objectives, appropriate to the responsibilities of the director, set at the start of each year and agreed by the Remuneration Committee.
- Performance compared to our peer group* (including capital strength, profitability, net lending and retail growth, cost income ratio and long term credit rating).

*our peer group is defined as the top eight building societies, excluding Nationwide.

- Robust risk evaluation measures, independently assessed by the Chief Risk Officer and Chairman of the Group Risk Committee.
- A deferral of 40% of the award, over a three year period has been introduced, to ensure the annual performance creates value sustained over the longer term. Independent assessment takes place prior to the payment of each deferred award, which provides the Remuneration Committee with the authority to make a reduction in the level of award payable (down to a minimum of zero), if appropriate. The assessment takes into account the following three key matters:
 - has management operated within the Risk Appetite of the business?
 - has the business been exposed to any regulatory or control failings?
 - has there been any financial exposure after the award has been made due to inappropriate management behaviour?
- The risk adjustment mechanism also considers the continued strength of our capital base.

The 2012 scheme has generated awards of between 61% and 63% of salary, reflecting between 82% and 83% of the maximum award available. The scheme provides for a maximum opportunity of 30% for the achievement of agreed personal objectives. For the performance outcomes which are common to all participants, the Committee's assessment was as follows:

- **Annual Performance Measures** (max. 30% opportunity)
 - both profit performance and business growth (essentially mortgage lending) were viewed very strongly versus our annual business plan. Similarly the enhancements we have made to our risk infrastructure are significant. On business development, performance was generally strong, although, in the opinion of the Remuneration Committee, not all of the objectives set at the start of the year were fully achieved.

- **Peer Group Assessment** (max. 15% opportunity) – these are hard measures, which were selected as being those most closely aligned to our long term vision and objectively compared to published data from our peer group, against which the Society has performed well.

3. Pensions and Other Benefits

P. A. Hill, R. S. P. Litten and K. R. Wint are members of the defined contribution section of the pension scheme. P. A. Hill has opted for a cash allowance in respect of any contributions which exceed £50,000 in the year.

K. L. Rebecchi, in common with other employees who are members of the defined benefits section of the pension scheme, is entitled to a pension based on final pensionable salary and length of service. Benefits for executive directors who are members of the defined benefit section accrue at a rate of 1/45th of pensionable salary for each year of service, with a maximum pension of two-thirds of final pensionable salary.

In last year's report and accounts we advised that, following Government changes to the tax regime for occupational pensions, K. L. Rebecchi had elected to become a deferred member of the defined benefits pension scheme. It has transpired that the external advice provided to enable her to make this decision was incorrect. Therefore, the Trustees of the Scheme have agreed that this decision should be reversed, with appropriate adjustments made such that her benefits are the same as if she had not ceased to accrue them.

No executive director has the right or opportunity to receive enhanced benefits beyond those already disclosed, and the Committee has not exercised its discretion during the year to enhance benefits. There have been no other changes to benefits during 2012.

Total Remuneration Summary

The total remuneration received by executive directors for 2012 is detailed on the next page, compared with 2011. The remuneration (pay and bonus) for executive directors equates to 2.7% of pre-tax profits. This information has been audited and shows remuneration for the years ending 31 December 2011 and 31 December 2012, as required to be reported under the Building Societies (Accounts and Related Provisions) Regulations 1998. The summary for 2011 has been restated to include payments due in 2013 and 2014 under the closed Long Term Incentive Schemes and to show the pension contributions elected to be received as cash for K. L. Rebecchi.

The Chief Executive is the Society's most highly paid employee and no employee earns more than any executive director.

As the Society is a mutual organisation, it has no share capital and, therefore, does not offer share based remuneration to directors or employees.

Executive Directors 2012	Salary £'000	Performance Related Pay ⁽¹⁾ £'000	Other Variable Pay £'000	Total Pay Package £'000	Increase in accrued pension £'000	Society's contribution to pension scheme ⁽²⁾ £'000	Total including accrued pension benefits £'000
P. A. Hill	310	200	36 ⁽³⁾	546	–	35	581
R. S. P. Litten	232	151	50 ⁽⁴⁾	433	–	46	479
K. L. Rebecchi	187	117	(5) ⁽⁵⁾	299	16 ⁽⁶⁾	–	315
K. R. Wint*	16	4	–	20	–	–	20
Total	745	472	81	1,298	16	81	1,395

*K. Wint appointed 1 December 2012

Executive Directors 2011	Salary £'000	Performance Related Pay £'000	Long Term Incentive ⁽⁷⁾ £'000	Other Variable Pay £'000	Total Pay Package	Increase in accrued pension £'000	Society's contribution to pension scheme ⁽²⁾ £'000	Total including accrued pension benefits £'000
I. W. Ward*	265	179	88	–	532	8 ⁽⁸⁾	–	540
D. Pickersgill**	133	–	–	–	133	4 ⁽⁹⁾	–	137
P. A. Hill	247	73	90	–	410	–	58	468
K. L. Rebecchi	172	57	56	11 ⁽⁵⁾	296	(4) ⁽⁶⁾	–	292
Total	817	309	234	11	1,371	8	58	1,437

*I. W. Ward retired 23 September 2011 **D. Pickersgill retired as a Director 30 June 2011

Notes:

- (1) Total award in respect of performance in 2012. 40% of these awards will be paid in 2014 to 2016.
- (2) Defined Contribution Section
- (3) This director has elected to receive part of the Society's pension contribution as cash
- (4) Payment to compensate lost earnings on leaving Skipton Building Society
- (5) The 2011 figure is in respect of pension contributions elected to be received as cash. The 2012 figure is in respect of pension contributions received / repaid as cash
- (6) This director ceased to be an active member in 2011. However, this decision has been reversed, the director was reinstated in the scheme over the year and the appropriate adjustments made
- (7) The Long Term Incentive awards were in respect of performance for the years 2009 to 2011. 15% of these awards will be paid in 2013 and 2014
- (8) This director ceased pensions accrual in 2010
- (9) This director ceased to be an active member of the scheme in 2011.

Pension Benefits Earned by Executive Directors (Defined Benefit Scheme)⁽¹⁾

Executive Directors 2012	Increase/(Decrease) in accrued pension 2012 ⁽²⁾ £'000	Accrued pension as at 31 December 2012 ⁽³⁾ £'000	Transfer value of accrued pension at 31 December 2011 ⁽⁴⁾ £'000	Transfer value of accrued pension at 31 December 2012 ⁽⁵⁾ £'000	Increase/(Decrease) in transfer value over the year net of Directors' Contributions ⁽⁶⁾ £'000
K. L. Rebecchi ⁽⁷⁾	16	90	1,140	1,405	250

Notes:

1. The accrued pension and transfer value set out in the table are to be provided through the Leeds Building Society Staff Pension Scheme
2. The increase in accrued pension during the year excludes any increase for inflation
3. The accrued pension is the amount which the director would be entitled to from normal retirement age if they left service at the relevant date
4. The transfer value has been calculated in accordance with the Transfer Values Amendment Regulations 2008
5. The increase in pension over the year relates to the increase in Pensionable Service and Pensionable Salary for the period from the date the director left the Scheme to the end of the year; a period of 16 months. The director is making full member contributions in respect of this additional service
6. The director's contribution is paid by Salary Sacrifice but attributed as member contributions for the purposes of this disclosure
7. The director was reinstated in the Scheme over the year

Directors' Remuneration Report *continued*

For the year ended 31 December 2012

P. A. Hill, R. S. P Litten and K. R. Wint are members of the Defined Contribution section of the pension scheme. The employer contribution is 20% of base salary, other than for P. A. Hill, who has elected to receive part of the Society's pension contribution as a cash allowance. Only annual salary payments are pensionable.

Service Contracts

Executive directors' terms and conditions of employment are detailed in their individual contracts, which include a notice period of twelve months. Each contract includes a provision of a termination payment in lieu of notice of up to a maximum of twelve months' basic salary, although, for certain directors, this may be increased to two years in some circumstances, where the Society effects a reorganisation such as a merger or the transfer of the business. In addition, a payment may be made in respect of the annual bonus scheme awards on termination, depending on the circumstances and in accordance with the rules of the plans, which are non-contractual. The non executive directors do not have service contracts with the Society.

Other Directorships

None of the executive directors currently hold any paid external directorships.

Directors' Loans, Transactions and Related Business Activity

The aggregate amount outstanding at 31 December 2012 in respect of loans from the Society or a subsidiary undertaking to directors of the Society or persons associated with directors

was £321,100, being three mortgages to directors and persons connected to Directors (2011: £278,600 being three mortgages to directors and persons connected to directors and one mortgage to a person connected with a director). These loans were at normal commercial rates. A register of loans and transactions with directors and their connected persons is maintained at the Head Office of the Society and may be inspected by members. There were no significant contracts between the Society or its subsidiaries and any Director of the Society during the year.

Chairman and Non-Executive Directors

The level of fees for non executive directors (excluding the Chairman) is reviewed annually, by the executive directors, with recommendation made to the Board. The level of fees for the Chairman is reviewed annually by the Remuneration Committee, prior to a recommendation to the Board. The reviews are based on the responsibilities and time commitments required for Board and Board sub-committee meetings and also reflect practices in other comparable mutual financial services organisations. The Chairman and non executive directors do not participate in any performance related pay scheme or receive any pension arrangements or other benefits.

As reported last year, the time commitment for the Chairman has significantly increased and, following benchmarking, it was agreed in 2011 that the Chairman's fees should be substantially increased to £125,000 p.a. An increase of 2.4%, to £128,000, was agreed for the Chairman in 2012. The Vice Chairman's fees were increased by 2.86% to £54,000, whilst the basic non executive director's fee was increased by 3.23% to £40,000.

Non Executive Directors' Remuneration

The total fees paid to each non executive director are shown below.

Non executive directors	2012 Fees (£'000)	2011 Fees (£'000)
R. A. Smith (Chairman)	126	94
S. R. G. Booth (Vice Chairman – resigned 23 September 2011)	–	36
R. W. Stott (Vice Chairman – appointed 26 September 2011)	53	44
C. M. Kavanagh – resigned 27 March 2012	9	38
J. N. Anderson – resigned 27 March 2012	9	38
R. J. Ashton – appointed 26 April 2011	43	27
I. Robertson	45	44
A. Rajguru	43	39
L. M. Platts	43	40
D. Fisher – appointed 27 March 2012	30	–
P. A. Jenks – appointed 27 March 2012	30	–
Total	431	400

Directors' Responsibilities

For the year ended 31 December 2012

Directors' Responsibilities for Preparing the Annual Accounts

The following statement, which should be read in conjunction with the statement of the Auditor's responsibilities on page 37, 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 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 those Annual Accounts, the Directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether 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.

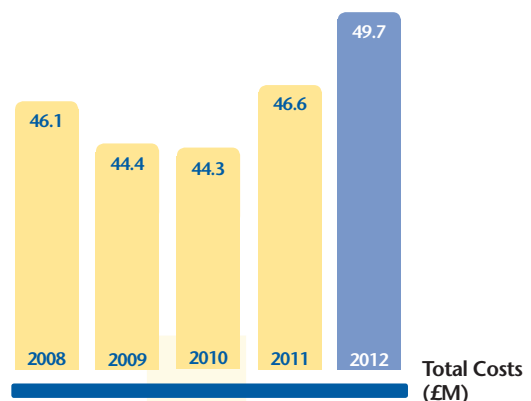
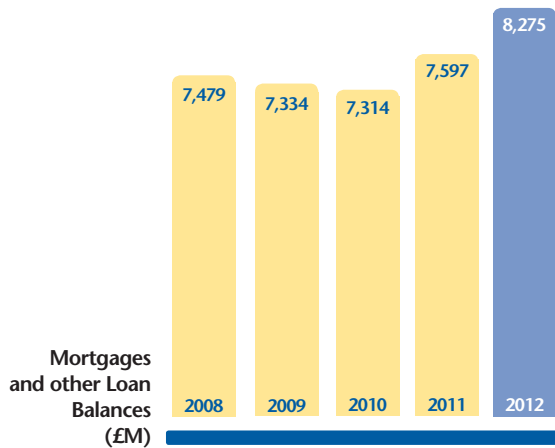
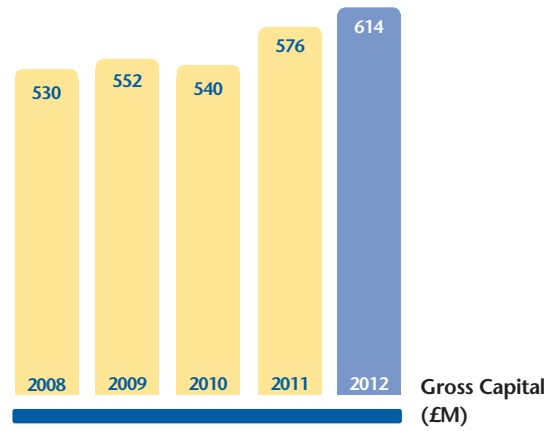
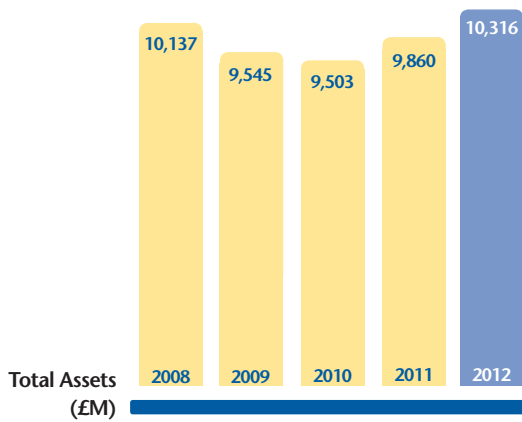
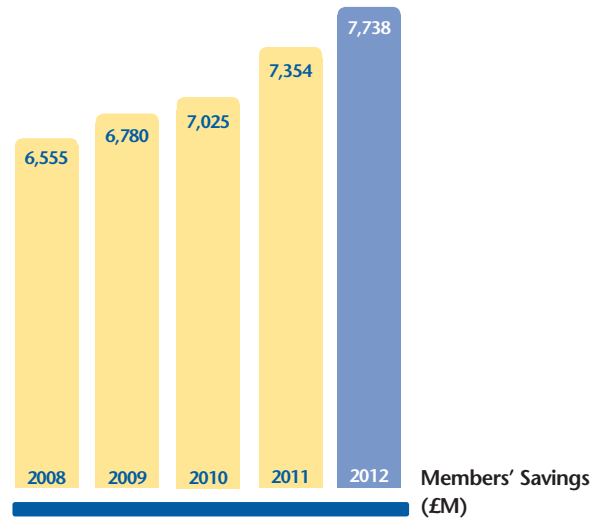
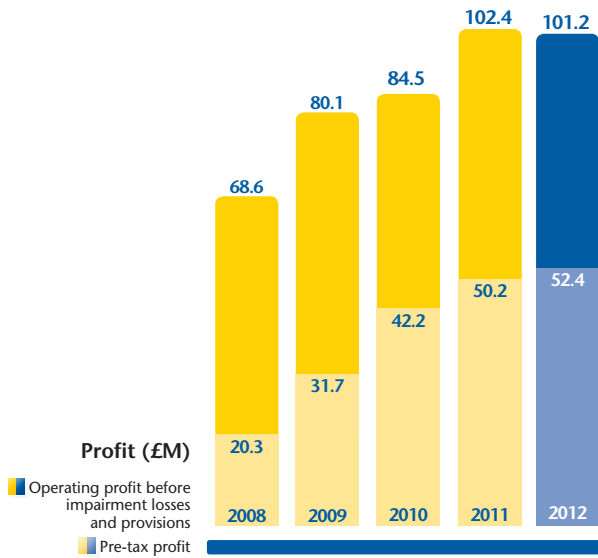
The Directors are responsible for the maintenance of the corporate and financial information included on the Society's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



Robin Smith
Chairman
18 February 2013

Five Year Review

“... our sustainable business model places us in a very good position to grow and prosper.”



Independent Auditor's Report

For the year ended 31 December 2012

We have audited the Group and Society financial statements of Leeds Building Society for the year ended 31 December 2012 which comprise the Group and Society Income Statements, the Group and Society Statements of Comprehensive Income, the Group and Society Statements of Financial Position, the Group and Society Statements of Changes in Members' Interest, the Group and Society Statements of Cash Flows and the related notes 1 to 35. 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.

This report is made solely to the Society's members, as a body, in accordance with section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society or the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2012 and of the Group's and the Society's income and expenditure for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

- the Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the accounting records and the financial statements; and
- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Building Societies Act 1986 requires us to report to you if, in our opinion:

- proper accounting records have not been kept by the Society; or
- the Society financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.



Matthew Perkins
(Senior Statutory Auditor)

for and on behalf of Deloitte LLP
Chartered Accountants and
Statutory Auditor
Leeds, United Kingdom
18 February 2013

Income Statements

For the year ended 31 December 2012

	Notes	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Interest receivable and similar income	3	360.7	334.9	360.7	334.9
Interest payable and similar charges	4	(227.5)	(207.3)	(227.5)	(207.3)
Net interest receivable		133.2	127.6	133.2	127.6
Fees and commissions receivable	5	16.1	19.7	11.7	11.4
Fees and commissions payable	5	(0.2)	(0.1)	(0.1)	(0.1)
Fair value gains less losses from derivative financial instruments	6	0.7	0.1	(4.5)	(1.0)
Income from shares in subsidiary undertakings	16	–	–	–	18.9
Other operating income	7	1.1	1.7	0.1	0.6
Total income		150.9	149.0	140.4	157.4
Administrative expenses	8	(48.9)	(45.7)	(45.8)	(42.6)
Depreciation	17	(0.8)	(0.9)	(0.8)	(0.9)
Operating profit before impairment losses and provisions		101.2	102.4	93.8	113.9
Impairment losses on loans and advances to customers	10	(41.9)	(48.5)	(41.9)	(48.5)
Provisions for liabilities and charges:					
Other	26	(0.6)	–	(0.6)	–
FSCS levy	26	(5.2)	(3.4)	(5.2)	(3.4)
Investment property fair value movement	18	(1.1)	(0.3)	–	–
Profit on ordinary activities before income tax		52.4	50.2	46.1	62.0
Income tax expense	11	(13.0)	(13.6)	(11.0)	(11.8)
Profit for the financial year		39.4	36.6	35.1	50.2

All amounts relate to continuing operations.

The notes on pages 43 to 88 are an integral part of these consolidated financial statements.

Statements of Comprehensive Income

For the year ended 31 December 2012

	Notes	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Profit for the financial year		39.4	36.6	35.1	50.2
Other comprehensive income					
Available for sale investment securities					
Fair value changes taken to reserves		4.6	3.4	4.6	3.4
Amortisation/disposals post 1 July 2008		3.3	4.3	3.3	4.3
Cash flow hedges					
Loss taken to reserves		(3.5)	–	(3.5)	–
Actuarial loss on retirement benefit obligations		(1.6)	(1.4)	(1.6)	(1.4)
Tax relating to components of other comprehensive income	33	(0.8)	(1.6)	(0.8)	(1.6)
Other comprehensive income net of tax	33	2.0	4.7	2.0	4.7
Total comprehensive income for the year		41.4	41.3	37.1	54.9

As permitted by the amendment to IAS 39 issued by the International Accounting Standards Board in October 2008, the Society reclassified, on 1 July 2008, its mortgage backed securities and floating rate note assets from the available-for-sale category to the loans and receivables category.

The available for sale reserve at 1 July 2008 is released to profit and loss as part of the effective interest rate based on the maturity profile of the underlying instruments. Further details are provided in note 15.

Statements of Financial Position

As at 31 December 2012

	Notes	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Assets					
Cash in hand and balances with the Bank of England	12	663.1	186.9	663.1	186.9
Loans and advances to credit institutions		117.0	79.7	58.4	59.6
Derivative financial instruments	13	118.9	139.5	72.4	109.7
Loans and advances to customers	14				
Loans fully secured on residential property		7,645.4	6,906.1	7,645.2	6,905.9
Other loans		629.9	690.6	629.9	690.6
Investment securities	15				
Available for sale		847.4	1,475.1	847.4	1,475.1
Loans and receivables		121.2	238.1	121.2	238.1
Investments in subsidiary undertakings	16	–	–	107.6	28.5
Property, plant and equipment	17	28.5	27.5	28.4	27.5
Investment properties	18	5.6	6.7	–	–
Deferred income tax assets	19	3.0	2.3	2.3	1.5
Other assets, prepayments and accrued income	20	135.9	107.2	157.5	105.1
Total Assets		10,315.9	9,859.7	10,333.4	9,828.5
Liabilities					
Shares	21	7,738.3	7,354.2	7,738.3	7,354.2
Derivative financial instruments	13	148.5	146.7	146.1	144.0
Amounts owed to credit institutions	22	433.1	355.6	433.1	355.6
Amounts owed to other customers	23	351.3	508.3	471.5	534.9
Debt securities in issue	24	937.0	815.7	894.4	787.3
Current income tax liabilities		7.6	7.1	7.1	5.4
Deferred income tax liabilities	19	2.8	1.3	1.1	1.2
Other liabilities and accruals	25	72.0	91.3	26.0	71.7
Provision for liabilities and charges	26	9.1	6.2	8.7	5.7
Retirement benefit obligations	31	2.4	0.9	2.4	0.9
Subordinated liabilities	27	0.9	0.9	0.9	0.9
Subscribed capital	28	25.0	25.0	25.0	25.0
		9,728.0	9,313.2	9,754.6	9,286.8
Reserves					
Cash flow hedge reserve		(2.6)	–	(2.6)	–
Available for sale reserve		2.2	(3.7)	2.2	(3.7)
Revaluation reserve		13.2	13.2	13.2	13.2
Other reserve		14.3	14.3	14.1	14.1
General reserve		560.8	522.7	551.9	518.1
		587.9	546.5	578.8	541.7
Total Reserves and Liabilities		10,315.9	9,859.7	10,333.4	9,828.5
Memorandum items					
Commitments: Irrevocable undrawn loan facilities	30	–	–	–	–

These financial statements were approved by the Board of Directors on 18 February 2013.

Signed on behalf of the Board of Directors.



Robin Smith
Chairman



Peter Hill
Chief Executive



Robin Litten
Finance Director

Statements of Changes in Members' Interest

For the year ended 31 December 2012

Group	General Reserve £M	Cash flow hedge Reserve £M	Available for Sale Reserve £M	Revaluation Reserve £M	Other Reserve £M	Total Reserves £M
Balance at 1 January 2012	522.7	–	(3.7)	13.2	14.3	546.5
Comprehensive income for the year	38.1	(2.6)	5.9	–	–	41.4
Balance at 31 December 2012	560.8	(2.6)	2.2	13.2	14.3	587.9

	General Reserve £M	Available for Sale Reserve £M	Revaluation Reserve £M	Other Reserve £M	Total Reserves £M
Balance at 1 January 2011	487.1	(9.4)	13.2	14.3	505.2
Comprehensive income for the year	35.6	5.7	–	–	41.3
Balance at 31 December 2011	522.7	(3.7)	13.2	14.3	546.5

Society	General Reserve £M	Cash flow hedge Reserve £M	Available for Sale Reserve £M	Revaluation Reserve £M	Other Reserve £M	Total Reserves £M
Balance at 1 January 2012	518.1	–	(3.7)	13.2	14.1	541.7
Comprehensive income for the year	33.8	(2.6)	5.9	–	–	37.1
Balance at 31 December 2012	551.9	(2.6)	2.2	13.2	14.1	578.8

	General Reserve £M	Available for Sale Reserve £M	Revaluation Reserve £M	Other Reserve £M	Total Reserves £M
Balance at 1 January 2011	468.9	(9.4)	13.2	14.1	486.8
Comprehensive income for the year	49.2	5.7	–	–	54.9
Balance at 31 December 2011	518.1	(3.7)	13.2	14.1	541.7

Statements of Cash Flows

For the year ended 31 December 2012

	Notes	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Profit before tax		52.4	50.2	46.1	62.0
Adjustments for changes in:					
Impairment provision		(7.1)	22.4	(7.1)	22.4
Provisions for liabilities and charges		2.9	1.2	3.2	1.2
Depreciation and amortisation		0.8	0.9	0.8	0.9
Change in value of investment property		1.1	0.3	–	–
Interest on subscribed capital		3.3	3.3	3.3	3.3
Cash generated from operations		53.4	78.3	46.3	89.8
Changes in operating assets and liabilities:					
Loans and advances to customers		(671.5)	(304.7)	(671.5)	(304.9)
Derivative financial instruments		19.8	(10.3)	36.8	27.9
Loans and advances to credit institutions		1.0	(0.7)	3.7	(1.1)
Investment in subsidiaries		–	–	(79.1)	(8.8)
Other operating assets		(28.6)	(13.8)	(52.6)	(13.4)
Shares		384.1	329.0	384.1	329.0
Credit institutions and other		(79.5)	(58.1)	14.1	(63.1)
Debt securities		127.2	61.3	113.0	20.4
Other operating (liabilities)/assets		(19.0)	(18.4)	(45.5)	(35.2)
Taxation paid		(11.9)	(10.8)	(10.2)	(8.8)
Net cash flows from operating activities		(225.0)	51.8	(260.9)	31.8
Returns on investments and servicing of finance		(11.3)	(11.0)	(11.3)	(11.0)
Purchase of securities		(1,897.2)	(3,645.7)	(1,897.2)	(3,645.7)
Proceeds from sale and redemption of securities		2,649.8	3,671.6	2,649.8	3,671.6
Purchase of property and equipment		(1.8)	(1.5)	(1.7)	(1.5)
Net cash flows from investing activities		739.5	13.4	739.6	13.4
Net increase/(decrease) in cash and cash equivalents		514.5	65.2	478.7	45.2
Cash and cash equivalents at beginning of year		261.0	195.8	241.0	195.8
Cash and cash equivalents at the end of year	29	775.5	261.0	719.7	241.0

Notes to the Accounts

For the year ended 31 December 2012

1. Accounting Policies

Basis of preparation

The accounts have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the European Union and in accordance with the Building Societies (Accounts and Related Provisions) Regulations 1998.

The accounts have been prepared on the going concern basis as outlined in the Directors' Report.

The particular accounting policies adopted are described below and have been consistently applied from the prior year.

The following standards were effective in 2012 and relevant to the Society and Group:

IAS 12 (amended): Deferred Tax: Recovery of Underlying Assets.

IFRS 7: Disclosure of transfers of Financial Assets.

At the date of authorisation of these financial statements, the following standards and interpretations, which are relevant to the Society and Group but which have not been applied in these financial statements, were in issue but not yet effective:

IFRS 9 Financial Instruments: Replacement of IAS 39 – Classification and Measurement

IAS 1 (amended): Presentation of Items of Other Comprehensive Income

IAS 19 (revised): Employee Benefits

IFRS 13: Fair Value Measurement

IFRS 7: Offsetting Disclosures

IAS 32: Offsetting Financial Assets and Financial Liabilities

IFRS 10 – 12 and amendments to IAS 27 and 28: Accounting for Consolidations

IFRS 7: Transitional Disclosures for IFRS 9

Annual improvements to IFRS's 2009-2011

The Directors expect that the adoption of these standards and interpretations in future periods may have a material impact on the financial statements of the Society and the Group although it is impractical to estimate the impact.

Accounting convention

The Group prepares its accounts under the historical cost convention, except for the revaluation of available-for-sale financial assets, financial assets and liabilities held at fair value through profit or loss, all derivative contracts, and certain freehold, long leasehold and investment properties.

Basis of consolidation

The Group accounts consolidate the accounts of Leeds Building Society and all its subsidiaries, as listed in note 17. Where subsidiaries are acquired during the period, their results are included in the Group accounts from the date of acquisition. Uniform accounting policies are applied throughout the Group.

Investment in subsidiaries

Investments in subsidiaries are recorded in the Society balance sheet at cost less any provision for impairment.

Financial Instruments

Purchases and sales of financial assets are accounted for at settlement date. In accordance with IAS 39, Financial Instruments: Recognition and Measurement, the financial instruments of the Group have been classified into the following categories:

(a) Loans and receivables

The Group's loans and receivables to customers are classified as 'loans and receivables', except for mortgage assets where the interest rate is linked to US interest rates and other collateralised loans which are held at fair value through profit or loss. Loans and receivables are measured at amortised cost using the effective interest rate method.

In accordance with the effective interest rate method, initial costs and fees such as cashbacks, mortgage premia paid on the acquisition of mortgage books, mortgage arrangement and valuation fees and procurement fees are amortised over the expected life of the mortgage. Mortgage discounts are also amortised over the expected life of mortgage assets.

As permitted by the amendment to IAS 39 issued by the International Accounting Standards Board in October 2008, the Society reclassified, on 1 July 2008, its mortgage backed securities and floating rate note assets from the available-for-sale category to the loans and receivables category. Since this date these have also been recorded at amortised cost using the effective interest rate method.

Notes to the Accounts *continued*

For the year ended 31 December 2012

1. Accounting Policies *continued*

(b) At fair value through profit and loss

The Group uses derivative financial instruments to hedge its exposure to interest rate risk from operational, financing and investment activities. In accordance with its treasury policy the Group does not hold derivative instruments for trading purposes.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into, and are subsequently remeasured at their fair value. The need for credit valuation adjustments is considered in the determination of the fair value of derivatives. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Derivatives can be designated as either cash flow or fair value hedges.

In addition, mortgage assets where the interest rate is linked to US interest rates, savings bonds where the interest rate is linked to increases in the FTSE, indexed linked gilts and other collateralised loans are held at fair value through profit or loss. This is because it provides more relevant information as it removes a measurement inconsistency that would otherwise arise from measuring assets or liabilities on a different basis. In particular, this is used for financial assets that are economically hedged but where it is not practical to apply hedge accounting.

(c) Available-for-sale

Available-for-sale assets are non-derivative financial assets that are not classified into either of the two categories above.

Changes in the fair value of available for sale assets are recognised in equity, except for impairment losses.

As permitted by the amendment to IAS 39 issued by the International Accounting Standards Board in October 2008, the Society reclassified, on 1 July 2008, its mortgage backed securities and floating rate note assets from the available-for-sale category to the loans and receivables category. The available-for-sale reserve at 1 July 2008 is released to profit and loss as part of the effective interest rate based on the maturity profile of the underlying instruments.

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

The fair values of quoted investments in active markets are based on current bid prices. If there is no active market then fair value is determined using alternative valuation techniques.

(d) Financial liabilities

All financial liabilities including wholesale funds and subordinated liabilities held by the Group are measured at amortised cost using the effective interest method, except for those financial liabilities measured at fair value through profit or loss, e.g. derivative liabilities.

The premia and discounts, together with commissions and other costs incurred in the raising of wholesale funds and subordinated liabilities, are amortised over the period to maturity using the effective interest rate method.

(e) Sale and repurchase agreements

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

The difference between sale and repurchase price is accrued over the life of the agreement using the effective interest method.

(f) Derecognition of financial assets and liabilities

Financial assets are only derecognised when the contractual rights to receive cash flows from them have expired or when the Group has transferred substantially all risks and rewards of ownership. The Group has not derecognised the mortgage loans which have been used to secure its issue of covered bonds or its access to the Funding for Lending Scheme as substantially all the risks and rewards are retained by the Group. Failed sale assets and liabilities are recognised by the Society and its subsidiaries to reflect intra-group transfer of risk and rewards which eliminate on consolidation. Financial liabilities are only derecognised when the obligation is discharged, cancelled or has expired.

(g) Cash flow hedges

A cash flow hedge is used to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities. The effective portion of changes in the derivative fair value is recognised in equity. The fair value gain or loss relating to the ineffective portion is recognised immediately in the Income Statement. Amounts accumulated in equity are recognised in the Income Statement in the periods in which the hedged item affects the Income Statement.



Notes to the Accounts *continued*

For the year ended 31 December 2012

1. Accounting Policies *continued*

(h) Fair value hedges

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans and investment products. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the Income Statement over the period to maturity.

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

Impairment of financial assets

Impairment of loans and advance to customers and investment securities

Individual assessments are made of all mortgage loans in possession and investment securities where there is objective evidence that all cashflows will not be received. Based upon these assessments an individual impairment reduction of these assets is made. In addition, a collective impairment reduction is made against those loans and advances to customers where objective evidence, including forbearance measures indicates that it is likely that losses may ultimately be realised and thus a loss event has occurred. The impairment value is calculated by applying various factors to each loan. These factors take into account the Group's experience of default and delinquency rate, loss emergence periods, regional house price movements and adjustments to allow for forced sale values. Impairment provisions are made to reduce the value of other impaired loans and advances to the amount that is considered to be ultimately received based upon objective evidence.

Forbearance strategies exercised by the Group comprise of mortgage term extensions, transfer of mortgages (in full or in part) to an interest only or hardship product and capitalisation of arrears once the customer has demonstrated six months of consecutive contractual payments. These strategies are only adopted where they will not give rise to customer detriment.

Interest income and expense

Interest income and expense on financial assets and liabilities held at amortised cost is measured using the effective interest rate method. The effective interest rate method is a method of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to its net carrying value.

Specifically, for mortgage assets the effect of this policy is to spread the impact of discounts, cashbacks, arrangement and valuation fees, and costs directly attributable and incremental to setting up the loan, over the expected life of the mortgage.

Fees and commission income

Fees and commissions are generally recognised on an accruals basis when the service has been provided.

Fees integral to the loan yield are included within interest income and expensed as part of the effective interest rate calculation. Commission may be repaid when certain policies are cancelled. A provision is included in the accounts to cover the estimate of the amount of clawbacks that will become payable in the future, based on products that have been sold and commissions received prior to the year end.

Rent receivable

Rent receivable comprises the value of rental income receivable, excluding VAT. All revenue arises in the United Kingdom.

Notes to the Accounts *continued*

For the year ended 31 December 2012

1. Accounting Policies *continued*

Property, plant and equipment

Freehold and long leasehold properties are revalued every four years by an independent firm of valuers and an interim valuation is carried out in year three by either an internal or an external valuer. The fair value of the properties is determined from market based evidence.

No provision is made for depreciation of freehold and long leasehold properties as in the opinion of the Directors, their residual value will not be materially different to book value.

Depreciation is calculated on all other assets on a straight line method to write down the cost of such assets to their residual values over the estimated useful lives as follows:

Short leasehold properties	Unexpired lease term
Improvements to properties	8 to 10 years
Equipment	3 to 5 years

Property, plant and equipment are reviewed annually for indication of impairment. Impairment losses are recognised as an expense immediately.

Investment properties

Investment properties are held for long term rental yields and capital appreciation. The properties are stated at fair value at the balance sheet date. Changes in fair value are included in the Income Statement in the period in which they arise. Depreciation is not charged on investment properties.

Pension benefits

Payments to defined contribution retirement benefit schemes are charged as an expense as they fall due.

For defined benefit retirement benefit schemes, the cost of providing benefits is determined using the Projected Unit Method, with actuarial valuations updated at each year-end. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the Income Statement and presented in the Statement of Comprehensive Income.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation less the fair value of Scheme assets.

Leases

Rentals under operating leases are charged to administrative expenses on a straight line basis.

Assets acquired under finance leases are capitalised at fair value at the start of the lease, with the corresponding obligations being included in other liabilities. The finance lease costs charged to the Income Statement are based on a constant periodic rate as applied to the outstanding liabilities.

Borrowings

Non-trading financial liabilities are held at amortised cost. Finance costs are charged to the Income Statement via the effective interest rate method.

Income tax

Income tax on the profits for the period comprises current tax and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in reserves, in which case it is recognised in reserves.

Current tax is the expected tax payable on the taxable income for the year, using tax rates applicable at the balance sheet date and any adjustment to tax payable in respect of previous years.

Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Foreign currency

Assets and liabilities denominated in foreign currencies are translated into sterling at the appropriate rates of exchange prevailing at the year end and exchange differences are dealt with in the Income Statement.



Notes to the Accounts *continued*

For the year ended 31 December 2012

2. Critical Accounting Estimates and Judgements

Some asset and liability amounts reported in the accounts are based on management estimates, judgements and assumptions. There is, therefore, a risk of changes to the carrying amounts for these assets and liabilities within the next financial year.

Impairment losses on loans and advances and investment securities

The Group reviews its loan portfolios and investment securities to assess impairment at least on a quarterly basis, in determining whether an impairment loss should be recorded in the Income Statement. In undertaking this review, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status or borrower's local economic conditions, including forbearance measures such as a transfer to interest only products and term extensions, that correlate with defaults on assets in the Group. Management uses estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment. Management also assesses the expected loss on loans and advances as a result of the expected movement in house prices and the discount on the sale of possession properties. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to minimise any differences between loss estimates and actual loss experience. If expected house prices reduced by 5%, the total impairment provision required would increase by £1.9m.

Fair value of derivatives, mortgages linked to US interest rates and collateral loans

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect the reported fair value of financial instruments. A 100 basis point downward parallel shift in interest rates would reduce the fair value of instruments held by £1.0m.

Retirement benefit obligations

The Income Statement cost and Balance Sheet liability of the defined benefit pension scheme are assessed in accordance with the advice of a qualified actuary. Assumptions are made for inflation, the rate of increase in salaries and pensions, the rate used to discount scheme liabilities, the expected return on scheme assets and mortality rates. Changes to any of the assumptions could have an impact on the Balance Sheet liability and to the costs in the Income Statement. The impact of a 0.1% decrease in the interest rate used to discount the future value of the benefit obligation would be to increase the present value of the liability by £2m.

Effective interest rate

IAS 39 requires that financial instruments carried at amortised cost be accounted for on an effective interest rate ("EIR") basis. Revenue on financial instruments classified as loans and receivables, available for sale, or financial liabilities at amortised cost, is recognised on an effective interest rate basis. This calculation takes into account interest received or paid and fees and commissions paid or received that are integral to the yield as well as incremental transaction costs. The effective interest rate is the rate that discounts the expected future cash flows over the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial instrument at initial recognition.

In respect of residential mortgages, all discounts, premiums, incremental fees and costs associated with the origination of a mortgage are deferred and amortised over the estimated mortgage life. Mortgage life is based upon historic observable data, amended for management's estimation of future economic conditions. The impact of a one month increase in the anticipated life of mortgage assets would result in a £0.5m increase in the Group's interest income.

Financial Services Compensation Scheme (FSCS)

The Society has a provision for a levy of £8.1m (2011: £5.4m) covering the period from March 2012 to March 2014. The amount has been determined by reference to the path of future interest rates applicable at the balance sheet date. Changes in interest rates over the period of the levy will impact the final amount of the payment.

The impact of a 50 basis point increase in the interest rate assumption would result in increasing the carrying value of the FSCS provision by approximately £0.8m.

Notes to the Accounts *continued*

For the year ended 31 December 2012

3. Interest Receivable and Similar Income

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
On loans fully secured on residential property	357.0	342.6	357.0	342.6
On other loans	30.3	34.0	30.3	34.0
On debt securities				
Interest and other income	13.4	17.5	17.3	17.5
On other liquid assets				
Interest and other income	4.3	2.4	4.3	2.4
Net expense on financial instruments	(44.3)	(61.6)	(48.2)	(61.6)
Total interest income	360.7	334.9	360.7	334.9
Interest received on amounts included in the cost of qualifying assets:				
From instruments held at fair value through profit and loss	17.7	17.3	17.7	17.3
From instruments not held at fair value through profit and loss	343.0	317.6	343.0	317.6
Total interest income	360.7	334.9	360.7	334.9

Included within interest receivable and similar income is interest accrued on impaired financial assets of £7.8m (2011: £6.1m).

4. Interest Payable and Similar Charges

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
On shares held by individuals	198.6	188.6	198.6	188.6
On subscribed capital	3.3	3.3	3.3	3.3
On subordinated debt	0.1	0.1	0.1	0.1
On deposits and other borrowings	42.5	34.4	42.5	34.4
Net income on financial instruments	(17.0)	(19.1)	(17.0)	(19.1)
Total interest expense	227.5	207.3	227.5	207.3
Interest expense on amounts included in the cost of qualifying assets:				
From instruments held at fair value through profit and loss	(17.0)	(19.1)	(17.0)	(19.1)
From instruments not held at fair value through profit and loss	244.5	226.4	244.5	226.4
Total interest expense	227.5	207.3	227.5	207.3

Notes to the Accounts *continued*

For the year ended 31 December 2012

5. Fees and Commissions Receivable and Payable

Included within the fees and commissions receivable and payable are the following amounts from instruments held and not held at fair value through profit and loss.

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Fees and commission receivable – at fair value	1.0	3.5	–	–
Fees and commission receivable – at amortised cost	15.1	16.2	11.7	11.4
Fees and commission payable	(0.2)	(0.1)	(0.1)	(0.1)
	15.9	19.6	11.6	11.3

6. Fair Value Gains Less Losses from Derivative Financial Instruments

The fair value accounting volatility gain of £0.7m (2011: £0.1m gain) represents the net fair value loss on derivative instruments that are matching risk exposures on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items.

The gain or loss is primarily due to timing differences in income recognition between the derivative instruments and the hedged assets and liabilities. This gain or loss will trend to zero over time and this is taken into account by the Board when considering the Group's underlying performance.

The profit for the year is after crediting/(charging) the following gains and losses:

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Change in fair value of financial assets designated at fair value through profit and loss	4.2	25.0	4.2	25.0
Change in fair value of financial liabilities designated at fair value through profit and loss	(5.6)	(25.3)	(5.3)	(25.3)
Derivatives in designated fair value hedge accounting relationships	(9.2)	81.7	(29.8)	42.8
Adjustment to hedged items in designated fair value hedge accounting relationships	11.2	(81.3)	25.4	(43.5)
Derivatives in designated cashflow hedge accounting relationships	(3.7)	–	(3.7)	–
Adjustments to hedged items in cashflow hedge accounting relationships	3.5	–	3.5	–
Cross currency swap	0.3	–	1.2	–
	0.7	0.1	(4.5)	(1.0)

The net position on the cross currency swap is composed of a fair value loss on a cross currency swap of £13.2m (2011: £50.2m loss) and an exchange gain of £13.5m (2011: £50.2m gain) on retranslation of the matched Euro liabilities. The cross currency swap was entered into to reduce the exchange risk from funding in foreign currency.

7. Other Operating Income

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Rent receivable	1.4	1.6	0.4	0.5
Pension fund (expense)/income	(0.2)	0.4	(0.2)	0.4
Net loss on exchange rate movements	(0.1)	(0.3)	(0.1)	(0.3)
	1.1	1.7	0.1	0.6

Notes to the Accounts *continued*

For the year ended 31 December 2012

8. Administrative Expenses

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Staff costs				
Wages and salaries	25.1	23.2	21.7	21.3
Social Security costs	2.3	2.2	2.1	2.1
Other pension costs	3.7	3.2	3.5	3.1
Remuneration of auditor (see below)	0.4	0.3	0.4	0.3
Other administrative expenses	17.4	16.8	18.1	15.8
	48.9	45.7	45.8	42.6

There are 31 directors, senior management and members of staff, whose actions have a material impact on the risk profile of the Society, with fixed remuneration of £3.5m and variable remuneration of £0.9m (2011: 32 individuals £3.1m and £0.8m).

The analysis of auditor's remuneration is as follows:

	Group & Society 2012 £'000	Group & Society 2011 £'000
Fees payable to the Society's auditor for the audit of the Society's annual accounts	111	111
Fees payable to the Society's auditor for the audit of the Society's subsidiaries pursuant to legislation	22	10
Total audit fees	133	121
Other services pursuant to legislation		
Tax services	44	72
Further assurance services	84	30
Corporate finance services	–	19
Other services	127	60
Total non-audit fees	255	181
Fees payable to the Society's auditor and its associates in respect of associated pension schemes	6	4

The above figures, relating to Auditor's remuneration, exclude Value Added Tax. Fees payable to Deloitte LLP and their associates for non-audit services to the Society are not required to be separately disclosed because the consolidated financial statements are required to disclose such fees on a consolidated basis.

9. Staff Numbers

	Group 2012 No	Group 2011 No	Society 2012 No	Society 2011 No
The average number of persons employed during the year was as follows:				
Head office	546	511	546	511
Branch offices	400	415	370	377
	946	926	916	888

Note: Details of the Directors remuneration is shown in the Directors Remuneration Report on pages 30 to 34.

Notes to the Accounts *continued*

For the year ended 31 December 2012

10. Impairment Losses on Loans and Advances to Customers

Group	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loans £M	Total £M
At 1 January 2012				
Collective impairment	16.4	17.9	0.4	34.7
Individual impairment	28.9	21.5	2.7	53.1
	45.3	39.4	3.1	87.8
Income and expenditure account				
Charge for the year				
Collective impairment	(0.9)	(9.1)	(0.4)	(10.4)
Individual impairment	18.5	34.3	0.2	53.0
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(0.6)	(0.1)	–	(0.7)
	17.0	25.1	(0.2)	41.9
Amount written off during the year				
Individual impairment	(17.9)	(28.5)	(2.6)	(49.0)
At 31 December 2012				
Collective impairment	15.5	8.8	–	24.3
Individual impairment	28.9	27.2	0.3	56.4
	44.4	36.0	0.3	80.7
Society				
	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loans £M	Total £M
At 1 January 2012				
Collective impairment	16.4	17.9	0.4	34.7
Individual impairment	28.9	21.5	2.7	53.1
	45.3	39.4	3.1	87.8
Income and expenditure account				
Charge for the year				
Collective impairment	(0.9)	(9.1)	(0.4)	(10.4)
Individual impairment	18.5	34.3	0.2	53.0
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(0.6)	(0.1)	–	(0.7)
	17.0	25.1	(0.2)	41.9
Amount written off during the year				
Individual impairment	(17.9)	(28.5)	(2.6)	(49.0)
At 31 December 2012				
Collective impairment	15.5	8.8	–	24.3
Individual impairment	28.9	27.2	0.3	56.4
	44.4	36.0	0.3	80.7

Notes to the Accounts *continued*

For the year ended 31 December 2012

11. Income Tax Expense

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Analysis of charge in the year				
Current tax				
UK corporation tax on profits of the year	11.5	13.4	10.9	11.7
Adjustments in respect of previous years	(0.2)	(0.1)	(0.1)	(0.1)
Total current tax	11.3	13.3	10.8	11.6
Deferred tax				
Origination and reversal of timing differences	1.6	0.2	0.1	0.1
Adjustments in respect of previous years	0.1	0.1	0.1	0.1
Total deferred tax	1.7	0.3	0.2	0.2
Tax on profit on ordinary activities	13.0	13.6	11.0	11.8
Factors affecting current tax charge for the year:				
Profit on ordinary activities before tax	52.4	50.2	46.1	62.0
Profit on ordinary activities multiplied by standard rate of corporate tax in the UK of 24.5% (2011: 26.5%)	12.8	13.3	11.3	16.5
Effects of:				
Expenses not deductible for tax purposes	0.2	0.2	–	0.4
Adjustment in respect of prior years	(0.1)	–	–	–
Affects of rate change	0.1	0.1	–	0.1
Group relief surrendered	–	–	–	(0.1)
Income not taxable	–	–	(0.3)	(5.1)
	13.0	13.6	11.0	11.8

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantially enacted by the balance sheet date.

Finance Act 2012, which was substantively enacted in July 2012, included provisions to reduce the rate of corporation tax to 24% with effect from 1 April 2012 and 23% with effect from 1 April 2013. Accordingly, deferred tax balances have been revalued to the lower rate of 23% in these accounts.

The government has announced that it intends to further reduce the rate of corporation tax to 21% with effect from 1 April 2014. As this legislation was not substantively enacted by 31 December 2012, the impact of the anticipated rate change is not reflected in the tax provisions reported in these accounts. If the deferred tax assets and liabilities of the group were all to reverse after 1 April 2014, the effect of the future changes from 23% to 21% would be to reduce the net deferred tax asset by less than £0.1m. To the extent that the deferred tax reverses more quickly than this the impact on the net deferred tax asset will be reduced.

12. Cash in Hand and Balances with the Bank of England

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Cash in hand	2.5	2.3	2.5	2.3
Balances with the Bank of England	660.6	184.6	660.6	184.6
Included in cash and cash equivalents (see note 29)	663.1	186.9	663.1	186.9

Balances with the Bank of England do not include mandatory reserve deposits of £8.5m (2011: £7.7m) which are not available for use in the Group's day to day operations. Such deposits are included within Loans and Advances to Credit Institutions in the Statement of Financial Position.

Notes to the Accounts *continued*

For the year ended 31 December 2012

13. Derivative Financial Instruments

Derivative financial instruments are contracts or arrangements whose value is derived from one or more underlying price, rate or index inherent in the contract or arrangement, such as interest rates, exchange rates or stock market indices. These types of instruments tend to have a smaller or no initial net investment relative to financial assets/liabilities offering the same risk/return as cash flows and generally settled at a future date. Derivatives are only used by the Group in accordance with Section 9A of the Building Societies Act 1986, to reduce the risk of loss arising from changes in interest rates or other factors of a prescribed description which affect the business. Accordingly, such instruments are not used in trading activity or for speculative purposes. The Group utilises the following derivative instruments for hedging purposes:

Types of derivatives

The main derivatives used by the Group are interest rate swaps, interest rate options, and foreign currency rate swaps. The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the types of derivatives which are typically used in managing such risks. These risks may alternatively be managed using on balance sheet instruments or natural hedges that exist in the Group balance sheet.

Activity	Risk	Type of Derivative
Fixed rate savings products	Sensitivity to falls in interest rates	Receive fixed interest rate swaps (fair value hedge)
Fixed rate mortgage lending	Sensitivity to increases in interest rates	Pay fixed interest rate swaps (fair value hedge)
Fixed rate funding	Sensitivity to falls in interest rates	Receive fixed interest rate swaps (fair value hedge)
Fixed rate asset investments	Sensitivity to increases in interest rates	Pay fixed interest rate swaps (fair value hedge)
Equity linked investment products	Sensitivity to changes in equity indices	Equity linked interest rate swaps
Investment and funding in foreign currencies	Sensitivity to changes in foreign exchange rates foreign	Cross currency interest rate swaps and exchange contracts (fair value hedge)

Hedge accounting

In certain circumstances the Group has taken advantage of the hedging rules set out in IAS 39 to designate derivatives as accounting hedges to reduce accounting volatility where hedge effectiveness is achieved. The Group's market risk policy and application of economic hedging is, however, materially unchanged. A fair value hedge is a hedge of the exposure in changes in fair value of a recognised asset, liability or unrecognised firm commitment, that is attributable to a particular risk that could have an impact on the Income Statement. As required by IAS 39, documentation is produced for each main class of fair value hedge.

A cash flow hedge is a hedge of the exposure to variability in cash flows that could affect profit and that is attributable to a particular risk associated with a recognised asset or liability. Documentation is produced in accordance with IAS 39. 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. For example, the mortgages linked to US interest rates originated by the Group may be hedged with a single contract incorporating both the interest rate and foreign exchange risk involved. In such cases the derivative used will be designed to match exactly the risks of the underlying asset. Exposure to market risk on such contracts is therefore fully hedged. Other derivatives held for hedging are used for financial assets that are economically hedged but where it is not practical to apply hedge accounting.

Cross currency interest rate swaps are used to reduce both the interest rate risk and exchange rate risk exposures that come from funding in foreign currency.

The Group continues to use discount curves based on term Libor rates to fair value both collateralised and non-collateralised positions. There is an increasing trend in the market for collateral held to be based on Overnight Index Swap (OIS) rather than Libor and the Group is currently assessing the implications of this.

Notes to the Accounts *continued*

For the year ended 31 December 2012

13. Derivative Financial Instruments *continued*

The Group utilises the following derivative instruments for hedging purposes:

	Group 2012			Group 2011		
	Contract or underlying principal amount £M	Positive market value £M	Negative market value £M	Contract or underlying principal amount £M	Positive market value £M	Negative market value £M
Derivatives designated as fair value hedges:						
Interest rate swaps	4,515.9	70.7	(85.1)	3,127.7	52.3	(90.4)
Derivatives designated as cash flow hedges:						
Interest rate swaps	143.5	–	(3.7)	–	–	–
Other derivatives held at fair value:						
Quanto swaps	55.0	–	(0.3)	59.0	–	(0.3)
Equity swaps	418.9	40.4	(51.3)	439.5	36.4	(52.3)
Cross Currency swaps	354.8	6.5	(5.4)	900.6	50.6	(2.7)
Floating swaps	836.2	1.3	(2.7)	306.2	0.2	(1.0)
Options	–	–	–	2.2	–	–
Total	1,664.9	48.2	(59.7)	1,707.5	87.2	(56.3)
Total derivative assets/(liabilities) held for hedging	6,324.3	118.9	(148.5)	4,835.2	139.5	(146.7)

	Society 2012			Society 2011		
	Contract or underlying principal amount £M	Positive market value £M	Negative market value £M	Contract or underlying principal amount £M	Positive market value £M	Negative market value £M
Derivatives designated as fair value hedges:						
Interest rate swaps	3,740.2	24.2	(87.0)	2,627.7	23.8	(90.4)
Derivatives designated as cash flow hedges:						
Interest rate swaps	143.5	–	(3.7)	–	–	–
Other derivatives held at fair value:						
Quanto swaps	55.0	–	(0.3)	59.0	–	(0.3)
Equity swaps	418.9	40.4	(51.3)	439.5	36.4	(52.3)
Cross Currency swaps	273.6	6.5	(1.1)	817.0	49.3	–
Floating swaps	836.2	1.3	(2.7)	306.2	0.2	(1.0)
Options	–	–	–	2.2	–	–
Total	1,583.7	48.2	(55.4)	1,623.9	85.9	(53.6)
Total derivative assets/(liabilities) held for hedging	5,467.4	72.4	(146.1)	4,251.6	109.7	(144.0)

Control of derivatives

Control of derivative activity undertaken by the Group is held by the Assets and Liabilities Committee ('ALCO'), a subcommittee of the Board of Directors. The minutes of the ALCO meetings are presented to the Board, which retains overall responsibility for monitoring Balance Sheet exposures. All limits over the use of derivatives are the responsibility of ALCO.

The Board has authorised the use of derivatives under Section 9A of the Building Societies Act 1986. Limits on the use of derivatives are provided for in the Board approved Policy on Financial Risk Management.

Notes to the Accounts *continued*

For the year ended 31 December 2012

14. Loans and Advances to Customers

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
(a) Loans and receivables				
Loans fully secured on residential property	7,557.7	6,808.9	7,557.5	6,808.7
Other loans				
Loans fully secured on land	438.5	504.9	438.5	504.9
Other loans	0.7	3.7	0.7	3.7
Fair value adjustment for hedge risk	74.4	81.2	74.4	81.2
	8,071.3	7,398.7	8,071.1	7,398.5
(b) At fair value through profit and loss				
Loans fully secured on residential property	57.6	61.7	57.6	61.7
Other loans	176.6	173.3	176.6	173.3
Fair value adjustment for hedge risk	50.5	50.8	50.5	50.8
	284.7	285.8	284.7	285.8
Less:				
Impairment losses (see note 10)	(80.7)	(87.8)	(80.7)	(87.8)
	8,275.3	7,596.7	8,275.1	7,596.5

The Society has a number of mortgage portfolios purchased from a third party. The Society retains certain, but not all, risks arising from these loans, and as a consequence these residential mortgages have been recognised as a collateral loan to a third party within other loans at fair value through profit and loss. The net loss on loans and advances which are designated as fair value through profit and loss was £0.4m (2011: £24.4m loss) for both the Group and Society.

Loans and advances to customers include, for both the Group and Society, £1.6bn (2011: £1.1bn) and £0.4bn (2011: nil) which have been transferred from the Society to Leeds Building Society Covered Bonds LLP and Albion No. 1 plc respectively. Both Leeds Building Society Covered Bonds LLP and Albion No. 1 plc are consolidated by the Group. The loans secure £0.8bn (2011: £0.6bn) of covered bonds issued by the Society, and £0.4bn of residential mortgage backed securities issued by Albion No. 1 plc. The covered bonds have been used to secure long term funding from other counterparties. The residential mortgage backed securities have been entirely issued to Leeds Building Society to enable the Group to participate in the Bank of England's Funding for Lending Scheme. The loans are retained on the Society's balance sheet as the Society substantially retains the risk and reward relating to the loans.

The Society accessed £200m through the Funding for Lending Scheme introduced by the Bank of England during 2012. This collateral swap transaction was entered into in contemplation of the Society's mortgage lending and is held off balance sheet.

15. Investment Securities

	Group & Society	
	2012 £M	2011 £M
Debt securities		
Listed	834.7	1,330.9
Unlisted	133.9	382.3
Total investment securities	968.6	1,713.2

Investment securities increased by £8.0m in 2012 (2011: £7.7m) due to changes in fair value. This movement was recorded in equity or through profit and loss. No provisions have been made against investment securities during the year, nor were there any provisions outstanding as at 31 December 2012 (2011: nil).

Notes to the Accounts *continued*

For the year ended 31 December 2012

15. Investment Securities *continued*

The movement in investment securities is summarised as follows:

Group and Society

	Available for sale £M	Loans and receivables £M	Total £M
At 1 January 2012	1,475.1	238.1	1,713.2
Additions	1,897.2	–	1,897.2
Disposals (sale and redemption)	(2,529.6)	(120.2)	(2,649.8)
Change in fair value	4.7	3.3	8.0
At 31 December 2012	847.4	121.2	968.6

As permitted by the amendment to IAS 39 issued by the International Accounting Standards Board in October 2008, the Society has reclassified, from 1 July 2008, its mortgage backed securities and floating rate note assets from the available for sale category to the loans and receivables category.

The assets were reclassified as the Society considered that, due to adverse conditions in financial markets, the market for the sale and purchase of mortgage backed securities and floating rate notes had become inactive. This was evidenced by significant fluctuations in the quoted market value of these instruments and that these instruments were no longer being actively traded. The market value of the assets reclassified on 1 July was £828m, which included £15.8m fair value losses recognised during the period directly in reserves. The carrying value of the assets at 31 December 2012 was £121.2m (2011: £238.1m) and this compares with the market value of £115.6m (2011: £218.2m).

The fair value gain that would have been recorded directly in reserves if the assets had not been reclassified was £14.3m (2011: £13m gain). The Society intends to hold these instruments to maturity and expects to receive cash flows equivalent to the nominal value of the assets, which amounts to £128m (2011: £248m). The net loss, after deferred tax, of £2.2m (2011: £3.7m) previously recognised in the available for sale reserve is released to profit and loss as part of the effective interest rate based on the maturity profile of the underlying instruments. The interest rate on the mortgage backed securities was 0.8% (2011: 1.19%). At 31 December 2012, £465.4m (2011: £403.9m) of investment securities were pledged as collateral under sale and repurchase agreements.

Notes to the Accounts *continued*

For the year ended 31 December 2012

16. Investments in subsidiary undertakings

	Society 2012 £M	Society 2011 £M
(a) Shares held in subsidiary undertakings		
Cost		
At 1 January 2012	19.6	19.6
At 31 December 2012	19.6	19.6
(b) Loans to subsidiary undertakings		
Cost		
At 1 January 2012	28.5	–
Additions	59.5	8.9
Repayments	–	–
At 31 December 2012	88.0	8.9
Total investments in subsidiary undertakings	107.6	28.5

(c) Interest in subsidiary undertakings

The Society holds directly the following interests in subsidiary undertakings, all of which are registered in England, except for Leeds Overseas (Isle of Man) Ltd, which is registered in the Isle of Man.

Name	Major activities	Class of Shares held	Interest of Society
Leeds Financial Services Ltd	Provision of Financial Services	Ordinary £1 shares	100%
Leeds Mortgage Funding Ltd	Provision of Mortgage Finance	Ordinary £1 shares	100%
Leeds Overseas (Isle of Man) Ltd	Provision of Mortgage Finance	Ordinary £1 shares	100%
Headrow Commercial Property Services Ltd	Rental Income from Commercial Properties	Ordinary £1 shares	100%
Mercantile Asset Management Ltd	Non-trading	Ordinary £1 shares	100%
Countrywide Rentals 1 Ltd	Non-trading	Ordinary 50p shares	100%
Countrywide Rentals 2 Ltd	Non-trading	Ordinary 50p shares	100%
Countrywide Rentals 3 Ltd	Non-trading	Ordinary 50p shares	100%
Countrywide Rentals 4 Ltd	Non-trading	Ordinary 50p shares	100%
Countrywide Rentals 5 Ltd	Non-trading	Ordinary 50p shares	100%
Leeds Building Society Covered Bonds LLP	Provision of Mortgage Assets and guarantor of covered bonds	*	*
Albion 1 PLC	Provision of Residential Mortgage Backed Securities	*	*

* The Society's interest is in substance equal to being a 100% owned subsidiary. Consequently it has been consolidated in the Group accounts in accordance with Standing Interpretations and Committee 12 – 'Consolidation – Special Purpose Entities'

The Society received no dividends from Leeds Financial Services Ltd or from Mercantile Asset Management Ltd during 2012 (2011: £15m Leeds Financial Services, £3.9m Mercantile Asset Management Ltd).

Notes to the Accounts *continued*

For the year ended 31 December 2012

17. Property, Plant and Equipment

	Freehold premises £M	Long leasehold premises £M	Short leasehold premises £M	Office & computer equipment £M	Motor vehicles £M	Total £M
(a) Group						
Cost or valuation						
At 1 January 2012	23.1	0.3	1.4	24.6	0.1	49.5
Additions	–	–	–	1.8	–	1.8
At 31 December 2012	23.1	0.3	1.4	26.4	0.1	51.3
Depreciation and impairment						
At 1 January 2012	0.3	–	1.3	20.3	0.1	22.0
Charged in year	–	–	–	0.8	–	0.8
At 31 December 2012	0.3	–	1.3	21.1	0.1	22.8
Net book value						
At 31 December 2012	22.8	0.3	0.1	5.3	–	28.5
At 31 December 2011	22.8	0.3	0.1	4.3	–	27.5
(b) Society						
Cost or valuation						
At 1 January 2012	23.1	0.3	1.4	24.6	–	49.4
Additions	–	–	–	1.7	–	1.7
At 31 December 2012	23.1	0.3	1.4	26.3	–	51.1
Depreciation						
At 1 January 2012	0.3	–	1.3	20.3	–	21.9
Charged in year	–	–	–	0.8	–	0.8
At 31 December 2012	0.3	–	1.3	21.1	–	22.7
Net book value						
At 31 December 2012	22.8	0.3	0.1	5.2	–	28.4
At 31 December 2011	22.8	0.3	0.1	4.3	–	27.5

The freehold and long leasehold premises were valued as at 31 December 2010 by DTZ Debenham Tie Leung Limited on the basis of existing use value.

Notes to the Accounts *continued*

For the year ended 31 December 2012

17. Property, Plant and Equipment *continued*

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
(c) The amount of freehold and long leasehold premises (included above at valuation) determined according to the historical cost accounting convention is as follows:				
Freehold premises	9.7	9.7	9.7	9.7
Long leasehold premises	0.1	0.1	0.1	0.1
Net book value	9.8	9.8	9.8	9.8
(d) Land and buildings occupied by the Group and Society for its own activities				
Net book value	17.3	17.3	17.3	17.3

The cost of equipment, fixtures and vehicles held under finance leases was £nil (2011: £0.7m). The related cumulative depreciation of £nil (2011: £0.7m) includes £nil charged during the year (2011: £nil).

18. Investment Properties

	Group 2012 £M	Group 2011 £M
At 1 January 2012	6.7	7.0
Net fair value movement	(1.1)	(0.3)
At 31 December 2012	5.6	6.7

The investment property was acquired on 31 December 2009 for £7.0m. The investment property was valued as at 31 December 2012 by DTZ Debenham Tie Leung Limited, registered chartered surveyors. The valuation has been prepared in accordance with the RICS Valuation Standards Manual. The property is considered to be specialist in nature and as such no readily available market value exists for it. The site has therefore been valued using a cash flow basis, that takes into account the future potential net income generated through use of the property, discounted using an appropriate discount factor.

19. Deferred Income Tax

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Deferred tax				
At 1 January 2012	1.0	0.8	0.3	–
Amount recognised directly in equity	1.2	0.5	1.2	0.5
Income and expenditure movement during the year	(2.0)	(0.3)	(0.3)	(0.2)
At 31 December 2012	0.2	1.0	1.2	0.3

Notes to the Accounts *continued*

For the year ended 31 December 2012

19. Deferred Income Tax *continued*

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Deferred income tax liabilities				
Excess of capital allowances over depreciation	0.2	–	0.1	–
Gain on revaluation	0.6	0.6	0.6	0.6
Other temporary differences	2.0	0.7	0.4	0.6
	2.8	1.3	1.1	1.2

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Deferred income tax assets				
Pensions and other post retirement benefits	0.5	0.2	0.5	0.2
Cash flow hedges	0.8	0.2	0.8	0.2
Other provisions	1.7	1.9	1.0	1.1
	3.0	2.3	2.3	1.5

20. Other Assets, Prepayments and Accrued Income

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Other assets, prepayments and accrued income	135.9	107.2	157.5	105.1

Other assets include £126.9m (2011: £94.9m) owed by credit institutions on cash collateralisation of swaps.

21. Shares

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Held by individuals	7,680.5	7,296.1	7,680.5	7,296.1
Other shares	7.3	8.9	7.3	8.9
Fair value adjustment for hedge risk	50.5	49.2	50.5	49.2
	7,738.3	7,354.2	7,738.3	7,354.2

Shares have either variable or fixed interest rates.

Notes to the Accounts *continued*

For the year ended 31 December 2012

22. Amounts Owed to Credit Institutions

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Amounts owed to credit institutions	433.1	355.6	433.1	355.6

All amounts owed to credit institutions have fixed interest rates.

23. Amounts owed to other customers

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Amounts owed to subsidiary undertakings	–	–	120.2	26.6
Other deposits	351.3	508.3	351.3	508.3
	351.3	508.3	471.5	534.9

The interest rates on deposits are a combination of fixed and variable.

24. Debt Securities in Issue

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Certificates of deposit	55.4	154.4	55.4	154.4
Floating rate notes	5.0	17.1	5.0	17.1
Covered bonds	876.6	644.2	834.0	615.8
	937.0	815.7	894.4	787.3

The interest rates on debt securities in issue are a combination of fixed and variable.

The underlying security for the covered bonds was the covered bond programme secured on certain loans and advances to customers.

25. Other Liabilities and Accruals

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Income tax	9.0	8.9	9.0	9.1
Accruals	11.3	11.0	10.8	10.5
Other creditors	51.7	71.4	6.2	52.1
	72.0	91.3	26.0	71.7

Included within other creditors is a liability for financial guarantee contracts of £3.1m (2011: £3.2m).

Other creditors includes £37.3m (2011: £56.4m) owed to credit institutions on cash collateralisation of swaps.

Notes to the Accounts *continued*

For the year ended 31 December 2012

26. Provisions for Liabilities and Charges

	FSCS levy £M	Customer redress and other related provisions £M	Commission Clawback £M	Total £M
Group				
At 1 January 2012	5.4	0.3	0.5	6.2
Amounts paid during the year	(2.5)	(0.3)	(0.1)	(2.9)
Provision increase in the year	5.2	0.6	–	5.8
At 31 December 2012	8.1	0.6	0.4	9.1
Society				
At 1 January 2012	5.4	0.3	–	5.7
Amounts paid during the year	(2.5)	(0.3)	–	(2.8)
Provision increase in the year	5.2	0.6	–	5.8
At 31 December 2012	8.1	0.6	–	8.7

Financial Services Compensation Scheme (FSCS) Levy

The levy represents the balance of the estimated amount payable under the FSCS for the periods to March 2013 and to March 2014 calculated with reference to the protected deposits held at 31 December 2011 and 2012. Previous year provision charges were calculated using the Society's share of interest payable, however in 2012 the FSCS announced that a capital element payable over three years would also be required. Refer to note 30 for the Society's contingent liability in relation to the FSCS as at the balance sheet date.

Customer redress and other related provisions

This provision is in respect of claims for redress by customers, including potential claims on payment protection insurance, endowment policies sold by the Group and other fees and premiums charged.

Commission clawback

This provision has been made for the potential clawback of commission on assurance policies sold.

27. Subordinated Liabilities

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
Subordinated debt notes 2015	0.9	0.9	0.9	0.9

The subordinated debt has a fixed interest rate of 4.34% (2011: 4.34%) and a maturity date of 9 March 2015. The debt is subordinated to the claims of members and all other creditors.

28. Subscribed Capital

	Group 2012 £M	Group 2011 £M	Society 2012 £M	Society 2011 £M
13 $\frac{3}{8}$ % permanent interest bearing shares	25.0	25.0	25.0	25.0

The subscribed capital, which is denominated in sterling, was issued for an indeterminate period and is only repayable in the event of the winding up of the Society.

Notes to the Accounts *continued*

For the year ended 31 December 2012

29. Cash and Cash Equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition.

	Group		Society	
	2012 £M	2011 £M	2012 £M	2011 £M
Cash in hand and balances with the Bank of England (note 12)	663.1	186.9	663.1	186.9
Loans and advances to credit institutions	112.4	74.1	56.6	54.1
	775.5	261.0	719.7	241.0

30. Guarantees and Other Financial Commitments

(a) Financial Services Compensation Scheme

The Society has a contingent liability in respect of contributions to the Financial Services Compensation Scheme provided by the Financial Services and Markets Act 2000.

Based on its share of protected deposits, the Society pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it. In September 2008 a claim was triggered against the FSCS by the transfer of Bradford and Bingley plc's retail deposit business to Abbey National plc. In October 2008 a further claim was triggered against the FSCS by the transfer of Kaupthing Singer and Friedlander's (KSF) internet deposit business ('Kaupthing Edge') and Heritable Bank's (a subsidiary of Landsbanki hf) deposit business to ING Direct. In December 2008 an additional claim against the FSCS was triggered by London Scottish Bank being placed in administration and later Dunfermline Building Society. The FSCS will also be liable to claims from depositors of Landsbanki hf and KSF whose balances have not been transferred to ING Direct, but are covered by the FSCS. The FSCS has met, or will meet, the claims by way of loans received from the Bank of England which will eventually be replaced by a loan from HM Treasury. The FSCS has, in turn, acquired the rights to the realisation of the assets of these banks. The FSCS is liable to pay interest on the loans from the Bank of England. The FSCS may have a further liability if there are insufficient funds available from the realisation of the assets of the banks to fully repay the respective Bank of England loans. The resolution of the Dunfermline Building Society under the Special Resolution Regime has now been completed. The capital costs of failure have been estimated at £505m, of which the Society's share would be £3.6m. There is significant uncertainty regarding the value of the capital costs. Due to the inherent uncertainty in respect to these matters, the ultimate liability for the Society is presently unknown, although the total liability will contain both an interest and capital element. This matter is therefore considered by the Directors to be a contingent liability for the Society.

(b) Subsidiary undertakings

The Society is obliged under the Building Societies Act 1986 to discharge the liabilities of its subsidiary undertakings to the extent they were incurred before 11 June 1996 and in so far as those bodies are unable to discharge the liabilities out of their own assets.

(c) Capital commitments

There were no capital commitments at 31 December 2012 (2011: nil) contracted but not provided for.

Notes to the Accounts *continued*

For the year ended 31 December 2012

30. Guarantees and Other Financial Commitments *continued*

(d) Leasing commitments

At 31 December the annual commitments under non-cancellable operating leases were as set out below:

	Group & Society	
	2012 £M	2011 £M
Land and buildings		
Commitment expiring:		
Within one year	0.2	0.2
Between two and five years inclusive	0.4	0.5
After five years	0.9	0.9
	1.5	1.6
Other operating leases		
Commitment expiring:		
Within one year	0.8	–
Between two and five years inclusive	–	1.0
	0.8	1.0
(e) Irrevocable loan facility commitments	–	–
	–	–

31. Retirement Benefit Obligations

The Society operates both defined benefit and defined contribution schemes. In addition, the Society has, for two individuals in the UK, an Employer funded retirement benefits scheme. The schemes have been accounted for under IAS19 covering employee benefits. IAS19 requires disclosure of certain information about the schemes as follows.

The defined benefit section of the Scheme provides benefits based on final salary for certain employees. The assets of the Scheme are held in a separate trustee-administered fund. Contributions to the defined benefit section 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 entrants from 1 January 2000.

Actuarial gains and losses are recognised immediately in full, through the Statements of Comprehensive Income. The major assumptions used by the actuary were (in nominal terms):

	Group & Society				
	2012	2011	2010	2009	2008
Rate of increase in salaries	4.65%	4.80%	5.70%	5.80%	5.30%
Rate of increase for pensions in payment*	2.80%	3.00%	3.60%	3.69%	3.25%
Rate of increase for deferred pensions*	2.90%	3.05%	3.70%	3.80%	3.30%
Discount rate	4.50%	4.85%	5.55%	5.85%	6.20%
Inflation assumption RPI	2.90%	3.05%	3.70%	3.80%	3.30%
Inflation assumption CPI	2.20%	2.05%	3.20%	n/a	n/a
Expected return on assets	4.48%	4.65%	6.07%	6.65%	5.86%

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



Notes to the Accounts *continued*

For the year ended 31 December 2012

31. Retirement Benefit Obligations *continued*

The expected return on assets has been derived as the weighted average of the expected returns from each main asset class (i.e. equities and bonds).

The expected return for each asset class reflects a combination of historical performance analysis, the forward looking views of the financial markets (as suggested by yields available), and the views of investment organisations.

The most significant non-financial assumption is the assumed rate of longevity, which is based on the SAPS tables known as S1PXA, projected in line with members' years of birth. Last year future improvement in mortality were allowed for in line with the medium cohort effect and a 0.5% underpin for members; however the Directors have changed this allowance to the more up to date CMI 2011 projection with a 1% long-term trend. The table below shows the life expectancy assumptions used in the accounting assessments. Pensioner life expectancies are for a member currently aged 63 retiring now. Non-pensioner life expectancies are for a member currently aged 43 retiring at age 63.

	2012		2011		2010	
	Pensioner	Non-pensioner	Pensioner	Non-pensioner	Pensioner	Non-pensioner
Male	24	25	23	24	23	24
Female	26	28	25	27	25	27

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

Category of assets	Group & Society				
	2012	2011	2010	2009	2008
Equities	53.0%	51.7%	53.7%	63.2%	54.4%
Property	4.8%	5.4%	5.5%	5.8%	6.8%
Government bonds	19.9%	21.3%	20.2%	20.1%	26.0%
Corporate bonds	21.8%	21.0%	19.9%	10.1%	12.6%
Cash/other	0.5%	0.6%	0.7%	0.8%	0.2%

Reconciliation of funded statement	Group & Society				
	2012	2011	2010	2009	2008
Present value of pension scheme's liabilities	(87.7)	(78.6)	(74.6)	(71.9)	(60.7)
Assets at fair value	85.3	77.7	73.9	68.9	57.7
Deficit	(2.4)	(0.9)	(0.7)	(3.0)	(3.0)

The amounts recognised in the Income Statements are as follows:

	Group & Society	
	2012 £M	2011 £M
Current service cost	2.1	2.1
Prior service cost	0.5	0.2
Interest cost	3.8	4.1
Expected return on plan assets	(3.6)	(4.5)
Total cost – defined benefit scheme	2.8	1.9

Note: Service cost is the Society's cost net of employee contributions and inclusive of interest to the reporting date.

Notes to the Accounts *continued*

For the year ended 31 December 2012

31. Retirement Benefit Obligations *continued*

Experience recognised in the Statements of Comprehensive Income (SOCl)

	Group & Society				
	2012 £M	2011 £M	2010 £M	2009 £M	2008 £M
Experience (loss)/gain on pension scheme liabilities	(5.3)	0.3	(2.3)	(7.2)	7.6
Percentage of scheme liabilities (%)	(6.0%)	0.4%	(3.1%)	(10.0%)	12.4%
Experience gain/(loss) on assets	3.7	(1.7)	3.2	6.1	(11.7)
Percentage of scheme assets (%)	4.3%	(2.2%)	4.3%	8.9%	(18.6%)
Total (losses)/gains recognised in SOCl during the year	(1.6)	(1.4)	0.9	(1.1)	(4.1)

Changes in the present value of the defined benefit obligations are as follows:

	Group & Society	
	2012 £M	2011 £M
At 1 January 2012	78.6	74.6
Current service cost	2.1	2.1
Interest cost	3.8	4.1
Prior service cost	0.5	0.2
Employee contributions	–	–
Actuarial loss/(gain)	5.3	(0.3)
Benefits paid	(2.6)	(2.1)
At 31 December 2012	87.7	78.6

Changes in the fair value of plan assets are as follows:

	Group & Society	
	2012 £M	2011 £M
At 1 January 2012	77.7	73.9
Expected return	3.6	4.5
Actuarial gain/(loss)	3.7	(1.7)
Contribution by employer	2.9	3.1
Employee contributions	–	–
Benefits paid	(2.6)	(2.1)
At 31 December 2012	85.3	77.7

The cumulative amount of actuarial gains and losses recognised in the other comprehensive income statement since the date of transition to IFRSs is £4.7m (2011: £6.3m).

In June 2011, the IASB issued a new IAS 19 – Employee Benefits which was endorsed by the EU in June 2012. The revised IAS 19 is effective for annual period beginning on or after 1 January 2013. Although early adoption of the standard is permitted, the Society has decided to adopt the revised standard for the period ending 31 December 2013 and as such, the new standard will require retrospective application and the presentation of transition effects for the opening statement of financial position at 31 December 2012.

Had the Society adopted the new standard for the period ending 31 December 2012 the net pension cost for the period would have been approximately £0.1m higher. The balance sheet position would not have changed from the figures disclosed in these financial statements.

Estimated contributions for 2013 financial year

	2013 £M
Estimated contributions in Financial Year 2013	2.4
Estimated employee contributions in Financial Year 2013	–
Estimated Total contributions in Financial Year 2013	2.4

Notes to the Accounts *continued*

For the year ended 31 December 2012

32. Related Party Transactions

Group

The Group enters into transactions in the ordinary course of business, with Directors of the Society and persons connected with the Directors of the Society, on normal commercial terms.

Society

Details of the Society's shares in group undertakings are given in note 16.

A number of transactions are entered into with the related parties in the normal course of business. These include loans, deposits and the payment and recharge of administrative expenses. The volumes of related party transactions, outstanding balances at the year end, and the related income and expenses for the year are as follows:

	Society subsidiaries		Directors and connected persons	
	2012 £M	2011 £M	2012 £M	2011 £M
Loans payable to the Society				
Loans outstanding at 1 January 2012	8.9	–	0.3	0.2
Net movement during the year	79.1	8.9	(0.1)	0.1
Loans outstanding at 31 December 2012	88.0	8.9	0.2	0.3
Deposits payable by the Society				
Deposits outstanding at 1 January 2012	26.6	31.6	1.6	2.8
Net movement during the year	93.6	(5.0)	(0.2)	(1.2)
Deposits outstanding at 31 December 2012	120.2	26.6	1.4	1.6
Net interest income				
Interest receivable	–	–	–	–
Interest expense	–	–	–	–
			2012 £M	2011 £M
Directors' emoluments				
Short-term benefits			1.7	1.7

Directors' emoluments include those emoluments received by directors from the Society and its associated bodies.

One Director is a member of the defined benefit section of the Leeds Building Society Pension Scheme (2011: one).

Three Directors are members of the defined contribution section of the Leeds Building Society Pension Scheme (2011: one).

Notes to the Accounts *continued*

For the year ended 31 December 2012

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

2012

Group & Society

	Before tax Amount £M	Tax benefit/ (expense) £M	Net of tax Amount £M
Available for sale investment securities	7.9	(2.0)	5.9
Cash flow hedges	(3.5)	0.8	(2.7)
Actuarial (losses)/gains on retirement benefit obligations	(1.6)	0.4	(1.2)
Other comprehensive income	2.8	(0.8)	2.0

2011

Group & Society

	Before tax Amount £M	Tax benefit/ (expense) £M	Net of tax Amount £M
Available for sale investment securities	7.7	(2.1)	5.6
Actuarial (losses)/gains on retirement benefit obligations	(1.4)	0.5	(0.9)
Other comprehensive income	6.3	(1.6)	4.7

34. Risk Management and Control

Significant Risks

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

The following table details the work of the main committees that have been established within the Group to manage these and other risks.

Committee	Status	Main responsibilities	Membership
Audit Committee	Group Board sub-committee	Approval of the Group's internal control policies. Monitor the integrity of the financial statements of the Group. Monitor and review the effectiveness of the Internal Audit function.	Non-executive Group Board Directors only. Executive Group Board Directors and other senior managers attend as required.
Assets and Liabilities Committee (ALCO)	Group Board sub-committee	Monitoring market and liquidity risk and recommending policy in these areas to the Board.	Non-executive Group Board Directors, Executive Group Board Directors and other senior managers.
Credit Committee	Group Board sub-committee	Formulation of policy pertaining to asset quality and credit risk for approval by the Board.	Non-executive Group Board Directors, Executive Group Board Directors and other senior managers.
Risk Committee	Group Board sub-committee	Establishing the risk appetite of the Group, and assessing the impact of decisions upon capital. Approval of the Group's overall risk management framework. Approval of policy for management of operational risk.	Non-executive Group Board Directors, Executive Group Board Directors and other senior managers.
Conduct Risk Committee	Group Board sub-committee	Provide oversight of conduct risk across the business and to ensure fairness principles are promoted across all the Society's operations.	Non-executive Group Board Directors, Executive Group Board Directors and other senior managers.

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

Credit risk

Credit risk is the risk of financial loss when a customer or counterparty is not able to meet their obligations as they fall due.

The Group is exposed to this risk in respect of:

- a) Retail lending (individual customers);
- b) Commercial lending (businesses); and
- c) Wholesale lending (other financial institutions)

a) Retail lending

General UK economic factors such as unemployment, problems in the housing market, and levels of household income impact credit risk within retail lending.

The Group is firmly committed to the management of this risk at all stages of the lending cycle. The Group monitors closely customer affordability and LTV multiples at the application stage. It employs appropriate underwriting and fraud detection techniques to minimise losses once loans have been approved, and it also takes a proactive approach to the control of bad and doubtful debtors which is managed by a specialist team dedicated solely to the collections and recovery process.

b) Commercial lending

Credit risk associated with lending to businesses is affected by similar factors that affect retail mortgages, although on average loans are generally larger than to individual customers. The Society ceased new commercial lending in 2008.

c) Wholesale lending

The Society holds various investments in order to satisfy operational demand at the same time as to meet current and future liquidity regulatory requirements. Credit risk arises because of factors such as deterioration in the investee's financial health and uncertainty within the wholesale market generally. Wholesale lending credit risk is managed through setting strict upper and lower limits to each type of investment that are dependent on criteria such as, time to maturity, credit rating and originating country. These limits are set by ALCO and monitored by the treasury team on a continuous basis.

Experienced credit and risk functions operate within the Group, and are driven both by the recognised need to manage the potential and actual risks, but also by the need to continually develop new processes to ensure sound decisions are made in the future. In this way, any variations in risk from market, economic or competitive changes are identified and the appropriate controls developed and put in place.

Comprehensive management information on movement and performance within the various personal and wholesale portfolios ensure that credit risk is effectively controlled, and any adverse trends are identified before they impact on performance. Group performance is also measured against the industry, where appropriate, to identify where debt default levels are out of line with that of the industry average. This management information is distributed widely across the Group and monitored within tight boundaries at Board and Board sub-committees.

There has been no change in the year to the manner in which the Group manages and measures all types of credit risk. However the range and depth of credit risk management information has been enhanced during the year.

The table below shows the split of the Group's loans and advances. The Society's exposure to Euro denominated loans and advances is shown in note 35.

	Group 2012		Group 2011	
	£M	%	£M	%
Retail lending:				
Secured on residential property	7,615.0	92.5	6,870.6	91.0
Other loans	177.3	2.2	177.0	2.3
Commercial lending	438.5	5.3	504.9	6.7
Gross balances	8,230.8	100.0	7,552.5	100.0
Impairment provisions	(80.7)		(87.8)	
Fair value adjustment	125.2		132.0	
	8,275.3		7,596.7	

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

a) Retail lending

The majority of the Group's retail lending relates to loans secured on residential property, however, the Group also has some lifetime mortgages and other loans within this area. The Group's retail lending exposures are predominantly in the United Kingdom, with some exposure in Ireland and Spain. The risk characteristics of the Irish residential portfolio are no longer similar to the rest of the Group's residential portfolio because of higher average arrears rates and lower house prices caused by Ireland's weak economic situation and the severe austerity measures imposed on them. The Spanish residential portfolio however, continues to perform in line with the UK because the majority of the properties are owned by UK residents.

The table below provides further information on the Group's loans and advances to customers by payment due status as at 31 December 2012. The balances exclude the fair value adjustment for hedge risk and impairment losses. The table includes £30.3m (2011: £25.2m) of loans and advances secured on residential property in the Republic of Ireland that are past due and £1.2m (2011: £1.6m) in possession.

	Group & Society Residential		Group & Society Other ⁽¹⁾	
	2012 £M	2012 %	2012 £M	2012 %
Not impaired:				
– neither past due nor impaired	7,183.0	94.4	176.6	99.6
– Past due up to 3 months but not impaired	213.7	2.8	–	–
Impaired:				
– Past due 3 to 6 months	78.2	1.0	–	–
– Past due 6 to 12 months	59.2	0.8	–	–
– Past due over 12 months	47.4	0.6	0.7	0.4
– Possessions	33.5	0.4	–	–
	7,615.0	100.0	177.3	100.0

Note:

1) Other loans include lifetime mortgages of £176.6m (2011: £173.3m) and other loans of £0.7m (2011: £3.7m).

	Group & Society Residential		Group & Society Other	
	2011 £M	2011 %	2011 £M	2011 %
Not impaired:				
– neither past due nor impaired	6,375.8	92.7	176.4	99.7
– Past due up to 3 months but not impaired	265.4	3.9	–	–
Impaired:				
– Past due 3 to 6 months	87.7	1.3	–	0.3
– Past due 6 to 12 months	70.3	1.0	0.6	–
– Past due over 12 months	46.6	0.7	–	–
– Possessions	28.3	0.4	–	–
	6,874.1	100.0	177.0	100.0

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

The Group continues to invest in developing and enhancing its arrears management strategies to minimise credit risk whilst ensuring that customers are treated fairly. Such forbearance strategies include the use of arrangements to assist borrowers in arrears who are now able to meet agreed repayment strategies, including or excluding arrears balances.



Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

Fair value of collateral held for residential loans:

	Group & Society Residential	
	2012 £M	2011 £M
Not individually impaired	7,335.2	6,573.5
Impaired	173.9	203.4
Possessions	28.2	25.4
	7,537.3	6,802.3

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

Upon initial recognition of loans and advances, the fair value of collateral is based on the sales price for the property. In subsequent periods, the fair value is updated to reflect market price based on the quarterly Halifax house price index. In general the lower the loan-to-value percentage the greater the equity within the property, and the lower the losses expected to be realised in the event of default or repossession. The indexed loan-to-value analysis on the Group's residential loan portfolio is as follows:

	Group & Society	
	2012 %	2011 %
Secured on residential property		
<70%	51.4	51.8
70% – 80%	19.1	17.8
80% – 90%	15.5	15.0
>90%	14.0	15.4
	100.0	100.0

The overall indexed loan-to-value of the residential portfolio is 51% (2011: 51%).

The indexed loan-to-value on the lifetime mortgage portfolio is 36% (2011: 32%). The collateral held amounts to £497m (2011: £529m).

Forbearance Arrangements

	Payment Arrangements £M	Concessions £M	Capitalisations £M	Transfer to interest only £M	Term extensions £M	Other £M	Total Forbearance £M
– Neither past due or impaired	70.6	18.8	46.7	66.2	60.6	9.3	272.2
– Past due up to 3 months	61.0	10.6	18.3	1.2	0.7	0.1	91.9
– Past due more than 3 months	58.8	9.3	6.1	0.5	–	–	74.7
– Possessions	2.7	0.6	0.1	0.1	–	–	3.5
Total	193.1	39.3	71.2	68.0	61.3	9.4	442.3

The table above provides further information on the residential loans existing at the 2012 reporting date by types of account renegotiations applied to our customers over the last 12 months. This includes renegotiations regardless of whether or not our customer has experienced financial difficulty in repaying their loan with the Group. For clarity, this table includes all balances which have had their terms renegotiated in the last 12 months, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms.

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

b) Commercial lending

The table below provides further information on the Group's commercial loans and advances by payment due status as at 31 December 2012. The balances exclude the fair value adjustment for hedge risk and impairment losses.

	Group & Society Commercial		Group & Society Commercial	
	2012 £M	2012 %	2011 £M	2011 %
Not impaired:				
– neither past due nor impaired	322.1	73.5	460.2	91.1
– Past due up to 3 months but not impaired	–	–	1.8	0.4
Impaired:				
– Not past due but impaired	60.0	13.6	–	–
– Past due up to 3 months	20.8	4.7	–	–
– Past due 3 to 6 months	–	–	–	–
– Past due 6 to 12 months	–	–	0.2	–
– Past due over 12 months	3.3	0.8	7.0	1.4
– Possessions	32.3	7.4	35.7	7.1
	438.5	100.0	504.9	100.0

No loans (2011: £nil) that would be past due or impaired have had their terms renegotiated during 2012.

Loans in the analysis above which are not impaired have collective impairment allowances set aside to cover credit losses.

Fair value of collateral held:

	Group & Society	
	2012 £M	2011 £M
Not individually impaired	346.6	454.9
Impaired	3.3	3.5
Possessions	29.2	31.2
	379.1	489.6

The collateral held against commercial loans consists of commercial property. The use of such collateral is in line with terms that are usual and customary to commercial lending activities. The fair value is based on open market value or indices of similar assets. The level of collateral in 2012 reflects the reduction in the portfolio during the year and lower valuations on impaired loans.

The Group continues to invest in developing and enhancing its arrears management strategies to minimise credit risk whilst ensuring that its corporate customers are treated fairly. Such forbearance strategies include the renegotiation of covenants and/or loan term to assist borrowers in arrears who are now able to meet agreed repayment strategies, including or excluding arrears balances.

Loans secured on commercial property are split by the industry type as follows:

	Group & Society Commercial		Group & Society Commercial	
	2012 £M	2012 %	2011 £M	2011 %
Leisure and Hotel	11.0	2.5	12.1	2.4
Retail	138.2	31.5	153.5	30.4
Offices	164.6	37.6	205.4	40.7
Commercial investment and industrial units	90.3	20.6	92.0	18.2
Miscellaneous	34.4	7.8	41.9	8.3
	438.5	100.0	504.9	100.0

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

The indexed loan-to-value analysis on the Group's commercial loan portfolio is as follows:

	Group & Society	
	2012 %	2011 %
Secured on land		
<70%	5.3	9.5
70% – 80%	13.2	14.1
80% – 90%	17.5	18.2
>90%	64.0	58.2
	100.0	100.0

The overall indexed loan-to-value of the commercial portfolio is 100.4% (2011: 94.0%).

c) Wholesale lending

At 31 December 2012 none of the Group's treasury portfolio exposure was either past due or impaired. There are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

95.9% (2011: 93.9%) of the Group's treasury investments are rated single A or better. The Group has implemented a policy that initial investments in treasury assets must be grade A3 or above.

The table below provides ratings details for the Group's treasury investment portfolio as at 31 December 2012:

	Group		Group	
	2012 £M	2012 %	2011 £M	2011 %
Aaa	1,426.6	81.7	1,440.7	72.8
Aa1	21.6	1.2	8.3	0.4
Aa2	28.0	1.6	13.0	0.7
Aa3	21.8	1.2	96.5	4.9
A1	43.5	2.5	51.7	2.6
A2	110.7	6.3	154.9	7.8
A3	21.1	1.2	93.2	4.7
Baa1	29.0	1.7	33.6	1.7
Baa2	5.0	0.3	4.0	0.2
Baa3	-	-	-	-
Ba1	7.5	0.4	14.5	0.7
Ba2	1.7	0.1	10.9	0.5
Caa2	-	-	11.7	0.6
Unrated:				
UK Building Societies	21.6	1.2	26.0	1.3
Other	10.6	0.6	20.8	1.1
	1,748.7	100.0	1,979.8	100.0

The Society investment portfolio mirrors the Group except in its holdings of Aaa rated investments where the value held is £1,426.5m (2011: £1,421.1m) and in its holdings of Aa2 rated investments where the value held is £21.6m (2011: £12.5m).

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

Geographical exposure:

	Group		Group	
	2012 £M	2012 %	2011 £M	2011 %
UK	1,559.3	89.1	1,734.0	87.6
Europe split into individual countries as follows:				
Germany	43.4	2.5	18.8	0.9
Netherlands	31.7	1.8	34.6	1.7
Greece	–	–	–	–
Portugal	–	–	–	–
Ireland	0.2	–	21.1	1.1
Italy	–	–	–	–
Spain	–	–	3.4	0.2
France	–	–	–	–
Europe Other	72.0	4.1	104.0	5.3
North America	20.2	1.2	48.5	2.4
Australasia	6.7	0.4	15.4	0.8
Far East	15.2	0.9	–	–
Total	1,748.7	100.0	1,979.8	100.0

The Society's geographical exposure is equal to the Group's except it holds £1,500.9m (2011: £1,714.0m) in the UK. £0.2m (2011: £0.2m) of the exposures to Ireland relates to Mandatory Deposits held with the Central Bank of Ireland.

The Group no longer holds any assets in European countries affected significantly by the Eurozone crises (2011: £21.8m of which none were impaired).

The nature of the instrument determines the level of collateral held. Loans and debt securities are generally unsecured with the exception of asset back securities which are secured by a collection of financial assets. The group prefers to document its derivative activity via the International Swaps and Derivatives Association ('ISDA') Master Agreement. In conjunction with this the Group has executed with some counterparties a Credit Support Annex ('CSA'). Under a CSA, cash is posted as collateral between the counterparties of the deal to mitigate some of the counterparty credit risk inherent in outstanding derivative positions, as well as credit risk exposure arising on sale and repurchase transactions and guaranteed equity bonds.

Transactions are usually settled on a gross basis, and therefore there is no netting in the Financial Statements. Legally the Group does have right of set-off for those transactions. Accordingly the credit risk associated with such contracts is reduced to the extent that negative mark to market valuations on derivatives will offset positive mark to market values on derivatives, subject to an absolute of zero.

The Society currently has the following types of derivatives. Notional principal amount indicates the volume of business outstanding at the balance sheet date and does not represent amounts at risk. The replacement cost represents the cost of replacing contracts calculated at market rates current at the balance sheet date and reflects the Group's exposure should the counterparty default. No account is taken of offsetting positions with the same counterparty. All derivatives have been transacted with OECD financial institutions.

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

The following tables analyse the derivatives by contract and residual maturity:

	Notional principal amount £M	Group 2012 Credit risk weighted amount £M	Replacement cost £M	Notional principal amount £M	Group 2011 Credit risk weighted amount £M	Replacement cost £M
Interest rate swaps	5,969.5	40.2	112.4	4,434.6	34.7	122.6
Cross currency swaps	354.8	2.5	6.5	400.6	4.1	16.9
	6,324.3	42.7	118.9	4,835.2	38.8	139.5
Under one year	1,109.7	0.9	11.9	1,059.1	3.1	22.7
Between one and five years	3,651.9	18.4	59.2	2,162.6	11.5	53.5
Over five years	1,562.7	23.4	47.8	1,613.5	24.2	63.3
	6,324.3	42.7	118.9	4,835.2	38.8	139.5

	Notional principal amount £M	Society 2012 Credit risk weighted amount £M	Replacement cost £M	Notional principal amount £M	Society 2011 Credit risk weighted amount £M	Replacement cost £M
Interest rate swaps	5,198.5	31.4	65.9	3,934.6	27.2	94.1
Cross currency swaps	269.2	2.0	6.5	317.0	3.6	15.6
	5,467.7	33.4	72.4	4,251.6	30.8	109.7
Under one year	1,109.7	0.9	11.9	1,059.1	3.1	22.7
Between one and five years	3,295.3	16.6	59.1	2,079.0	11.0	52.2
Over five years	1,062.7	15.9	1.4	1,113.5	16.7	34.8
	5,467.7	33.4	72.4	4,251.6	30.8	109.7

Market risk

Market risk is the risk that the value of a financial instrument will fluctuate due to movement in market factors. Market risk comprises the following types of risk: interest rate risk, currency risk, operational risk and other price risk. These risks are measured and managed at Group level.

The Group recognises that the effective management of market risk is essential to the maintenance of stable earnings and the preservation of member value.

The Group's exposure to market risk is governed by a policy approved by the ALCO. This policy sets out the nature of risk which may be taken and aggregate risk limits. Based on these aggregate limits, the ALCO assigns risk limits to all Group businesses and monitors compliance with these limits. At each meeting the ALCO reviews reports showing the Group's exposure to market and liquidity risks.

The Group's exposure to market risk is managed by Group Treasury. Group Treasury manages market risk by using appropriate hedging instruments or by taking advantage of natural hedges within the Group's businesses. Market risk is managed within a clearly defined framework of policy limits.

Market risk is measured and reported using a variety of techniques, according to the appropriateness of the technique to the exposure concerned. The techniques used include interest rate gap analysis, duration analysis, basis point value analysis, scenario analysis, and earnings at risk.

There has been no change in the year to the Group's exposure to market risks or the manner in which it manages and measures the risk.

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

a) Interest rate risk

The primary market risk faced by the Group is interest rate risk. The net interest income and market value of the Group is exposed to movements in interest rates. This exposure is managed on a continuous basis, within limits set by the Board, using a combination of derivatives. There has been no change to the way that interest rate risk is managed during the year.

The Group does not run a trading book and therefore does not have the type of higher risk exposure run by many banking institutions. Given the Group's policy of hedging fixed rate assets and liabilities back to floating rate, outright interest rate risk arises mainly from the Board's decision to invest the Group's reserves according to a specified fixed rate maturity profile.

The level of risk can deviate from this – subject to limits – in particular as a result of decisions made by the Group's Treasury department to temporarily deviate from the benchmark profile in the light of market conditions. The Group uses interest rate stress testing and gap analysis to manage its interest rate position.

The following table provides a summary of the interest rate repricing profile of the Group's assets and liabilities as at 31 December 2012. Assets and liabilities have been allocated to time bands by reference to the earlier of the next interest rate reset date and the contractual maturity date.

The table takes account of derivative financial instruments whose effect is to alter the interest basis of Group assets and liabilities. The non-interest bearing balances have been included in a separate column.

31 December 2012	Not more than 3 months £M	More than 3 months but not more than 6 months £M	More than 6 months but not more than 1 year £M	More than 1 year but not more than 5 years £M	More than 5 years £M	No specific reprice date £M	Non interest bearing £M	Total £M
Assets								
Liquid assets	1,130.8	47.6	107.0	343.0	19.2	–	101.1	1,748.7
Loans fully secured on residential property and other loans	5,007.6	139.4	448.8	2,491.7	187.8	–	–	8,275.3
Property, plant and equipment	–	–	–	–	–	–	28.5	28.5
Investment properties	–	–	–	–	–	–	5.6	5.6
Other assets	–	–	–	–	–	–	257.8	257.8
Total assets	6,138.4	187.0	555.8	2,834.7	207.0	–	393.0	10,315.9
Liabilities								
Shares	4,706.7	516.1	598.8	1,780.8	29.0	–	106.9	7,738.3
Amounts owed to credit institutions, other customers and debt securities in issue	1,047.2	116.5	50.7	5.5	500.0	–	1.5	1,721.4
Other liabilities	–	–	–	–	–	–	242.4	242.4
Subordinated debt	–	–	–	0.9	–	–	–	0.9
Subscribed capital	–	–	–	–	–	25.0	–	25.0
Reserves	–	–	–	–	–	–	587.9	587.9
Total liabilities	5,753.9	632.6	649.5	1,787.2	529.0	25.0	938.7	10,315.9
Effect of derivative items	370.4	(142.9)	437.5	(951.4)	286.4	–	–	–
Interest rate sensitivity gap	754.9	(588.5)	343.8	96.1	(35.6)	(25.0)	(545.7)	–

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

31 December 2011	Not more than 3 months £M	More than 3 months but not more than 6 months £M	More than 6 months but not more than 1 year £M	More than 1 year but not more than 5 years £M	More than 5 years £M	No specific reprice date £M	Non interest bearing £M	Total £M
Assets								
Liquid assets	1,248.9	441.5	–	230.7	26.2	–	32.5	1,979.8
Loans fully secured on residential property and other loans	4,550.4	185.3	458.0	2,004.9	269.7	–	128.4	7,596.7
Property, plant and equipment	–	–	–	–	–	–	27.5	27.5
Investment properties	–	–	–	–	–	–	6.7	6.7
Other assets	–	–	–	–	–	–	249.0	249.0
Total assets	5,799.3	626.8	458.0	2,235.6	295.9	–	444.1	9,859.7
Liabilities								
Shares	3,971.9	255.8	688.0	2,210.0	69.0	–	159.5	7,354.2
Amounts owed to credit institutions, other customers and debt securities in issue	930.9	161.9	28.3	1.2	500.0	–	57.3	1,679.6
Other liabilities	–	–	–	–	–	–	253.5	253.5
Subordinated debt	–	–	–	0.9	–	–	–	0.9
Subscribed capital	–	–	–	–	–	25.0	–	25.0
Reserves	–	–	–	–	–	–	546.5	546.5
Total liabilities	4,902.8	417.7	716.3	2,212.1	569.0	25.0	1,016.8	9,859.7
Effect of derivative items	(39.5)	(295.5)	93.4	(43.2)	284.8	–	–	–
Interest rate sensitivity gap	857.0	(86.4)	(164.9)	(19.7)	11.7	(25.0)	(572.7)	–

Liquid assets include cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.

Other assets include derivative financial instruments, other assets, prepayments and accrued income.

Other liabilities include derivative financial instruments, other liabilities, accruals and deferred income.

The Society's interest rate repricing profile is not materially different to the Group position.

The following table details the Group's and Society's sensitivity to a 100 basis point change in interest rates at the year end with all other variables held constant. A positive number indicates an increase in profit or loss and other equity.

	Group & Society +100bps 2012 £M	Group & Society –100bps 2011 £M	Group & Society +100bps 2012 £M	Group & Society –100bps 2011 £M
Impact on equity reserves	8.8	12.4	(24.4)	(26.3)
Impact on profit and loss	5.7	2.9	(6.2)	(2.7)

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

The above interest rate risk represents the market value movement, calculated using a discounted cashflow basis, on all of the Society's financial assets and liabilities, resulting from an immediate 100 basis points parallel shift in interest rates. All exposures include investments of the Group's reserves. The movements in the Society's sensitivity to a 100 basis points change in rates have been largely driven by the low interest rate environment.

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

b) Foreign currency risk

Foreign currency risk arises as a result of the Group's activities in raising funds and making investments in foreign currencies. This is done to ensure cost effective funding is obtained across a wider pool of providers. The Group's policy is not to run any speculative foreign exchange positions. The Group issues Euro mortgages as well as receiving funding via its commercial paper programme in foreign currencies, hence exposures to exchange rate fluctuations arise. Cross-currency interest rate swaps are utilised to reduce both the interest rate and exchange rate risk exposures that come from funding in foreign currency.

The carrying amount of the Group's foreign currency denominated monetary assets and monetary liabilities at the reporting date is as follows:

	Assets		Liabilities	
	2012 £M	2011 £M	2012 £M	2011 £M
Euro	523.4	439.5	523.4	439.5

At the year end the Group has hedges in place to match 100% of its foreign currency exposures, via the use of currency swaps and foreign currency forward contracts. Therefore any movement in foreign currency through profit or loss and other equity will be minimised.

c) Operational risk

Operational risk is defined by the Group as 'the potential risk of financial loss or impairment to reputation resulting from inadequate or failed internal processes and systems, from the actions of people or external events'. Within the Group, operational risk is sub-categorised by type such as regulatory, theft or fraud, systems failure and people risk.

An independent operational risk function has the overall responsibility for establishing the framework within which operational risk is managed and for its consistent application across the Group. The framework is based on industry best practice and anticipated regulatory requirements. Day-to-day management of operational risk rests with line managers. It is managed through a combination of internal controls, processes and procedures and various risk mitigation techniques, including insurance and business continuity planning.

The Group monitors its operational risk through a variety of techniques. These include the Group Risk Committee being presented with an assessment of the extent of each of the Group's key operational risks.

In particular, the Group manages its regulatory risk through a compliance function that proactively identifies and deals with emerging and current regulatory risks.

d) Conduct risk

Conduct risk is a sub-set of operational risk and is considered to be the risk that actual or potential customer detriment arises or may arise from the way the Society conducts its business. The Society ensures independent assessment of conduct risk through a dedicated conduct oversight function and a Conduct Risk Committee which is a Board Sub-Committee.

e) Other price risk

Other price risk is the risk resulting from the possibility that the price of a security may decline.

The Group's policy is to have no material exposure to equity markets. Any exposures arising from the Group's products are eliminated as far as it is practicable by appropriate hedging contracts.

Liquidity risk

Liquidity risk is the risk that the Society and Group will be unable to meet current and future financial commitments as they fall due. The Group's liquidity policy is to maintain sufficient liquid resources to cover cashflow imbalances and fluctuations in funding, to retain full public confidence in the solvency of the Group and to enable the Group to meet its financial obligations. This is achieved through maintaining a prudent level of liquid assets, through committed wholesale funding facilities through securitisation arrangements and through management control of the growth of the business.

It is Group policy to ensure that sufficient liquid assets are at all times available to meet the Group's obligations including the withdrawal of customer deposits, the drawdown of customer facilities and growth in the balance sheet. The development and implementation of liquidity policy is the responsibility of the ALCO. The day-to-day management of liquidity is the responsibility of Treasury.

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

A series of liquidity stress tests are performed each month to confirm that the limits remain appropriate. ALCO is responsible for setting limits over the level and maturity profile of wholesale funding and for monitoring the composition of the Group balance sheet.

Liquidity policy is approved by ALCO and agreed with the Board. Limits on potential cash flow mismatches over defined time horizons are the principal basis of liquidity control. The size of the Group's holdings of readily realisable liquid assets is primarily driven by such potential outflows.

At the year end the Group had committed facilities of £nil (2011: £nil).

An analysis of the liquidity portfolio by instrument type is set out in the table below:

	Group & Society		Group & Society	
	2012	2012	2011	2011
	£M	%	£M	%
Cash in hand and balances with the Bank of England	663.1	37.9	184.6	9.3
Deposits with Financial Institutions	116.4	6.7	72.4	3.7
UK Government Securities	407.2	23.3	975.2	49.2
Non-UK Government Securities	17.5	1.0	–	–
Certificates of deposit	133.9	7.7	382.3	19.3
Floating rate notes	–	–	46.3	2.3
Fixed rate bonds	177.2	10.1	92.4	4.7
UK RMBS	146.3	8.4	198.4	10.0
Covered bonds	84.8	4.8	17.1	0.9
Other	2.3	0.1	11.1	0.6
	1,748.7	100.0	1,979.8	100.0

The Society's liquidity portfolio is equal to the Group's except it has £58.4m (2011: £59.6m) of Deposits with Financial institutions.

The Group's liquidity is invested with highly rated counterparties and in investment grade securities. The Group's holdings of listed securities comprise investment grade floating rate notes issued by financial institutions and highly rated UK residential mortgage backed securities. Of the mortgage backed securities held 73.0% (2011: 82.9%) are in AAA rated tranches with the remainder in AA, or BBB+ or A rated tranches.

There has been no change in the manner in which the Group manages and measures liquidity risk.

The following tables detail the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables below have been drawn up based on the undiscounted contractual maturities of the financial liabilities including interest that will be accrued to those instruments except where the Group is entitled and intends to repay the liabilities before their maturity.

The subscribed capital has a fixed rate of interest of 13³/₈% payable semi-annually for an indeterminate period.

31 December 2012	Not more than 3 months	More than 3 months but not more than 6 months	More than 6 months but not more than 1 year	More than 1 year but not more than 5 years	More than 5 years	Total
	£M	£M	£M	£M	£M	£M
Liabilities						
Shares	5,212.7	388.5	514.9	1,525.4	268.1	7,909.6
Amounts owed to credit institutions, other customers and debt securities in issue	477.4	670.5	102.4	362.7	310.9	1,923.9
Subordinated debt	–	–	–	0.9	–	0.9
Other liabilities	242.4	–	–	–	–	242.4
Subscribed capital	–	–	–	–	25.0	25.0
Reserves	–	–	–	–	587.9	587.9
Total liabilities	5,932.5	1,059.0	617.3	1,889.0	1,191.9	10,689.7

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

31 December 2011	Not more than 3 months £M	More than 3 months but not more than 6 months £M	More than 6 months but not more than 1 year £M	More than 1 year but not more than 5 years £M	More than 5 years £M	Total £M
Liabilities						
Shares	4,961.8	171.4	563.0	1,740.9	81.7	7,518.8
Amounts owed to credit institutions, other customers and debt securities in issue	594.3	126.4	212.8	314.0	570.0	1,817.5
Subordinated debt	–	–	–	0.9	–	0.9
Other liabilities	253.5	–	–	–	–	253.5
Subscribed capital	–	–	–	–	25.0	25.0
Reserves	–	–	–	–	546.5	546.5
Total liabilities	5,809.6	297.8	775.8	2,055.8	1,223.2	10,162.2

The following table details the Group's expected maturity for its derivative financial instruments. The table has been drawn up based on the undiscounted net cash inflows/(outflows) on the derivative instruments that settle on a net basis and the undiscounted gross inflows and (outflows) on those derivatives that require gross settlement. When the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to the conditions existing at the reporting date. For example, interest rates have been projected as illustrated by the yield curves existing at the reporting date and where the amount varies with changes in an index, the amount disclosed may be based on the level of the index at the reporting date.

	Not more than 3 months £M	More than 3 months but not more than 6 months £M	More than 6 months but not more than 1 year £M	More than 1 year but not more than 5 years £M	More than 5 years £M
31 December 2012					
Swap contracts	8.0	11.7	20.6	79.9	23.0
31 December 2011					
Swap contracts	10.3	8.9	16.6	77.2	12.0

Value of financial instruments

The following tables summarise the carrying amounts and fair values of those financial assets and liabilities by category.

Where available, market values have been used to determine fair values. Where market values are not available, fair values have been calculated for other financial instruments by discounting cash flows at prevailing interest rates.



Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

		Group 2012		Society 2012	
		Carrying value £M	Fair value £M	Carrying value £M	Fair value £M
Financial assets					
Cash in hand and balances with the Bank of England		663.1	663.1	663.1	663.1
Loans and advances to credit institutions	i)	117.0	117.0	58.4	58.4
Derivative financial instruments	ii)	118.9	118.9	72.4	72.4
Loans and advances to customers					
Loans fully secured on residential property	iii)	7,645.4	7,837.9	7,645.2	7,837.7
Other loans		629.9	638.7	629.9	638.7
Investment Securities	iv)				
Available for sale		847.4	847.4	847.4	847.4
Loans and receivables		121.2	115.6	121.2	115.6
Investment in subsidiary undertakings	v)	–	–	107.6	107.6
Property, plant and equipment		28.5	28.5	28.4	28.4
Investment properties		5.6	5.6	–	–
Deferred income tax assets		3.0	3.0	2.3	2.3
Other assets, prepayments and accrued income		135.9	135.9	157.5	157.5
		10,315.9	10,511.6	10,333.4	10,529.1
Financial liabilities					
Shares	iii)	7,738.3	7,835.1	7,738.3	7,835.1
Derivative financial instruments	ii)	148.5	148.5	146.1	146.1
Amounts owed to credit institutions	vi)	433.1	433.1	433.1	433.1
Amounts owed to other customers	iii)	351.3	351.3	471.5	471.5
Debt securities in issue	iv)	937.0	1,053.6	894.4	1,011.0
Current income tax liabilities		7.6	7.6	7.1	7.1
Deferred income tax liabilities		2.8	2.8	1.1	1.1
Other liabilities and accruals		72.0	72.0	26.0	26.0
Provisions for liabilities and charges		9.1	9.1	8.7	8.7
Retirement benefit obligations		2.4	2.4	2.4	2.4
Subordinated liabilities	vii)	0.9	0.9	0.9	0.9
Subscribed capital	vii)	25.0	25.0	25.0	25.0
Total Reserves		587.9	587.9	578.8	578.8
		10,315.9	10,529.3	10,333.4	10,546.8

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

		Group 2011		Society 2011	
		Carrying value £M	Fair value £M	Carrying value £M	Fair value £M
Financial assets					
Cash in hand and balances with the Bank of England		186.9	186.9	186.9	186.9
Loans and advances to credit institutions	i)	79.7	79.7	59.6	59.6
Derivative financial instruments	ii)	139.5	139.5	109.7	109.7
Loans and advances to customers					
Loans fully secured on residential property	iii)	6,906.1	7,052.5	6,905.9	7,052.5
Other loans		690.6	702.4	690.6	702.4
Investment Securities	iv)				
Available for sale		1,475.1	1,475.1	1,475.1	1,475.1
Loans and receivables		238.1	218.2	238.1	218.2
Investment in subsidiary undertakings	v)	–	–	28.5	28.5
Property, plant and equipment		27.5	27.5	27.5	27.5
Investment properties		6.7	6.7	–	–
Deferred income tax assets		2.3	2.3	1.5	1.5
Other assets, prepayments and accrued income		107.2	107.2	105.1	105.1
		9,859.7	9,998.0	9,828.5	9,967.0

Financial liabilities

Shares	iii)	7,354.2	7,471.3	7,354.2	7,471.3
Derivative financial instruments	ii)	146.7	146.7	144.0	144.0
Amounts owed to credit institutions	vi)	355.6	355.6	355.6	355.6
Amounts owed to other customers	iii)	508.3	508.3	534.9	534.9
Debt securities in issue	iv)	815.7	883.0	787.3	854.6
Current income tax liabilities		7.1	7.1	5.4	5.4
Deferred income tax liabilities		1.3	1.3	1.2	1.2
Other liabilities and accruals		91.3	91.3	71.9	71.9
Provisions for liabilities and charges		6.2	6.2	5.5	5.5
Retirement benefit obligations		0.9	0.9	0.9	0.9
Subordinated liabilities	vii)	0.9	0.9	0.9	0.9
Subscribed capital	vii)	25.0	25.0	25.0	25.0
Total Reserves		546.5	546.5	541.7	541.7
		9,859.7	10,044.1	9,828.5	10,012.9

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arms length transaction. The following methods and assumptions have been applied in determining fair value:

- The carrying amount of loans and advances to credit institutions with a maturity of under 12 months is assumed to equate to their fair value.
- All derivatives are all held for economic hedge purposes. The fair value of interest rate swaps is calculated via a discounted cash flow valuation model. The fair value of cross currency swaps is obtained from external counterparties.
- Loans and advances to customers, shares and amounts due to customers are calculated using the effective interest rate method, less provisions for impairment together with a fair value adjustment for the entire mortgage portfolio using discounted cashflow principles set out in IAS 39. This value is considered to be a good approximation of fair value.
- Fair values are based on quoted market prices. For instruments where quoted market prices are not available, the market price is based on discounted cash flows using interest rates for securities with similar credit, maturity and yield characteristics.
- The fair value of investments in subsidiary undertakings is assumed to approximate their carrying amounts.
- The fair value of floating rate and overnight deposits is approximately equal to their carrying amount. The estimated fair value of fixed rate loans and deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.
- The fair value of subordinated liabilities and subscribed capital are obtained from market prices.

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

Maturity profile of financial instruments

The table below analyses the Group assets and liabilities into relevant maturity groupings based on the remaining period between the balance sheet date and the contractual maturity date. The Society's maturity grouping is not materially different to the Group position.

31 December 2012	Repayable on demand £M	Less than 3 months £M	3 months to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Assets						
Cash and balances with the Bank of England	663.1	–	–	–	–	663.1
Loans and advances to credit institutions	–	112.4	4.6	–	–	117.0
Derivative financial instruments	–	1.5	10.4	59.2	47.8	118.9
Loans and advances to customers:						
Loans fully secured on residential property	5.6	7.4	35.9	389.9	7,206.6	7,645.4
Other loans	81.2	6.5	41.8	203.1	297.3	629.9
Investment securities	–	274.2	155.7	369.8	168.9	968.6
Property, plant and equipment	28.5	–	–	–	–	28.5
Investment properties	5.6	–	–	–	–	5.6
Deferred income tax assets	3.0	–	–	–	–	3.0
Other assets, prepayments, accrued income and current tax	135.9	–	–	–	–	135.9
Total assets	922.9	402.0	248.4	1,022.0	7,720.6	10,315.9
Liabilities						
Shares	4,170.0	405.2	998.2	1,942.7	222.2	7,738.3
Derivative financial instruments	–	1.7	2.5	72.0	72.3	148.5
Amounts owed to credit institutions	–	30.8	258.8	143.5	–	433.1
Amounts owed to other customers	84.1	149.6	96.7	12.7	8.2	351.3
Debt securities in issue	–	23.1	31.6	336.7	545.6	937.0
Current income tax liabilities	7.6	–	–	–	–	7.6
Deferred income tax liabilities	2.8	–	–	–	–	2.8
Provision for liabilities, accruals and deferred income	81.1	–	–	–	–	81.1
Retirement benefit obligations	2.4	–	–	–	–	2.4
Subordinated liabilities	0.9	–	–	–	–	0.9
Subscribed capital	–	–	–	–	25.0	25.0
Cash flow hedge reserve	–	–	–	(2.6)	–	(2.6)
Available for sale reserve	2.2	–	–	–	–	2.2
Revaluation reserve	13.2	–	–	–	–	13.2
General and other reserves	575.1	–	–	–	–	575.1
Total reserves and liabilities	4,939.4	610.4	1,387.8	2,505.0	873.3	10,315.9

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

31 December 2011	Repayable on demand £M	Less than 3 months £M	3 months to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Assets						
Cash and balances with the						
Bank of England	186.9	–	–	–	–	186.9
Loans and advances to credit institutions	–	74.1	5.6	–	–	79.7
Derivative financial instruments	–	11.2	11.4	53.6	63.3	139.5
Loans and advances to customers:						
Loans fully secured on residential property	4.3	4.4	35.5	372.9	6,489.0	6,906.1
Other loans	38.3	47.9	30.8	260.2	313.4	690.6
Investment securities	–	781.6	462.6	242.6	226.4	1,713.2
Property, plant and equipment	27.5	–	–	–	–	27.5
Investment properties	6.7	–	–	–	–	6.7
Deferred income tax assets	2.3	–	–	–	–	2.3
Other assets, prepayments, accrued income and current tax	107.2	–	–	–	–	107.2
Total assets	373.2	919.2	545.9	929.3	7,092.1	9,859.7
Liabilities						
Shares	4,701.3	261.4	720.8	1,592.2	78.5	7,354.2
Derivative financial instruments	–	0.5	3.8	58.8	83.6	146.7
Amounts owed to credit institutions	–	74.2	7.0	274.4	–	355.6
Amounts owed to other customers	57.6	344.6	104.0	2.1	–	508.3
Debt securities in issue	–	115.3	48.9	91.6	559.9	815.7
Current income tax liabilities	7.1	–	–	–	–	7.1
Deferred income tax liabilities	1.3	–	–	–	–	1.3
Provision for liabilities, accruals and deferred income	97.5	–	–	–	–	97.5
Retirement benefit obligations	0.9	–	–	–	–	0.9
Subordinated liabilities	0.9	–	–	–	–	0.9
Subscribed capital	–	–	–	–	25.0	25.0
Available for sale reserve	(3.7)	–	–	–	–	(3.7)
Revaluation reserve	13.2	–	–	–	–	13.2
General and other reserves	537.0	–	–	–	–	537.0
Total reserves and liabilities	5,413.1	796.0	884.5	2,019.1	747.0	9,859.7

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

Categories of financial assets and liabilities

The following table analyses the Group's assets and liabilities by the class of financial instrument to which they are assigned by the measurement basis:

31 December 2012	Financial assets at fair value through Income Statement £M	Financial assets at available for sale £M	Financial assets at held at maturity £M	Loans and receivables £M	Financial liabilities at fair value through Income Statement £M	Financial liabilities at amortised cost £M	Non financial assets/liabilities £M	Total £M
Assets								
Financial assets:								
Cash and balances with the Bank of England	–	–	–	663.1	–	–	–	663.1
Loans and advances to credit institutions	–	–	–	117.0	–	–	–	117.0
Derivative financial instruments	118.9	–	–	–	–	–	–	118.9
Loans and advances to customers:								
Loans fully secured on residential property	1,680.1	–	–	5,965.3	–	–	–	7,645.4
Other loans	220.6	–	–	409.3	–	–	–	629.9
Investment securities	–	847.4	–	121.2	–	–	–	968.6
Non financial assets	–	–	–	–	–	–	173.0	173.0
Total assets	2,019.6	847.4	–	7,275.9	–	–	173.0	10,315.9
Liabilities								
Financial liabilities:								
Shares	–	–	–	–	952.1	6,786.2	–	7,738.3
Derivative financial instruments	–	–	–	–	148.5	–	–	148.5
Amounts owed to credit institutions	–	–	–	–	–	433.1	–	433.1
Amounts owed to other customers	–	–	–	–	–	351.3	–	351.3
Debt securities in issue	–	–	–	–	876.6	60.4	–	937.0
Subordinated liabilities	–	–	–	–	–	0.9	–	0.9
Subscribed capital	–	–	–	–	–	25.0	–	25.0
Non financial liabilities	–	–	–	–	–	–	93.9	93.9
General and other reserves	–	–	–	–	–	–	587.9	587.9
Total reserves and liabilities	–	–	–	–	1,977.2	7,656.9	681.8	10,315.9

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

Categories of financial assets and liabilities

The following table analyses the Group's assets and liabilities by the class of financial instrument to which they are assigned by the measurement basis:

	Financial assets at fair value through Income Statement	Financial assets at available for sale	Financial assets at held at maturity	Loans and receivables	Financial liabilities at fair value through Income Statement	Financial liabilities at amortised cost	Non financial assets/liabilities	Total
31 December 2011	£M	£M	£M	£M	£M	£M	£M	£M
Assets								
Financial assets:								
Cash and balances with the Bank of England	-	-	-	186.9	-	-	-	186.9
Loans and advances to credit institutions	-	-	-	79.7	-	-	-	79.7
Derivative financial instruments	139.5	-	-	-	-	-	-	139.5
Loans and advances to customers:								
Loans fully secured on residential property	1,052.3	-	-	5,853.8	-	-	-	6,906.1
Other loans	259.9	-	-	430.7	-	-	-	690.6
Investment securities	-	1,475.1	-	238.1	-	-	-	1,713.2
Non financial assets	-	-	-	-	-	-	143.7	143.7
Total assets	1,451.7	1,475.1	-	6,789.2	-	-	143.7	9,859.7
Liabilities								
Financial liabilities:								
Shares	-	-	-	-	829.8	6,524.4	-	7,354.2
Derivative financial instruments	-	-	-	-	146.7	-	-	146.7
Amounts owed to credit institutions	-	-	-	-	-	355.6	-	355.6
Amounts owed to other customers	-	-	-	-	-	508.3	-	508.3
Debt securities in issue	-	-	-	-	644.2	171.5	-	815.7
Subordinated liabilities	-	-	-	-	-	0.9	-	0.9
Subscribed capital	-	-	-	-	-	25.0	-	25.0
Non financial liabilities	-	-	-	-	-	-	106.8	106.8
General and other reserves	-	-	-	-	-	-	546.5	546.5
Total reserves and liabilities	-	-	-	-	1,620.7	7,585.7	653.3	9,859.7

The financial assets designated as at fair value through profit and loss consist of mortgages which have been classified as such to avoid an accounting mismatch. As discussed in the accounting policies these are economically hedged but where it is not practical to apply hedge accounting. The maximum exposure to credit risk of these loans and receivables at 31 December 2012 was £196.9m (2011: £205.5m), which is equal to the carrying value of the assets. Maximum credit risk exposure at 31 December 2012 approximates to the carrying value for all assets and loan commitments apart from loans and advances to customers where the carrying value included an increase of £74.4m (2011: increase of £81.2m) in respect of hedged interest rate risk. The Group's mortgage assets are secured on residential property. Due to the nature of the Society's business there is a lack of significant concentrations of credit risk and, hence, no credit derivatives or similar products are held to mitigate this risk. There is no material movement in the fair value of these assets in relation to credit risk.

Notes to the Accounts *continued*

For the year ended 31 December 2012

34. Risk Management and Control *continued*

For all financial liabilities designated as at 'fair value through profit and loss' there is no material difference between financial liabilities at fair value and the amount payable upon maturity. In addition, there is no material movement in the fair value of these liabilities in relation to credit risk.

In accordance with the security arrangements on derivative liabilities cash assets to the value of £127m (2011: £95m), have been pledged as security. The holder of the security does not have the right to sell or re-pledge the assets.

Fair Value Measurement

The following table analyses the fair value measurement basis used for assets and liabilities held at the Balance Sheet date at fair value.

2012	Level 1	Level 2	Level 3	Total
Group and Society	£M	£M	£M	£M
Financial assets				
Investment securities – available for sale	293.3	554.2	–	847.5
Derivative financial instruments	–	119.2	–	119.2
Financial liabilities				
Derivative financial instruments	–	97.9	50.5	148.4
2011				
Group and Society	Level 1	Level 2	Level 3	Total
Financial assets	£M	£M	£M	£M
Investment securities – available for sale	422.5	1,052.6	–	1,475.1
Derivative financial instruments	–	139.5	–	139.5
Financial liabilities				
Derivative financial instruments	–	95.9	50.8	146.7

Level 1: Relates to financial instruments where quoted prices (unadjusted) in active markets can be found for identical assets or liabilities.

Level 2: Valuation techniques are used to value these instruments for which significant inputs are taken from observable market data for the asset and liability, either directly (i.e. as price) or indirectly (i.e. derived prices) other than quoted prices included in Level 1. These include valuation models used to calculate the present value of expected future cash flows, using curves from published market sources and are employed when no active market exists or when no quoted prices for similar instruments can be obtained.

Level 3: The valuation of the asset or liability is not based on observable market data (unobservable inputs). Valuation techniques include net present value and discounted cash flow methods. The assumptions used in such models include risk-free benchmark interest rates, foreign currency exchange rates, equity index prices and expected price volatilities. The objective of the valuation techniques is to determine a fair value that reflects the price of the financial instrument that would have been used by two counterparties in an arms length transaction. These derivatives are used to provide an effective hedge.

Reconciliation of Level 3 fair value measurements of financial liabilities

	Fair value through profit and loss
	£M
Balance at 1 January 2012	50.8
Total losses in the Income Statement	(0.3)
Balance at 31 December 2012	50.5

The table above only includes financial liabilities. There were no financial assets subsequently measured at fair value on Level 3 fair value measurement bases.

Of the total gains for the year included in the Income Statement, £0.3m (2011: £24.3m loss) related to derivatives included within the Level 3 fair value category. These movements are included in fair value gains less losses from derivative financial instruments in the Income Statement.

Notes to the Accounts *continued*

For the year ended 31 December 2012

35. Operating Segments

Products and services from which reportable segments derive their revenues

The information reported to the Group's Chief Executive for the purposes of resources allocation and assessment or segment performance is specifically focused on the category of customer for each type of activity. The Group's reportable segments under IFRS 8 are therefore as follows:

- Core Activities
- Commercial Lending
- Euro Lending

Information regarding the Group's reporting segments is reported below.

Segment Income Statement

The following is an analysis of the Group's Income Statement by reportable segment:

	Core Activities 2012 £M	Commercial Lending 2012 £M	Euro Lending 2012 £M	Total 2012 £M	Core Activities 2011 £M	Commercial Lending 2011 £M	Euro Lending 2011 £M	Total 2011 £M
Interest receivable and similar income	341.7	11.5	7.5	360.7	315.0	12.1	7.8	334.9
Interest payable and similar charges	(215.7)	(7.3)	(4.5)	(227.5)	(193.7)	(7.8)	(5.8)	(207.3)
Net interest receivable	126.0	4.2	3.0	133.2	121.3	4.3	2.0	127.6
Fees and commissions receivable	15.8	0.3	–	16.1	19.7	–	–	19.7
Fees and commissions payable	(0.2)	–	–	(0.2)	(0.1)	–	–	(0.1)
Fair value gains less losses from derivative financial instruments	(1.2)	1.7	0.2	0.7	–	0.1	–	0.1
Other operating income	1.1	–	–	1.1	1.7	–	–	1.7
Total income	141.5	6.2	3.2	150.9	142.6	4.4	2.0	149.0
Administrative expenses including depreciation	(49.3)	(0.3)	(0.1)	(49.7)	(46.2)	(0.3)	(0.1)	(46.6)
Impairment losses on loans and advances to customers	(18.6)	(25.1)	1.8	(41.9)	(18.6)	(19.1)	(10.8)	(48.5)
Provisions for liabilities and charges	(5.8)	–	–	(5.8)	(3.4)	–	–	(3.4)
Impairment losses on land and buildings	(1.1)	–	–	(1.1)	(0.3)	–	–	(0.3)
Profit on ordinary activities before income tax	66.7	(19.2)	4.9	52.4	74.1	(15.0)	(8.9)	50.2
Income tax expense	(16.7)	4.9	(1.2)	(13.0)	(19.9)	3.9	2.4	(13.6)
Profit for the financial year	50.0	(14.3)	3.7	39.4	54.2	(11.1)	(6.5)	36.6

Segment loans and advances to customers

The following is an analysis of the Group's loans and advances to customers by reportable segment:

	Core Activities 2012 £M	Commercial Lending 2012 £M	Euro Lending 2012 £M	Total 2012 £M	Core Activities 2011 £M	Commercial Lending 2011 £M	Euro Lending 2011 £M	Total 2011 £M
Loans and advances to customers	7,292.9	438.5	265.5	7,996.9	6,535.0	504.9	277.6	7,317.5
At fair value through profit and loss	284.7	–	–	284.7	285.8	–	–	285.8
Total	7,577.6	438.5	265.5	8,281.6	6,820.8	504.9	277.6	7,603.3
Less: Impairment provisions	(29.5)	(36.3)	(14.9)	(80.7)	(37.1)	(42.1)	(8.6)	(87.8)
Fair value adjustment for hedge risk	74.4	–	–	74.4	81.2	–	–	81.2
Total loans and advances to customers	7,662.5	402.2	250.6	8,275.3	6,864.9	462.8	269.0	7,596.7

Annual Business Statement

For the year ended 31 December 2012

1. Statutory Percentages

	31 December 2012	Statutory Limit
Lending limit	11.6%	25%
Funding limit	18.8%	50%

Explanation

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The lending limit measures the proportion of business assets not in the form of loans fully secured on residential property. Business assets are the total assets of the Group as shown in the Balance Sheet plus impairment provisions for loans and advances to customers, less liquid assets and tangible fixed assets.

Loans fully secured on residential property are the amount of principal owing by borrowers and accrued interest not yet payable. This is the amount shown in the Balance Sheet plus provisions for impairment.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals.

2. Other percentages

	31 December 2012	31 December 2011
As a percentage of shares and borrowings:		
Gross capital	6.49%	6.38%
Free capital	6.39%	6.38%
Liquid assets	18.49%	21.92%
Profit for the financial year as a percentage of mean total assets	0.39%	0.38%
Management expenses as a percentage of mean total assets	0.49%	0.48%

The above percentages have been prepared from the Society's consolidated 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, other reserve, revaluation reserve, subordinated liabilities and subscribed capital.
- 'Free capital' represents the aggregate of gross capital and collective impairment provisions for loans and advances to customers less tangible fixed assets and investment properties.
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- 'Liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment securities.
- 'Management expenses' represent the aggregate of administration expenses, depreciation and amortisation.

Annual Business Statement *continued*

For the year ended 31 December 2012

3. Information Relating to the Directors and Other Officers

Name	Occupation	Date of Birth	Date first appointed
Chairman			
R. A. Smith	Company Director	15.02.43	18.05.98
Vice Chairman			
R. W. Stott (Vice Chairman from 8 August 2011)	Company Director	22.03.43	08.12.08
Chief Executive			
*P. A. Hill	Chief Executive	28.07.61	01.08.06
Directors			
J. N. Anderson (resigned 27 March 2012)	Company Director	20.08.45	01.08.06
R. J. Ashton	Company Director	19.01.58	26.04.11
P. A. Brown	Company Director	31.03.66	15.01.13
P. A. Jenks	Company Director	03.01.51	27.03.12
D. Fisher	Company Director	02.08.58	27.03.12
C. M. Kavanagh (resigned 27 March 2012)	Company Director	30.03.62	13.12.05
*R. S. P. Litten	Finance Director	11.05.63	10.01.12
L. M. Platts	Company Director	10.02.54	26.10.10
A. Rajguru	Company Director	14.09.65	02.04.08
*K. L. Rebecchi	Sales and Marketing Director	31.03.66	07.12.09
I. Robertson	Company Director	10.08.47	08.12.08
*K. R. Wint (*Executive Directors)	Operations Director	02.05.65	01.01.12

The Society's Executive Director Service contracts can be terminated on twelve months' notice by either the Society or the Director. Certain Executive Directors are entitled to 24 months notice in the event of a reorganisation such as a merger or the transfer of the business.

Documents may be served on the above named Directors at: c/o Deloitte LLP (Ref MP), 1 City Square, Leeds LS1 2AL.

Details of Directors – Other Directorships

(*Society Subsidiary)

R. A. Smith	Bartlett Group (Holdings) Ltd Catholic Trust for England and Wales Diocese of Leeds Trustee (Ltd by Guarantee) Hinsley Properties Ltd Hinsley Properties No. 2 Ltd Yorkshire County Cricket Club Ltd
P. A. Hill	Leeds Financial Services*
R. J. Ashton	Shawbrook Bank Ltd Albermarle & Bond Holdings PLC
P. A. Brown	PHD International Ltd Omnicom Media Group UK Ltd M2M International Opera Media Ltd OMD International Ltd
D. Fisher	Leeds Building Society Staff Pension Scheme Ltd

Annual Business Statement *continued*

For the year ended 31 December 2012

P. A. Jenks	Phil Jenks Consultancy Ltd Broadlands Finance Ltd Charter Court Financial Services Group Ltd Charter Court Financial Services Ltd Charter Mortgages Ltd Exact Mortgage Experts Ltd
R. S. P. Litten	Countrywide Rentals 1,2,3,4,5 Ltd* Leeds Mortgage Funding Ltd* Leeds Overseas (Isle of Man) Ltd* Mercantile Asset Management Ltd*
L. M. Platts	A J Bell Holdings Ltd
A. Rajguru	Alexander Rosse Ltd Arcadium Capital Partners Ltd Northampton College
K. L. Rebecchi	Leeds Financial Services Ltd* Headrow Commercial Property Services Ltd*
I. Robertson	Homes and Communities Agency for England
R. W. Stott	First Milk Ltd Leeds Building Society Staff Pension Scheme Ltd Frank Roberts & Sons Ltd RFL (Governing Body) Ltd The Greyhound Board of Great Britain Ltd The Rugby Football League Ltd Yorkshire County Cricket Club Charitable Youth Trust
K. R. Wint	None

Executive Management

Name	Occupation	Directorships (*Society Subsidiary)
A. J. Greenwood	Chief Risk Officer & Secretary	Leeds Financial Services Ltd*
P. M. Kaye	General Manager	Headrow Commercial Property Services Ltd* Leeds Financial Services Ltd*
G. M. Mitchell	General Manager	Countrywide Rentals 1, 2, 3, 4, 5 Ltd (Dormant)* Headrow Commercial Property Services Ltd* Leeds Building Society Staff Pension Scheme Ltd Leeds Mortgage Funding Ltd* Leeds Overseas (Isle of Man) Ltd* Leeds Financial Services Ltd*
M. J. Richardson	General Manager	Mercantile Asset Management Ltd*
P. Riley	General Manager	Leeds Building Society Staff Pension Scheme Ltd

Glossary of Terms

For the year ended 31 December 2012

Set out below are the definitions of the terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears

A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue. Such a customer can also be said to be in a state of delinquency.

Basel II

Basel II is the second framework issued by the Basel Committee on Banking supervision, which defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook.

Basis point

One hundredth of a per cent (0.01%), so 100 basis points is 1%. Used in quoting movements in interest rates or yields on securities.

Commercial lending

Loans secured on commercial property.

Contractual maturity

The final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal and interest is due to be repaid.

Cost Income Ratio

Total management expenses, including depreciation as a percentage of total income.

Covered bonds

Debt securities backed by a portfolio of mortgages that is segregated from the issuer's other on-balance sheet assets solely for the benefit of the holders of the covered bonds.

The Group issues covered bonds as part of its funding activities.

Credit risk

This is the risk that a customer or counterparty is unable to pay the interest or to repay the capital on a loan when required.

Credit Risk Weighted Amount

The notional value of derivative contracts adjusted to determine their inherent credit risk using FSA predetermined risk weights.

Debt securities

Assets held by the Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.

Debt securities in issue

Transferable certificates of indebtedness of the Group to the bearer of the certificates.

These are liabilities of the Group and include certificates of deposit.

Delinquency

See Arrears.

Derivative financial instruments

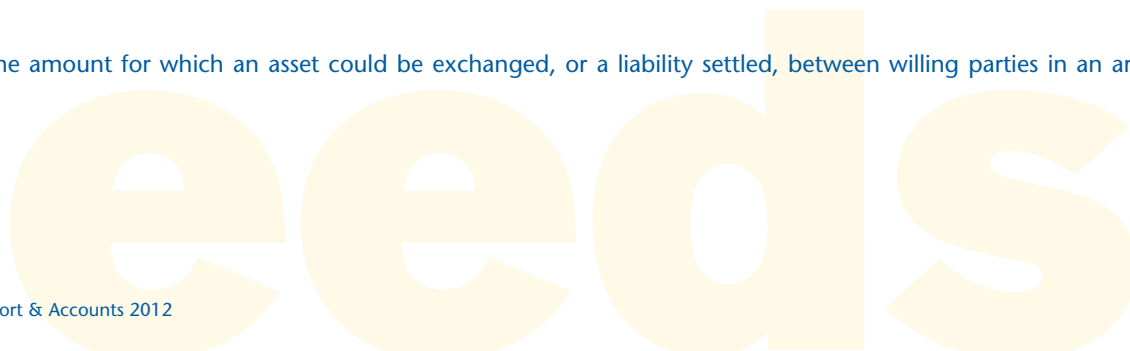
A derivative financial instrument is a type of financial instrument (or an agreement between two parties) whose value is based on the underlying asset, index or reference rate it is linked to. The Group uses derivative financial instruments to hedge its exposures to market risks such as interest rate, equity and currency risk.

Effective interest rate method (EIR)

The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense to produce a level yield over the relevant period.

Fair value

Fair value is the amount for which an asset could be exchanged, or a liability settled, between willing parties in an arm's length transaction.



Glossary of Terms *continued*

For the year ended 31 December 2012

Financial Services Compensation Scheme (FSCS)

The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FSA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.

Forbearance strategies

Strategies to assist borrowers in financial difficulty, such as agreeing a temporary reduction in payments, extending loan terms and temporarily converting loans to an interest-only basis. Forbearance strategies aim to avoid repossession.

Free capital

The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and investment properties.

Funding limit

Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals.

General reserves

The accumulation of the Society's post-tax profit since inception. It is the Society's main component of Tier 1 Capital which is a measure of strength and stability.

Gross capital

The aggregate of general reserve, other reserve, revaluation reserve, subordinated liabilities and subscribed capital.

Impaired loans

Loans where there is objective evidence that an impairment event has occurred, meaning that the Group does not expect to collect all the contractual cash flows or expect to collect them when they are contractually due.

Individually/collectively assessed

Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be realised.

Internal capital adequacy assessment process (ICAAP)

The Group's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of regulatory capital requirements for risks it faces under a business-as-usual scenario and a variety of stress scenarios.

International Swaps and Derivatives Association (ISDA) master agreement

A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions granting legal rights of offsetting for derivative transactions with the same counterparty.

Lending limit

Measures the proportion of business assets not in the form of loans fully secured on residential property.

Liquid assets

Total of cash in hand and balances with the Bank of England, loans and advances to credit institutions, and investment securities.

Liquidity risk

The risk that the Group is not able to meet its financial obligations as they fall due, or will have to do so at an excessive cost. This risk arises from timing mismatches of cash inflows and outflows.

Loan-to-value ratio (LTV)

A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).

Loans past due/past due loans

Loans are past due when a counterparty has failed to make a payment when contractually due.

Glossary of Terms *continued*

For the year ended 31 December 2012

Management expenses

Management expenses represent the aggregate of administrative expenses, depreciation and amortisation. The management expense ratio is management expenses expressed as a percentage of mean total assets.

Market risk

The risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and customer-driven factors will create losses or decrease portfolio values.

Mean total assets

Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.

Member

A person who has a share investment or a mortgage loan with the Society.

Mortgage backed securities (MBS)

Assets which are referenced to underlying mortgages. They are securities that represent investor interests in a group of mortgages.

Net interest income

The difference between interest received on assets and similar income and interest paid on liabilities and similar charges.

Notional Principal Amount

The notional principal amount indicates the amount on which payment flows are derived at the balance sheet date and does not represent amounts at risk.

OECD

Used to refer to member countries of the OECD (Organisation for Economic Cooperation and Development). The OECD is an international organisation of countries with highly developed economies and democratic governments.

Operational risk

The risk of loss arising from inadequate or failed internal processes, people and systems or from external events.

Permanent Interest Bearing Shares (PIBS)

Unsecured, deferred shares that are a form of Tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing members of the Group. Also known as subscribed capital.

Quanto Swaps

Sterling swaps that exchange US LIBOR for UK LIBOR to hedge sterling US LIBOR tracker mortgages.

Replacement Cost

The amount the Society would need to replace derivative contracts that are favourable to the Society, if the Counterparty with whom the contract was held, were unable to honour their obligation.

Repurchase Agreements "Repo"

A repurchase agreement that allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a commitment to repurchase the asset at a specified price on a given future date. For the party selling the security and agreeing to repurchase the asset in the future, it is a repo.

Residential mortgage backed securities (RMBS)

A category of asset backed security that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).

Risk appetite

The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Society's members whilst achieving business objectives.



Glossary of Terms *continued*

For the year ended 31 December 2012

Residential loans

Loans that are made to individuals rather than institutions. Residential mortgage lending is secured against residential property.

Shares

Money deposited by a person in a retail savings or current account with the Society. Such funds are recorded as liabilities for the Society.

Shares and borrowings

Represents the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

Solvency Ratio

Measures the size of a company's after-tax income, excluding non-cash depreciation expenses, as compared to the firm's total debt obligations. It provides a measurement of how likely a company will be to continue meeting its debt obligations.

Sovereign Debt

Sovereign debt is bonds issued by a national government. Historically sovereign debt has been viewed as less risky than other forms of debt issued.

Subordinated debt/liabilities

A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors, and investing members but before holders of PIBS.

Subscribed capital

See permanent interest bearing shares (PIBS).

Tier 1 capital

A measure of financial strength as defined by the FSA. Tier 1 capital is divided into Core Tier 1 and other Tier 1 capital. Core Tier 1 capital comprises general reserves from retained profits. The book values of goodwill and intangible assets are deducted from Core Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as PIBS are included in other Tier 1 capital (i.e. not Core Tier 1).

Wholesale funding

The total of amounts owed to credit institutions, amounts owed to other customers and debt securities in issue less balances deposited by offshore customers.

Where to find us

Aberdeen

68 Carden Place, Aberdeen AB10 1UL
Tel: 01224 642641

Banbury

19 High Street, Banbury OX16 5EE
Tel: 01295 277912

Barkingside

84 High Street, Barkingside IG6 2DJ
Tel: 020 8550 7678

Barnsley

2 Peel Square, Barnsley S70 1YA
Tel: 01226 770773

Belfast

19-21 Cornmarket, Belfast BT1 4DB
Tel: 028 9024 2277

Birmingham

33-35 Corporation Street,
Birmingham B2 4LS
Tel: 0121 643 6722

Bradford

Broadway House, Bank Street,
Bradford BD1 1HJ
Tel: 01274 391401

Braintree

61 High Street, Braintree CM7 1JX
Tel: 01376 553063

Brecon

12a The Bulwark, Brecon, Powys LD3 7AD
Tel: 01874 611525

Bristol

Wine Street, Bristol BS1 2HP
Tel: 0117 922 6772

Cardiff

5 St John Street, Cardiff CF10 1GJ
Tel: 029 2037 2730

Cheltenham

12 Winchcombe Street, Cheltenham
GL52 2LX
Tel: 01242 222911

Derby

8 St James Street, Derby DE1 1RL
Tel: 01332 344644

Dewsbury

17 Foundry Street, Dewsbury WF13 1QH
Tel: 01924 469206

Doncaster

8 Frenchgate, Doncaster DN1 1QQ
Tel: 01302 730485

Epsom

13 High Street, Epsom KT19 8DA
Tel: 01372 728695

Glasgow

182 Hope Street, Glasgow G2 2UE
Tel: 0141 331 4525

Gloucester

43 Northgate Street, Gloucester GL1 2AN
Tel: 01452 520163

Halifax

31 Commercial Street,
Halifax HX1 1BE
Tel: 01422 362359

Harrogate

12 Oxford Street, Harrogate HG1 1PU
Tel: 01423 546510

Huddersfield

8 Cherry Tree Centre, Market Street,
Huddersfield HD1 2ET
Tel: 01484 530842

Hull

78 Paragon Street, Hull HU1 3PW
Tel: 01482 224892

Kendal

83 Stricklandgate, Kendal LA9 4RA
Tel: 01539 724460

Leeds Area Branches

Head Office

105 Albion Street, Leeds LS1 5AS
Tel: 0113 225 7555

Adel

475 Otley Road, Adel, Leeds LS16 7NR
Tel: 0113 225 8500

Armley

45/47 Town Street, Armley, Leeds LS12 1XD
Tel: 0113 225 8510

Beeston

665 Dewsbury Road, Beeston,
Leeds LS11 5LF
Tel: 0113 225 8520

Boston Spa

181a High Street, Boston Spa,
Wetherby LS23 6AA
Tel: 01937 843190

Chapel Allerton

3 Stainbeck Corner, Chapel Allerton,
Leeds LS7 3PG
Tel: 0113 225 8550

Crossgates

57 Station Road, Crossgates,
Leeds LS15 8DT
Tel: 0113 225 8560

Garforth

38 Main Street, Garforth LS25 1AA
Tel: 0113 286 3757

Harehills Road

13 Harehills Road, Leeds LS8 5HR
Tel: 0113 225 8610

Headingley

18 Arndale Centre, Otley Road,
Headingley, Leeds LS6 2UE
Tel: 0113 225 8620

Horsforth

80 Town Street, Horsforth, Leeds LS18 4AP
Tel: 0113 258 1668

Moortown

4/5 Harrogate Parade, Moortown,
Leeds LS17 6PX
Tel: 0113 225 8680

Morley

23 Windsor Court, Morley LS27 9BG
Tel: 0113 253 7444

Street Lane

69 Street Lane, Roundhay, Leeds LS8 1AP
Tel: 0113 225 8720

Wetherby

2 Horsefair Centre, Wetherby LS22 6FL
Tel: 01937 585768

Yeadon

59 High Street, Yeadon LS19 7SP
Tel: 0113 250 6313

Leicester

13 Halford Street, Leicester LE1 1JA
Tel: 0116 251 6748

London (Kingsway)

41 Kingsway, London WC2B 6TP
Tel: 020 7240 2808

Manchester

47 Cross Street, Manchester M2 4JF
Tel: 0161 832 0346

North East Area Branches

Blyth

18 Church Street, Blyth NE24 1BG
Tel: 01670 354725

Chester-le-Street

144 Front Street, Chester-le-Street
County Durham DH3 3AY
Tel: 0191 389 1794

Durham

9 North Road, Durham DH1 4SH
Tel: 0191 384 0561

Morpeth

34 Bridge Street, Morpeth NE61 1NL
Tel: 01670 514083

Newcastle

142 Northumberland Street,
Newcastle NE1 7DQ
Tel: 0191 232 2801

North Shields

23 West Percy Street, North Shields
NE29 0AH
Tel: 0191 296 0222

Silverlink

Mercantile House, Kingfisher Way, Silverlink
Business Park, Wallsend NE28 9NY
Tel: 0191 295 9500

South Shields

42 Fowler Street, South Shields NE33 1PG
Tel: 0191 427 1122

South Tyneside District Hospital

South Shields NE34 0PL
Tel: 0191 497 5336

Wallsend

64/66 High Street West, Wallsend
NE28 8HX
Tel: 0191 262 4751

Whitley Bay

104 Park View, Whitley Bay NE26 3QL
Tel: 0191 251 1376

Norwich

6/7 Guildhall Hill, Norwich NR2 1JG
Tel: 01603 626978

Nottingham

23 Listergate, Nottingham NG1 7DE
Tel: 0115 947 2841

Peterborough

2 Queen Street, Peterborough PE1 1PA
Tel: 01733 896565

Reading

10 Cross Street, Reading RG1 1SN
Tel: 0118 957 5192

Ripon

17 Market Place North, Ripon HG4 1BW
Tel: 01765 600300

Sale

26 School Road, Sale, Cheshire M33 7XF
Tel: 0161 973 0093

Sheffield

14 Pinstone Street, Sheffield S1 2HN
Tel: 0114 272 2230

Southampton

41 London Road, Southampton SO15 2AD
Tel: 023 8022 6699

Stevenage

52 Queensway, Stevenage SG1 1EE
Tel: 01438 741822

Swansea

16 Union Street, Swansea SA1 3EH
Tel: 01792 472503

Watford

67 The Parade, High Street,
Watford WD17 1LJ
Tel: 01923 240589

York

49 York Road, Acomb, York YO24 4LN
Tel: 01904 335500

Overseas Branches

Dublin

Ground Floor, 7 Upper Fitzwilliam Street
Dublin 2
Tel: 00353 16788824

Gibraltar

For customers in Gibraltar and Spain
First Floor, Heritage House,
235 Main Street, Gibraltar
Tel: (00350) 20050602



Or call our UK-based call centre, with calls answered personally by a member of staff, from 8am-8pm, seven days a week on **08450 505 065**

We may monitor and/or record your telephone conversations with the Society to ensure consistent service levels (including staff training).



Or go online – whenever and wherever it suits you!
www.leedsbuildingsociety.co.uk

www.leedsbuildingsociety.co.uk

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