Leeds Building Society

Annual Report & Accounts

2011

Leeds
Building Society

Financial Highlights

For the year ended 31 December 2011

£102.4 million
operating profits before impairment losses and provisions

£50.2 million
pre-tax profits

£7.4 billion
member savings balances

£1.23 billion
new mortgage lending

£572 million
capital and reserves

Leeds

Contents

Directors

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

Robert W. Stott
(*Vice Chairman*)

Peter A. Hill, ACIB
(*Chief Executive*)

John N. Anderson, QA, CBE

Robin J. Ashton, BA, ACA

Carol M. Kavanagh, BA, MA

Robin S. P. Litten, ACMA
(*Finance Director*)

Les M. Platts, BA, FCA

Abhai Rajguru, BSC (Hons), ACMA

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

Ian Robertson, CA, CCMI

Secretary

Andrew J. Greenwood, LLB

Chairman's Statement

For the year ended 31 December 2011

In 2011, Leeds Building Society delivered record operating profits, improved capital and reserves and boosted market share in both new lending and savings, despite the difficult economic backdrop. This excellent performance is the result of our strong and sustainable business model delivering value and security to our members. As a member owned organisation, our capital strength provides ongoing stability as all our profit is invested in the business rather than being distributed to external shareholders.

We expect the difficult market conditions to continue in 2012 with a subdued economy and uncertainty in the Eurozone. Rising unemployment will put further pressure on household budgets and the full impact of the Government's expenditure cuts will be felt. Notwithstanding this challenging environment, we are confident that the plans we have in place will continue to deliver strong results in 2012 and beyond.

OUR MARKETS

Competition in our core savings market has been strong. Through a combination of excellent customer service, a wide range of competitive accounts and product innovation, we increased savings balances to £7.4bn (£7.0bn 2010). Our net savings inflow of £153m (excluding capitalised interest) significantly exceeded our natural market share and we welcomed 58,000 new members to the Society.

The UK mortgage market saw modest growth in the year with £141bn of new lending compared to £136bn in 2010. Our ability to attract deposits enabled us to be very active in this market and we increased lending by 25% compared to the previous year. We also helped 4,000 first time buyers onto the property ladder, which we see as key to kick-starting the housing market.

WHOLESALE FUNDING AND LIQUIDITY

Financial strength has enabled us to be successful in attracting wholesale funding. This included £250m of 7-year money taking the proportion of our funding with more than 1 year to maturity, to over 50%, which provides even greater stability to our business. Our overall wholesale funding ratio reduced from 19.9% to 19.2%.

As is appropriate through continuing turbulent market conditions, the Society's overall liquid assets have remained strong, at £2.0bn, and our liquidity ratio is 21.9% (22.2% 2010).

Due to the unpredictable situation in the Eurozone, we reduced our exposure to Irish and Spanish banks by £22m, to just £24m at the year end, and this will reduce to zero by the end of June, 2012. We have no exposure to sovereign debt other than to the UK Government.

BALANCE SHEET

Society assets at the year end rose to £9.9bn. Continued profitability enabled us to increase capital and reserves to a record £572m from £531m in 2010, which is significantly in excess of the minimum regulatory requirement. Only 4.5% of our capital and reserves is borrowed (and therefore remunerated) and is the lowest ratio of the top 10 building societies, by asset size. Our core Tier 1 capital ratio improved to 13.8% from 13.2% in 2010.

PROFITABILITY AND EFFICIENCY

The Society's net interest margin increased from 1.15% in 2010 to 1.32%. This improvement, together with high levels of efficiency, helped deliver a record operating profit of £102m and a 19% increase in pre-tax profit to £50.2m (£42.2m 2010). Our strong interest margin has been achieved through closely managing the requirements of both borrowers and savers, and offering a broad range of competitive products.

We pride ourselves on being highly efficient and, in 2010, had the lowest cost income ratio in the building society sector. Through continuous improvement, we reduced this ratio even further in 2011 to 31% (34% in 2010) and report one of the best cost asset ratios of 0.48% (0.47% in 2010). Throughout the year, we have continued to invest in the business, making improvements to the service we offer our members with new technology introduced in our branches, as detailed in the Chief Executive's Review, and a number of branches refurbished.

MANAGING OUR LOAN PORTFOLIO

Household budgets were squeezed in 2011 with high inflation and rising unemployment. It is, therefore, pleasing to report that residential arrears (1.5% or more of outstanding mortgage balances) reduced, from 3.25% in 2010 to 3.23%. We work closely with those borrowers experiencing financial difficulty, offering a range of forbearance strategies including payment arrangements, term extensions, changes to repayment type and alternative mortgage products.

The Society withdrew from new commercial lending in 2008 and we are actively managing our commercial loan portfolio. Loan balances in default reduced from 8.7% in 2010 to 8.0%, including a high proportion of loans which are not in arrears but are being managed by a Receiver. Excluding these cases, loans actually in arrears reduced to just 2.5% (7.9% 2010). The Society's exposure to this sector reduced in the year and now represents 5.1% (5.7% 2010) of total assets.

The difficult economic conditions in Ireland and Spain, and speculation over the long term future of the Euro, give rise to a great deal of uncertainty. Our Irish and Spanish lending books of £278m (£290m 2010), now represent just 3.7% (4% 2010) of our total mortgage portfolio.

The charge for specific provisions reduced in 2011 to £34m from £40m in 2010. However, given the economic environment outlined above, we have increased the collective provision charge from £4.5m to £15m to cover any further deterioration in 2012. As a result, the total residential and commercial provision charge increased to £49m from £44m in 2010. Total balance sheet provisions against mortgages at the year end rose to £85m from £61m at the end of 2010.

> "Through a combination of excellent customer service, a wide range of competitive accounts and product innovation, we increased savings balances to £7.4bn..."

REGULATION AND INDUSTRY BODIES

We continue to operate in a highly regulated environment which will see changes as the Financial Services Authority (FSA) splits into the Financial Conduct Authority (FCA), focusing on consumer protection, and the Prudential Regulation Authority (PRA) that will focus on financial stability. We are also facing changes resulting from the FSA's Mortgage Market Review and Retail Distribution Review.

Regulatory product reviews have significantly changed the Payment Protection Insurance market leading to many high street lenders having to make significant provisions for customer redress. Our robust sales processes and good product offering, means we have been required to make only modest levels of refunds to customers.

Our relationships with our members, regulators, the Bank of England, the media, industry trade bodies and the credit ratings agencies, Fitch and Moody's, continue to be strong. Despite the agencies' ratings of the Society moving down by one notch, we have not seen any material impact. In fact, in November, 2011, Fitch recognised the Society's resilient profitability driven by good interest margins and low costs, and whilst commenting on potential impairments on our commercial loan book still awarded the Society a long term 'A' rating, as did Moody's.

BOARD COMPOSITION AND REMUNERATION

New Board appointments have been made to ensure we have the relevant skills and expertise required to remain a strong and successful business in an ever evolving environment. This resulted in the appointment of Robin Ashton as a non-executive Director in April, 2011. Robin qualified as a Chartered Accountant with Coopers and Lybrand and has had a successful career in the financial services sector, including holding the position of Chief Executive of Provident Financial plc. A summary of his details, together with those of Bob Stott, Abhai Rajguru and Ian Robertson are included on page 13. These directors are all subject to election or re-election at the Annual General Meeting (AGM) that will be held on 27 March, 2012 at The Howard Assembly Room, The Grand Theatre, Leeds, and I ask you to support their nominations.

I made you aware last year that Ian Ward, who was our Chief Executive for 16 years, would retire in 2011. This happened in August when Ian stepped down from this position and then formally retired from the Board in September. I once again thank Ian for all his hard work during the last 16 years and for his patience in delaying his retirement to facilitate an orderly handover to his successor. To ensure that the Society had the best possible candidate for Chief Executive, the Board engaged recruitment consultants, advertised nationally and considered a wide range of external and internal candidates. On 10 August, our new Chief Executive, Peter Hill, took up the position. Peter is only the seventh Chief Executive in our 136 year history. He has worked for the Society for ten years and been an executive Director for five years. He has a wealth of knowledge about the Society and finance industry and I know his first class skills and expertise will enable him to lead the Society through another successful period. His first Chief Executive's Review can be found on pages 4 and 5.

David Pickersgill, who was Deputy Chief Executive and Finance Director, has also retired, leaving the Board in June. I would like to place on record my appreciation for the contribution David made during his many years of service with the Society. Gary Mitchell continued as Acting Finance Director throughout the year pending the recruitment of David's successor and I would like to thank him for the excellent way he shouldered these extra duties and responsibility. I am pleased to report that we have appointed Robin Litten as Finance Director and he joined the Society in January, 2012. He has significant experience in the building society sector, having held senior positions with both the Skipton and Scarborough Building Societies. He is a qualified accountant who has also worked in both banking and retail. He will stand for election at the 2013 AGM.

I am also pleased to report that Bob Stott took up the position of non-executive Vice Chairman in August, following the retirement of Rodger Booth. I would like to thank Rodger, as well as Carol Kavanagh and John Anderson, who will both stand down from the Board at the AGM in March, 2012. They have all given valuable service to the Society in their roles of non-executive Directors and contributed to our overall success in recent years. These changes form part of our ongoing succession planning and we are currently recruiting two non-executive Directors.

Continued close scrutiny of executive performance and measurement against testing criteria specified by the Board, have resulted in performance-related awards being made this year to the senior executives and most staff. Details are contained in the Directors' Remuneration Report on pages 21 and 22.

RULE CHANGES

The Board is proposing a number of changes to the Society's Rules at this year's AGM (full details are available in the Notice of AGM), following the publication by the Building Societies Association (BSA) of a new edition of its Model Rules (on which the Society's Rules are based). This has been produced by the BSA to reflect changes in building society law and practice since the publication of the previous edition of the Model Rules in 1997.

The Board considers that these changes will benefit the Society and its members and recommends that members vote for the alterations. It also recommends you vote in favour of the Directors standing for election or re-election, and all the other resolutions.

SUMMARY

Your Society is both independent and successful with a strong capital base and has been consistently profitable, despite the challenging environment. Throughout the economic downturn, we have continued to invest in the business and be an active player in the savings and mortgage markets, the benefits of which can be clearly seen in our results.

The economic outlook is not promising, but we have a solid foundation from which we hope to grow and prosper. We are financially strong, which is so important in these turbulent times. Our focus remains on doing what we do best: providing good value for money products backed up by excellent service, delivered by our highly professional staff.

The Society's Senior Management Team, led by our Chief Executive, Peter Hill, has the experience and skills to continue the success we have enjoyed over recent years.

I would like to thank all our members for their high level of support and commitment. Our Society continues to be successful and has a long term independent future.

Robin Smith
Chairman
20 February 2012

Chief Executive's **Review**

For the year ended 31 December 2011

2011 Highlights:
• Operating profit increased by 21% to a record £102.4m (£84.5m 2010).
• Pre-tax profit rose by 19% to £50.2m (£42.2m 2010).
• Savings balances grew by £329m to a record level of £7.4bn.
• 58,000 new members attracted, taking total membership to a record 691,000.
• New residential lending increased by 25% to £1.23bn (£984m 2010) which is significantly above our natural market share.
• Remained highly efficient, as demonstrated by our cost income ratio reducing to 31% from 34% which was the best of any building society in 2010.
• Capital and reserves increased by 8% to a record £572m (£531m 2010).

In my first report as Chief Executive, I am very proud to present an excellent set of results. I have inherited a great business and my aim is to build on our success and provide continuity. My strategy will be evolutionary, not revolutionary, and our mission will remain *'To be a successful independent building society providing excellent value through quality customer service, efficiency and competitive products'*.

I am particularly pleased that we achieved a record operating profit, with our membership and savings balances reaching their highest ever levels. We also saw new residential mortgage lending increase by 25%. In challenging trading conditions, we grew our market share in both mortgages and savings. This performance would not have been possible without our loyal and professional staff working hard to serve the needs of all our members.

SAVINGS

The Society attracted over £2.1bn of retail deposits in the year and balances increased to a record £7.4bn. Our net savings growth of £153m (excluding capitalised interest) was £156m better than our natural market share. Despite intense competition, our national branch network contributed significantly to this achievement.

This strong performance was through a combination of existing members increasing their balances, and attracting 41,000 new savings customers. Helping members maximise the return on their savings is vital in this historically low interest rate environment and we offer a broad range of instant access, notice, monthly income, fixed term and tax free savings accounts.

We are very proud to have won the 'Best Cash ISA for Consistency of Rates' award from Moneywise, a consumer magazine, based on votes from over 12,000 people. We also continued to reward our existing members by offering a Member Loyalty Bond last year and I am delighted that we have just launched yet another exclusive product.

We listen to our members to ensure we continue to innovate and offer the products and services you need. In 2011, we introduced a 30-day notice account which proved popular with our branch customers. We also entered the Self Invested Personal Pension (SIPP) market, a facility that has been well received.

MORTGAGE LENDING

Our strong funding platform enabled us to be even more active in the UK mortgage market, increasing lending by 25% to £1.23bn compared to £984m in 2010. We have ensured that quality remains high through sophisticated credit scoring techniques and prudent underwriting. The average loan-to-value on new lending was just 51% (53% 2010).

Our focus on building a balanced mortgage portfolio continued, including lending for buy to let and first time buyers. The Shared Ownership market, which is particularly suited to first time buyers, proves a very effective way of helping people on the first step of home ownership. The Society remains a key player in this sector with one of the most comprehensive Shared Ownership product ranges in the market.

Net lending increased to £259m following a contraction in 2010 of £20m and this helped to increase residential mortgage balances to £6.9bn. With no new commercial lending during the year and net repayments of £40m, we were able to reduce commercial real estate balances to £505m. We have also reduced our Euro based lending balances in Ireland and Spain by £12m to £278m and our strategy is to manage our existing book with no new lending planned.

Good and consistent levels of profitability and a stable funding base provides us with the ability to grow our business over the coming years. While we are currently assessing the potential impact of changes to regulation, as a result of the Mortgage Market Review, we intend to remain active in the mortgage market in 2012 and have plans to increase lending even further, particularly to help first time buyers. To achieve this, we have allocated a limited amount of funding for higher loan-to-values of up to 95%.

OTHER INCOME

Other Income at £21.3m was in line with 2010 and given the difficult market conditions, we consider this a creditable performance. Our Financial Planning Managers (FPMs) continue to advise on a range of investment and protection options through our partnership with Aviva. We also provide a tax efficient capital guarantee structured product facility which continues to prove popular with our members.

We offer a full range of general insurance products through Aviva. Sales increased in 2011 and the re-launch of our home insurance product was a particular success.

The Society continues to assess the impact of the new regulatory requirements from the Retail Distribution Review (RDR) which comes into force in January 2013. This will increase the training requirements for our FPMs and already a number of managers have completed and passed the new, more stringent, qualifications. We are also continuing to discuss RDR implications with product providers to ensure we deliver a solution that will meet the needs of our members and comply with the new regulations.

CUSTOMER SERVICE

I am delighted that our relentless focus on customer service has been reflected in record levels of member satisfaction. Independent surveys, carried out each month, confirm that the proportion of satisfied customers reached 96% in the year. The surveys also assess us against other financial services organisations used by our members and the results show we continue to outperform the industry across a wide range of measures.

Our commitment to service was further endorsed when our York branch won the Consumer Moneyfacts 'Best Branch' award 2011. This was a great accolade as there are many thousands of bank and building society branches across the UK.

Feedback remains a key part of our work to improve service and as always we encourage our members to comment both on positive and negative experiences whenever they are in contact with the Society. We take all customer comments seriously, conducting rigorous reviews of issues raised and taking appropriate corrective action where necessary.

We also launched our 'Nominate a Star' initiative in 2011, which encourages customers to recommend a member of staff or team that has delivered outstanding customer service. I am pleased to report that we have received a fantastic response with excellent feedback about all areas of the business, including the branch network, our Head Office and our North East based Call Centre and processing operations.

Our multi-channel approach means members can choose to contact the Society online, by post, by telephone and through our national branch network. Our Call Centre achieved an average speed of answer of only 20 seconds. A specific area of our website, The Member Zone, has been added to keep members informed of activities and events.

We continue to invest in branches through refurbishments. We also installed new PCs, servers and IT infrastructure across our national branch network, which improved processing speed and reliability, and will provide an even higher level of service. This represents an investment of over £1m and together with a spend of over £1.2m on other capital projects, shows our commitment to maintaining superior levels of service and continued careful investment in the Society's future.

CORPORATE RESPONSIBILITY

The Society takes its commitment to Corporate Responsibility (CR) very seriously and published its first CR report in January 2012, which is available online or in our branches.

We have a national reach through our branch network but maintain a local feel and this is reflected in our charitable and community projects, which contribute to large national charities but also support local communities. An example of this is Mencap Leeds where, with a combination of funding and the hard work of our staff, we renovated the children's play area and parents' room. This initiative was made possible by the Leeds Building Society Charitable Foundation which has donated over £1.1m to charities since its inception.

Other schemes include our Caring Saver account, which pays 1% of the average balance held over the year to our partner charities: Age UK; Marie Curie; Save the Children; Variety, the Children's Charity and our Foundation. By casting your vote at this year's Annual General Meeting, either at the meeting, by post or online, you can also support our other charity partners including British Heart Foundation, World Wildlife Fund, Help for Heroes or St. George's Crypt. The 'Your Interest in Theirs' scheme, where savings members opt to donate the pence amount of any interest they earn, is increasing year on year. Through these three initiatives alone, you donated over £94,000 in 2011.

Our staff freely give their own time to raise money for charities and have held a number of fundraising events. This, combined with our 'Match Funding' scheme, which looks to support everyone at Leeds Building Society who raises funds for charity, has once again been very successful, and our staff have raised over £30,000 in 2011 for worthy causes.

The communities within which we operate are important to the Society, and our contribution was recognised when we received the Mortgage Finance Gazette 'Community Services Award for Large Lenders' in November 2011.

We continue to develop initiatives to reduce our carbon footprint and improve sustainability. Our approach is to do what is right for the Society, our members and the environment. The improvements to our branch systems I mentioned earlier will not only deliver a better service, but will use far less power and, therefore, further reduce our environmental impact.

We have maintained our sporting affinities. Our sponsorship of Leeds Rhinos rugby league team has once again proved an effective way of raising awareness of the Society, particularly as they have won the Super League Grand Final for a magnificent fifth time.

We have high levels of colleague engagement and we encourage the sharing of views and opinions so that they can have input into our future plans. The 2011 employee survey maintained our high satisfaction levels, confirming our inclusive approach to the way the Society operates.

OUTLOOK

The threats from economic uncertainty seen in recent years are set to continue with increasing concerns about the Euro and some economies within the European Union. This backdrop will continue to adversely impact the UK economy as will the potential need to make further cuts to government spending which may, in turn, lead to more job losses and put increasing pressure on household incomes. Therefore, effective management of our current mortgage portfolio, helping customers through any financial difficulties they face, as well as assessing the impact on new business generation will be very important throughout 2012 and beyond.

Achieving our Other Income targets will require significant focus in these volatile markets and as we enter into a period of uncertainty with the introduction of RDR in early 2013.

Notwithstanding this, we will continue to deliver good value products, which will enable new and existing mortgage customers to fulfil their borrowing requirements and help our investor members effectively manage their savings. Our focus will remain on developing business in the UK residential mortgage and savings markets whilst continuing to manage our legacy commercial and Euro mortgage portfolios.

We intend to carry on improving our capital, reserves and overall financial strength which will enable us to take advantage of opportunities that arise, and thus grow in a measured way.

SUMMARY

It has been a pleasure to be able to present such a strong performance in my first Chief Executive's Review. I took up my position in August 2011 and I am already enjoying my new role and the many and varied tasks it entails. I have a strong Board of Directors and senior managers, and a talented team focused on delivering high levels of customer service. I would like to thank them all for their support.

Conditions remain challenging and we continuously monitor economic and financial services sector developments, which may impact on the Society. Whilst market conditions do remain difficult, there are good opportunities for growth for organisations such as your Society, that are well capitalised with strong member support, offering good value products and excellent service.

We remain firmly committed to mutuality, allowing us to focus on the needs of our members rather than shareholder returns and I would like to thank you for your continued support.

Peter Hill
Chief Executive
20 February 2012

Business Review

For the year ended 31 December 2011

This section provides a detailed review of the Society's performance in 2011 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 continuing financial strength provides a secure platform for its continued success. In 2011, the Society was able to:

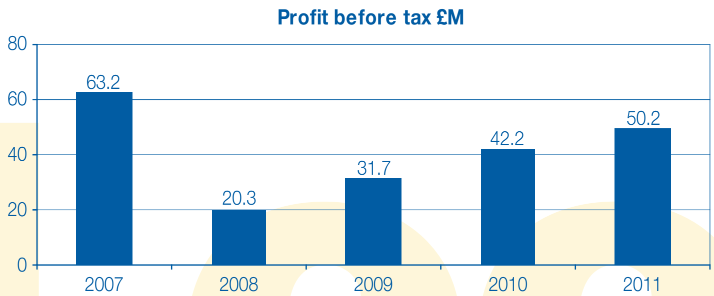
- Grow its capital and further improve profitability;
- Increase the interest margin to cover the higher level of losses being experienced in the current economic environment;
- Continue to focus on efficiency and careful management of costs;
- Effectively manage the level of arrears and contain the credit losses that emerge as a result;
- Ensure that the Society remains well funded by growing its retail balances and its wholesale funding presence;
- Continue to deliver quality service and value for money for its members.

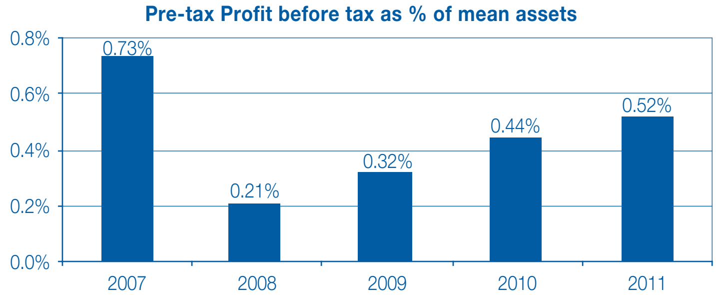
INCOME STATEMENT OVERVIEW

Pre-tax Profit

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 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 2011 increased by £8m, a 19% improvement, to £50.2m from £42.2m in 2010. Pre-tax profit as a percentage of mean assets also improved to 0.52% from 0.44%. The level of pre-tax profit generated by the Society is sufficient to support its on going capital requirements.



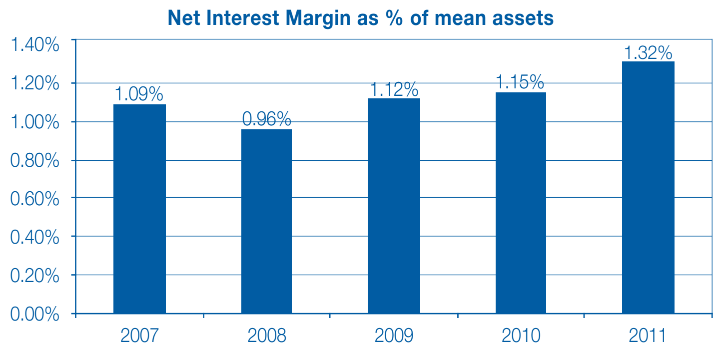


The increase in pre-tax profit in 2011 was achieved as higher provisions and cost increases were covered by improvement in the net interest margin.

The key components of pre-tax profit are discussed in more detail below.

Net Interest Margin

The net interest margin for the year was 1.32% compared with 1.15% in 2010.



The increase in margin in 2011 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 due to two main factors. Firstly, the earnings from those mortgages on the Society's standard variable rate (SVR) product increased as, in common with the experience of other lenders, more borrowers remained on SVR following the expiry of fixed or discounted rates. Secondly, the Society increased the amount of new lending in 2011 to £1.23bn from £0.98bn in 2010. Notwithstanding the competitive positioning of the mortgage products throughout the year, the margin on new lending is higher than on the lending that matured during 2011 and this has also contributed to the overall improvement in earnings from mortgages.

As a result of the ongoing difficult economic and financial market conditions, less wholesale funding, particularly unsecured funding is available and its price has been higher. Despite these difficult conditions, the Society was successful in raising further secured long term funding of £395m in the first half of the year to add to the £290m raised in the second half of 2010. However, long term funding is significantly more expensive than short term unsecured funding and the extra cost associated with these funds has reduced the improvement in the overall interest margin.

“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…”

As a consequence of the difficult wholesale funding market, competition for retail savings has remained strong, 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.

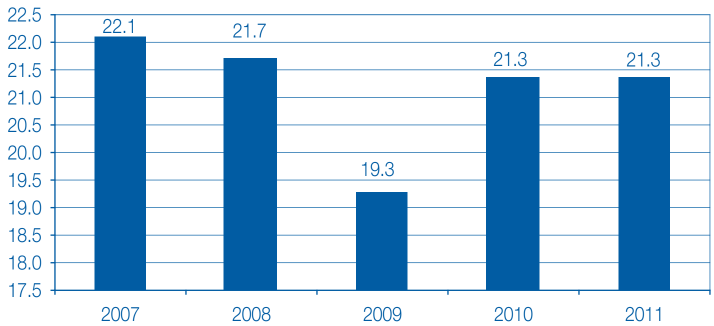
The Society's objective in these difficult market conditions is to achieve a net interest margin that balances the requirements of both mortgage and savings members whilst ensuring that sufficient profits are generated to maintain a strong capital position.

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 was £21.3m compared to £21.3m in 2010.

Other Income £M



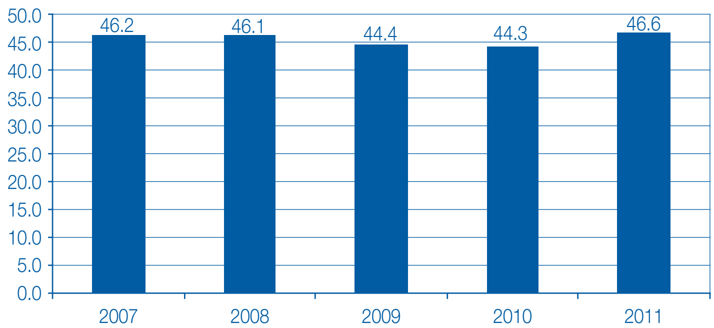
Administrative Expenses

Managing expenses and optimising efficiency remains 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 2011 by £2.3m to £46.6m from £44.3m in 2010. The increase includes higher staff costs (£1.8m), the impact of the change in VAT to 20% from 17.5% (£0.3m) and the one-off costs associated with the early retirement, due to ill health, of an executive Director (£0.6m). The higher inflation rate throughout 2011 has also contributed to the increase in expenses.

Notwithstanding this increase, the Society's cost to income ratio improved further to 31% from 34% in 2010 and this is expected to be the lowest of any major building society. The cost to mean assets ratio remains one of the lowest in the sector, though it increased modestly in 2011 to 0.48% from 0.47%. 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 are shown in the following table.

Management Expenses £M



Notwithstanding the impact of higher inflation over the last five years, the Society's own expenses have only increased by £0.4m, which is just 1%.

Fair Value Gains Less Losses from Derivative Financial Instruments

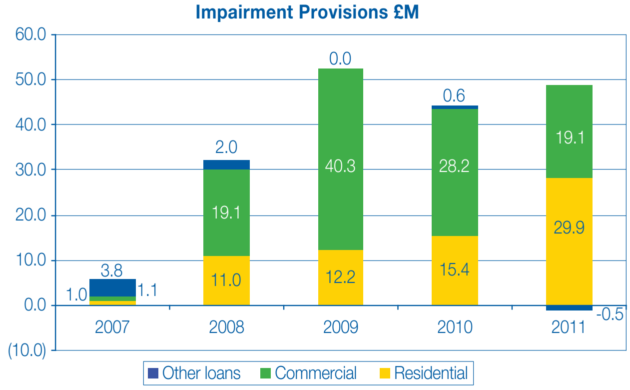
Fair value movements are changes in the value of certain assets and liabilities, mainly derivatives, to reflect their current market value. The movements are primarily due to timing differences which will trend to zero as the asset or liability reaches maturity.

Fair value changes in 2011 resulted in a gain of £0.1m compared to losses of £1.6m in 2010.

Impairment Provisions

The Group's impairment charge on loans and advances increased in 2011 by £4.3m to £48.5m from £44.2m in 2010 as the impact of the worsening economic conditions, particularly in Ireland, has begun to flow through. Overall, balance sheet provisions represent 33% (2010: 24%) of impaired loan balances (where 1.5% or more of the balance is in arrears) leaving the Society well covered against future losses. The charge, split between residential, commercial and other loans is shown in the following table.

Impairment Provisions £M



The residential provision charge increased by £14.5m to £29.9m of which £7.4m (2010: nil) is in respect of the collective provision. This covers those cases which are not in arrears but have experienced payment difficulties in the last twelve months, particularly in Southern Ireland where the Society is taking a cautious approach in view of the very difficult economic conditions in that country.

The commercial loan charge has reduced by £9.1m to £19.1m from £28.2m in 2010 and this in part reflects a reduction in the level of new arrears cases in 2011. The charge of £19.1m also includes an increase in the collective provision of £7.9m to reflect the expectation that further loan defaults, from loans that are currently performing but under some stress, may be experienced throughout 2012. This increase reflects the weaker outlook for the UK economy compared to twelve months ago, which could have a detrimental impact on the borrowers' ability to meet interest payments from rental income.

Other Provisions

Since 2008 the Society, along with other deposit-taking institutions, has been required to contribute to the Financial Services Compensation Scheme (FSCS) to fund the failure of a number of financial institutions. The charge in 2011 of £3.4m is in respect of the estimated (FSCS) levy for the current scheme year. The basis of the levy has not yet been finalised and the charge could be higher or lower dependent upon the

Business Review continued

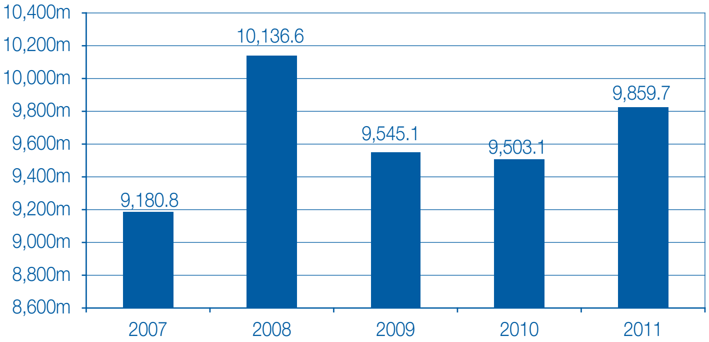
For the year ended 31 December 2011

final outcome. Unlike some other financial institutions, the Society has not had to make any significant provisions in respect of the mis-sale of payment protection policies.

BALANCE SHEET OVERVIEW

The Society's balance sheet total assets grew by 4% in 2011. The change in total assets over the last five years is shown in the following table.

Total assets £M



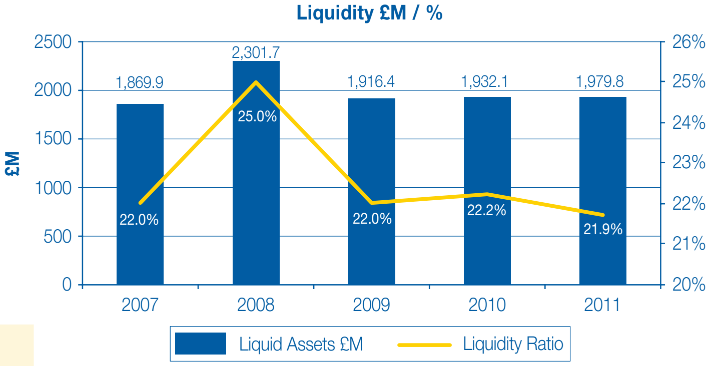
The main components of the balance sheet assets and liabilities are discussed in more detail below.

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.

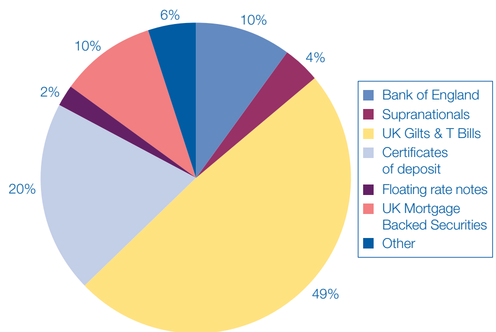
The Society continued to maintain a strong liquidity position in view of the difficult funding conditions in the wholesale markets, ending 2011 with liquidity of £2.0bn representing 21.9% of share and deposit liabilities (SDLs) compared to 22.2% at the end of 2010.

Liquidity £M / %



Within total liquidity of £2.0bn, £0.9bn 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 liquidity assets is shown in the following table.

Liquidity Portfolio 2011



The Society does not have any sovereign debt exposure to Greece, Ireland, Italy, Portugal or Spain and has continued to reduce its senior debt exposure to financial institutions in these regions as shown in the table below.

	2007 £M	2008 £M	2009 £M	2010 £M	2011 £M
Ireland	198.7	77.3	21.4	21.1	20.9
Spain	71.8	70.7	50.4	25.2	3.4
Portugal	11.5	11.9	13.8	1.7	–
Italy	38.3	35.0	10.0	19.3	–
Total	**320.3**	**194.9**	**95.6**	**67.3**	**24.3**

The Society does not have any counterparty exposures to Greece.

Since the year end, the Spanish exposure has been realised and all the Irish exposures are due for repayment before the end of June 2012.

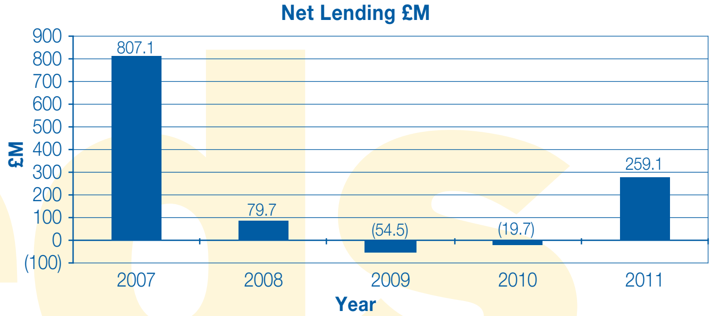
Loans and Advances to Customers

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 arrears ratios indicate how borrowers are coping with maintaining their mortgage payments and provide an indication of the Society's exposure to future loan defaults and loan losses. The key performance indicators monitored by the Society include the level of net lending, the arrears ratio and the portfolio mix.

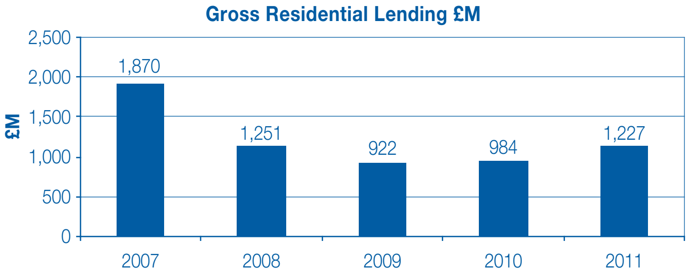
The Society's loans and advances to customers of £7.6bn include £6.9bn of residential mortgages, £0.5bn of commercial loans and £0.2bn of other loans. The Society ceased commercial lending in 2008.

The Society's gross and net mortgage lending increased in 2011. Gross residential lending increased by £243m to £1.23bn whilst total net lending increased to £259m following a reduction in 2010 of £20m. The changes in gross and net lending reflects 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 as appropriate.

Net Lending £M



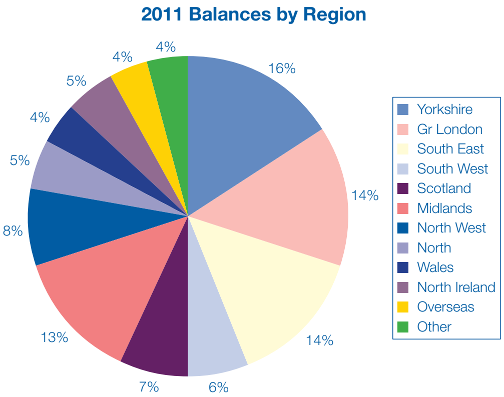
"The Society's residential lending is well diversified and the split of the 2011 lending and year end balances by region, product type and loan to value are shown..."



Both the Society's gross and net residential lending in 2011 are above its natural market share (based on the mortgage data from the Council of Mortgage Lenders – CML). Gross lending was £442m above our natural market share, whilst net lending was £249m above.

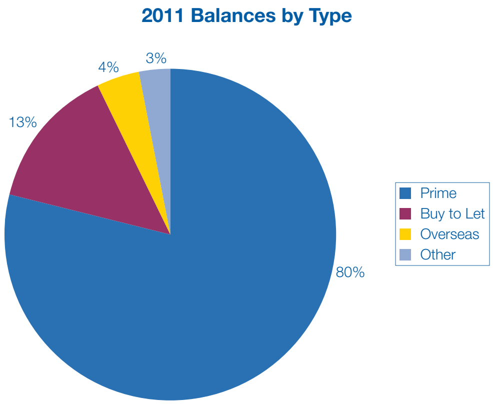
The Society's residential lending is well diversified and the split of the year end balances by region, product type and loan to value (LTV) percentage are shown in the following charts.

Analysis by Region



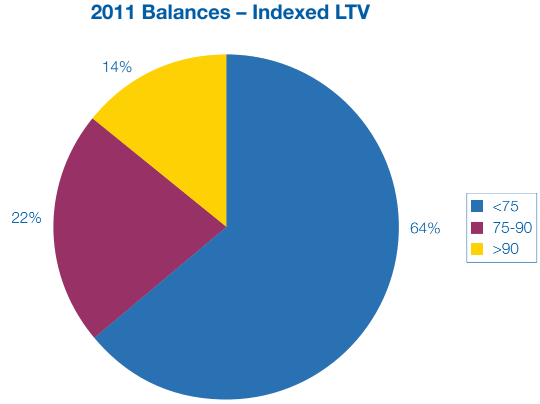
The Society's lending portfolio is geographically diverse with the largest exposures being in Yorkshire, the South East and Greater London reflecting the concentration of activities in Yorkshire and the higher property values in the South East and London.

Analysis by Product Type



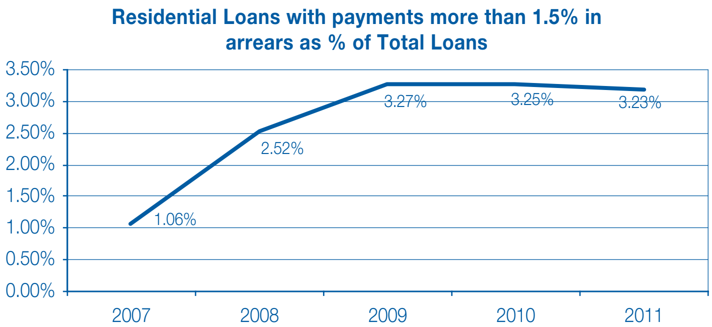
The Society concentrates predominantly on the prime residential mortgage market, including shared ownership, but also lends to buy to let landlords. The Society is no longer active in overseas lending, which historically relates to Southern Ireland and lending to UK residents in Spain.

Analysis by LTV



The overall indexed LTV on the mortgage portfolio at the end of 2011 was 51% compared to 50% in 2010, reflecting the Society's conservative lending policy in the absence of house price growth.

The level of arrears in the residential portfolio has increased since the onset of the credit crunch in 2007 as shown in the following table.



Since 2009, the total level of arrears, including possessions, has levelled out at under 3.50%, although this is above the CML average. The above average arrears are due to a combination of the Society's higher SVR and its exposure to higher risk segments (Buy to Let, Shared Ownership and higher LTV lending), although these segments also contribute positively to the Society's overall net interest margin and are within the Society's risk/reward appetite.

The Society has balance sheet loan loss provisions against residential mortgages of £45.3m (2010: £26.7m), of which £28.9m (2010: £17.7m) is classified as specific and £16.4m (2010: £9m) collective.

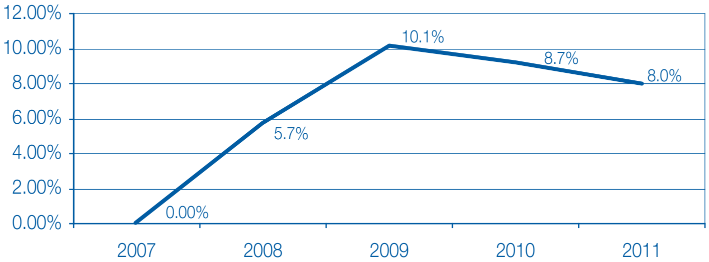
As noted above, the Society withdrew from the commercial lending market in 2008 and since then the portfolio has reduced from a peak of £626m in 2008 to £505m at the end of 2011 and now represents less than 7% of total loans and advances to customers.

The level of reported arrears on the portfolio, which also includes those loans not in arrears but where an LPA receiver has been appointed, has also increased since the credit crunch as shown overleaf.

Business Review continued

For the year ended 31 December 2011

Commercial Loans with payments more than 1.5% in arrears as % of Total Loans



The arrears ratio improved to 8% at the end of 2011 compared with 8.7% in 2010. The ratio excluding these LPA receiver cases is just 2.5%.

The Society has balance sheet loan loss provisions against commercial mortgages of £39.4m (2010: £34.4m), of which £21.5m (2010: £24.4m) is classified as specific and £17.9m (2010: £10m) collective.

Investment Property

In 2009, the Group purchased the freehold of a retail park, Hornsea Freeport, to protect its interests and to enhance yield and value 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 £0.25m to £6.75m.

Fixed assets

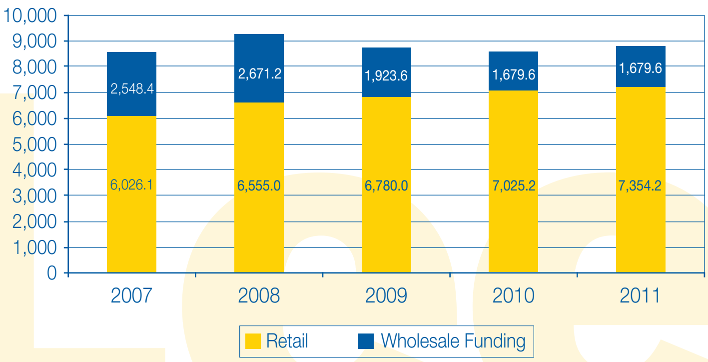
Fixed assets, which represent land and buildings and office and computer equipment, were £27.5m at the end of 2011 compared to £26.9m at the end of 2010. The Society spent £1.5m in 2011 investing in the branch network and infrastructure projects.

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.

Funding Profile - £M

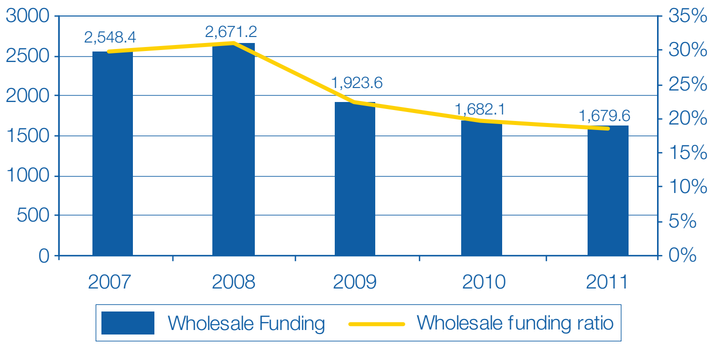


Retail funds from members now accounts for 81% of the Society's total funding compared with 70% in 2007.

The Society continued to maintain a high level of retail savings in 2011, despite the very competitive environment, which reflected the lack of availability and high cost of funds from the wholesale market. The Society's net retail receipts of £153m were £156m above its natural market share of building societies.

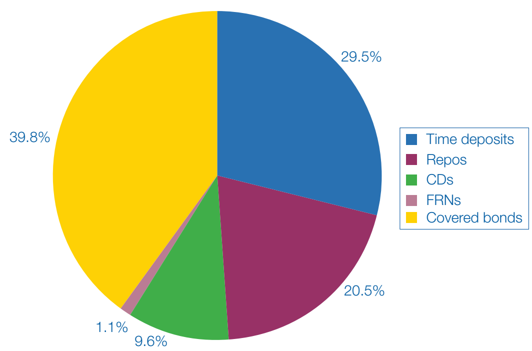
The Society has reduced its reliance on wholesale funding since 2007. The Society's wholesale balances as a percentage of total shares and deposits (the non retail funding ratio) was 19.2% compared with 19.9% at the end of 2010. The change in the Society's wholesale balances and the non retail funding ratio is shown in the following table.

Non retail funding £M/%



The Society's non retail funding portfolio at the end of the year is as follows:

Wholesale funding portfolio



During the first six months of 2011, the Society was successful in raising £395m of new long term wholesale funds and this has enabled it to repay all the Bank of England Special Liquidity Scheme (SLS) funding ahead of its contractual maturity date. In addition, the proportion of the Society's wholesale funds that have a maturity in excess of 12 months increased to 54% from 43% at the end of 2010.

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 ratio, solvency ratio and level of the capital buffer.

The amount of the Society's capital and its capital ratios improved further in 2011 as a result of the strong underlying profit generated in the year and lower growth in the value of its risk weighted assets (RWA).

“In the 2011 survey, staff who were either satisfied or very satisfied, was 80%...”

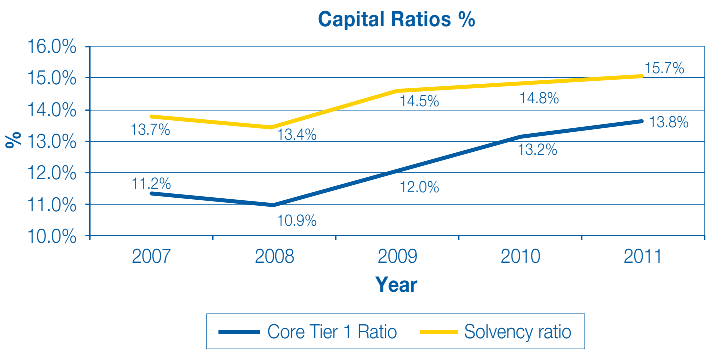
Core tier 1 capital is the very strongest form of capital and, in the most part, represents the Society’s accumulated post-tax profit (general reserves) built up over time. The ratio compares the core tier 1 capital to its RWA, which is the sum of its assets modified to incorporate the level of risks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

	2007	2008	2009	2010	2011
Core Tier 1 Capital (£’M)	436.7	448.0	469.8	501.4	537.0
Core Tier 1 Ratio	11.2%	10.9%	12.0%	13.2%	13.8%
Total Capital (£’M)	532.3	548.5	567.1	560.4	610.8
Solvency ratio	13.7%	13.4%	14.5%	14.8%	15.7%

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



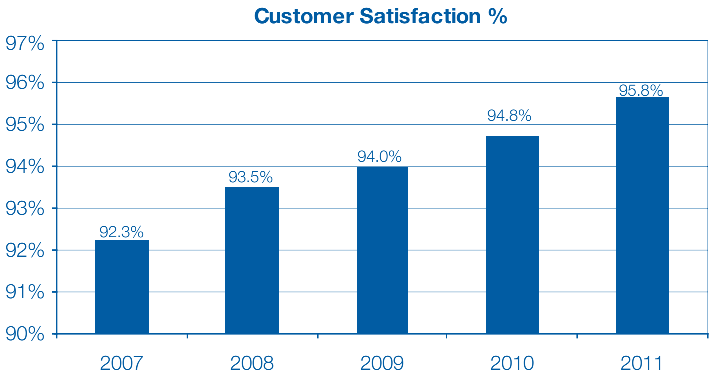
The FSA also sets minimum capital requirements based on their assessment of the Society’s risk profile of its assets and business activities. Throughout 2011, the Society’s actual regulatory capital was significantly in excess of this minimum requirement.

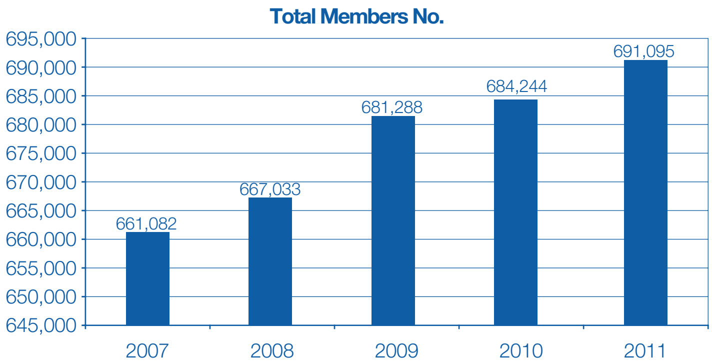
NON-FINANCIAL PERFORMANCE OVERVIEW

Maintaining or improving the Society’s relationship with members and staff (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, and member and staff 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 increased to over 95% in 2011.

Staff Satisfaction

Staff satisfaction is monitored through an annual staff survey and monthly through the level of staff turnover.

In the 2011 survey, staff who were either satisfied or very satisfied, was 80% and staff turnover was 20%.

The Society has maintained a high level of staff satisfaction and an acceptable turnover rate, based on the Society’s own internal targets, throughout the period since 2007.

Outlook

During 2011, 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.

Robin S. P. Litten
Finance Director
20 February 2012

The Board of **Directors**

Robin Smith

Peter Hill

John Anderson

Robin Ashton

Carol Kavanagh

Robin Litten

Les Platts

Abhai Rajguru

Kim Rebecchi

Ian Robertson

Bob Stott

“As a member owned organisation, our capital strength provides ongoing stability as all our profit is invested in the business rather than being distributed to external shareholders”

Robin Smith (69)

I have been the Society’s Chairman since 2007. I am proud of the Society’s Board and its Executive Team and of the success achieved in responding to the market challenges of the last few years. I am proud too of the Society’s mutual status, which has been a significant dimension throughout the Board’s handling of the consequences of the crisis. 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. and of the Yorkshire County Cricket Club. I maintain my links with the Territorial Army and with a number of local and national charities.

Peter Hill (50)

I am a Chartered Banker, with 32 years’ experience in financial services. I was appointed Chief Executive in August 2011, having been an employee of the Society for 10 years, and a Board member, as Operations Director for five years. It is my role to provide clear leadership at all levels across the Society, ensuring a common commitment to its vision and values, delivering a strong business performance and, most of all, putting our membership at the heart of everything we do. My interests outside work revolve around my family. I am married to Alison and have two sons at secondary school. I enjoy golf, cycling and follow the Leeds Rhinos.

John Anderson (66)

I joined the Board in 2006 as a result of the merger between Leeds Building Society and the Mercantile Building Society, of which I was Chairman. I am a great believer in mutuality and I am delighted to have joined a Board which is totally committed to mutual status. I hold several public/private partnership directorships and I am Chairman of City Hospitals Sunderland Foundation Trust. In my spare time I am a keen follower of cricket, being an honorary life member of Durham County Cricket Club.

Robin Ashton (54)

I joined the Board as a non-executive Director in April 2011. I am a member of the Group Risk and Assets and Liabilities 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 and a consultant to a specialist motor insurance intermediary. I am married with three children and my interests include reading, walking, watching tennis and motorsports. With a strong focus on its core mortgage and savings products, great customer service and low costs, the Leeds provides its members with valued products.

Carol Kavanagh (49)

I joined the Board in 2005 and I am a member of the Society’s Remuneration Committee. I believe that my 25 years’ business experience provides value to customers and staff alike. I hold another position as Executive Group HR Director for Travis Perkins plc. I am a firm supporter of the benefits of mutuality and believe that this is the key to the continuing success of the Society and a major differentiator in the wider financial services sector. I devote most of my spare time to my family.

Robin Litten (48)

I am delighted to have joined the Society in January this year. 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 (58)

I joined the Board in 2010 and I am Chair of the Remuneration Committee and a member of the Audit and Credit 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 a pensions 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 (46)

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 and 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 (45)

I have been a member of the Board since 2009 having worked for the Society since 1988. I am a Chartered Banker and currently have executive responsibility for distribution, marketing and am Chairman of the Society’s financial services subsidiary. I sit on the Cancer Research UK’s Yorkshire and Humber Regional Advisory Board and I am also an active Rotarian. Being a Leeds girl, I am proud to be on the Board of the only mutually owned financial services organisation with its Head Office in Leeds. Outside work, I enjoy walking, sailing and spending time with my family.

Ian Robertson (64)

I joined the Board in 2008 and am a member of the Audit, Group Risk and Credit Committees. I was delighted to join such a highly regarded local institution and to work with the Society in further enhancing 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 currently Chairman of the Audit Advisory 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. I live in the Leeds area.

Bob Stott (68)

I was appointed to the Board in 2008, following my retirement as a Director of Wm Morrison Supermarkets plc. I am a member of the Society’s Assets and Liabilities, Remuneration and Nomination Committees. I was delighted to be appointed Vice Chairman of your Society in September 2011 and elected Chair of the Pensions Trustee Board in December 2011. I hold four 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 and I intend to play my part in keeping it this way. I enjoy spending time with my family and I follow most team sports.

Directors' Report

For the year ended 31 December 2011

Statement of the Society and its subsidiaries ('the Group') for the year ended 31 December 2011.

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 5 and in the Business Review on pages 6 to 11. The Business Review identifies and explains the Group's Key Performance Indicators and how it has performed against them during 2011.

Profit and Capital Position

The pre-tax profit of the Group increased by 19% to £50.2m compared with £42.2m in 2010.

At 31 December 2011, gross capital, represented by general and other reserves, revaluation reserves, subordinated liabilities and subscribed capital, amounted to £576m and this was 6.4% (2010: 6.2%) 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 £577m, 6.4% (2010: 6.0%) of shares and borrowings. One of the Group's other key measures of capital strength is the core tier 1 ratio which increased to 13.8% in 2011 compared to 13.2% in 2010.

Overall, the capital ratios reflect the continued financial strength of the Group.

Mortgage Arrears

At 31 December 2011, there were 504 (2010: 471) mortgage accounts 12 months or more in arrears. The total mortgage arrears in these cases was £6.6m (2010: £8.0m) and the total of principal loans outstanding was £73.2m (2010: £93.7m).

Principal Risks and Uncertainties

A summary of the principal risks and uncertainties facing the Society, and its subsidiary undertakings, and the procedures put in place to manage them is set out below with more detail provided in Note 35 to the Accounts, on pages 59 to 77.

The Board retains full responsibility for the operational activities of the Society. In order to ensure that the interests of its members are adequately protected at all times, the Board has established and embedded a robust governance structure and risk management framework that are designed to identify, manage, monitor and control the major risks exposed in the delivery of the Society's strategic objectives. Details of the Society's governance structure are included in the Corporate Governance Report, on pages 18 to 20.

The principal risks that arise from the Society's operations are credit, treasury, operational, conduct, strategic and external risks. These key categories of risk are common to most financial services organisations in the UK.

Risk Management Framework

The oversight and direction of the Board is central to the Society's risk management framework. It ensures, through a series of Board sub-committees and management forums, that appropriate policies, procedures and processes are implemented across the business to control and monitor risk exposure.

The framework identifies operational roles and responsibilities (both individual and collective) in the risk management process and seeks to ensure that exposed risks are aligned to the Risk Appetite Statements of the Board, with any unacceptable risk exposures being managed and mitigated. Each of the Board sub-committees includes at least two non-executive Directors, with other committee members drawn from the executive and appropriate members of senior management.

The key risk orientated committees, operating under the delegated authority of the Board, include the Group Risk Committee (GRC), Assets and Liabilities Committee (ALCO), Board Credit Committee (BCC) and Audit Committee (AC).

Further details relating to the GRC, ALCO, AC and BCC are set out in the Corporate Governance Report on pages 18 to 20.

Additional oversight and direction is delivered through a weekly Operational Review Committee (ORC) and a monthly Strategic Review Committee (SRC), which enable the senior management team to manage the day-to-day risks within the business.

At an operational level, specialist management forums have been established to review the day-to-day performance of the business. These include a Conduct Risk Committee and Management Risk Committee, both established in 2011, a Management Assets and Liabilities Committee, a Management Credit Committee, a Business Continuity Group, an Information Security Forum, and a Pricing Committee.

During 2011, the Society's Risk Management Framework was enhanced with the appointment of a Chief Risk Officer who is accountable to the GRC and reports directly to the Chief Executive. The Chief Risk Officer is responsible for the oversight of credit, treasury, conduct and operational risks.

Credit Risk

The Board accepts that, in the delivery of its strategic plans, the Society will be exposed to the risk of loss arising out of the failure of borrowers to repay their credit commitments. As a building society, Leeds Building Society is inherently exposed to credit risk within its core operations.

Material exposures are limited to the provision of loans secured on property within the UK and, although the Society has some elements of credit risk attached to commercial, overseas and unsecured lending, over 85% of the Society's credit risk is in the form of UK residential mortgages.

Residential mortgage exposures are managed in accordance with the Board approved Lending Policy. This policy is implemented with the support of credit scoring systems and underwriting processes, which assess the applicants' ability and willingness to pay, alongside the suitability of the proposed security property. These front end processes underpin the assessment of potential borrowers, prior to completion. Post completion, day-to-day management of borrowers' accounts is the responsibility of the Customer Service and Customer Care teams.

The BCC reviews high level trends and indicators by monitoring product and sector limits, together with detailed analysls of arrears, loan-to-value ratios, expected losses and scorecard performance. In 2011,

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

the Society made appropriate changes to its Residential Lending Policy and product range to reflect the economic environment. For two credit risk exposures (unsecured and commercial loans) the Society withdrew from new lending in 2008 due to a reduced risk appetite for such lending. Operationally, Management has retained appropriately skilled staff to ensure the orderly run-off of the closed books. Sub-committee oversight continues to challenge Management on its performance. In the short term, it is unlikely that the Society will re-enter these markets.

In addition to the retail credit risk exposures noted above, there is also an inherent risk that Treasury counterparties default on their obligations to the Society and create counterparty credit risk losses. The risks associated with, primarily, unsecured Treasury counterparty lending appear, overall, to be low, given that the Society only lends to financial organisations which have a minimum credit rating of A3 (93.9% of the portfolio), although some lending is also undertaken to unrated building societies. The risks arising from counterparty failure are overseen by the ALCO and are considered to have reduced in 2011, when compared to 2010. In particular, the Society has reduced its exposure to counterparties in Spain, Ireland, Italy and Portugal from £67.3m, at the end of 2010, to £24.3m, at the end of 2011. This is expected to reduce further in 2012. The Society has no exposure to Greek or non UK sovereign debt.

Treasury Risk

Interest rate risk relates to the potential adverse change in the Society's income or the value of the Society's net worth, arising from movements in interest rates. Interest rate risk arises from the differing interest rate characteristics of the Society's mortgages, savings and other financial instruments.

Operating under a Board approved Financial Risk Management Policy, interest rate risk is managed by Group Treasury, through the use of appropriate hedging instruments, or by taking advantage of natural hedges within the Society's balance sheet. In 2011, the operating environment has continued to be influenced by prevailing low interest rates and lower business volumes than in recent years.

Liquidity risk is whether the Society will be unable to meet current and future financial commitments as they become due. The Society's policy has always been to maintain sufficient liquidity to cover cash-flow imbalances and fluctuations in funding, to retain full public confidence in the solvency of the Society and enable it to meet its financial and regulatory obligations. At the end of 2011, the proportion of long term wholesale funding represented over 50% of the Society's total funding received from wholesale counterparties and provides a stable and secure base for the Society's operations.

In 2011, the Society did not experience any significant events relating to its other treasury risk exposures (settlement, currency and complex product risk). Notwithstanding this position, it maintains a highly controlled environment which is subject to the oversight of the ALCO.

Operational Risk

To minimise operational risk, the Society maintains a system of internal controls, which reflects the size and scale of the business. Central to the risk management framework is an ongoing risk assessment, which identifies and assesses all risks that may arise from operational activity. Whilst credit and treasury risk exposures are principally borne out of the Board's Appetite for Risk, operational risk arises as a consequence of fulfilling the stated appetite.

The Society has, therefore, embedded its operational risk management framework and established a common structure in all business activities for managing risk and identifying control issues. Whilst the Audit Committee acts as the relevant oversight body, the day-to-day management of operational risk is the responsibility of line management and the ORC and SRC.

The Society has developed broad groupings of operational risk that incorporate various different types of risk including legal and regulatory process and system type risks, and people and financial crime type risks.

Under the Basel II framework the Society currently operates the Basic Indicator Approach to its calculation and allocation of capital for Operational Risk. In 2011, the Society has developed its methodology so that it is in a position to migrate to the more sophisticated and sensitive risk Standardised Approach (TSA) in 2012. This is in line with the Society's commitment to the continuous improvement of its risk management practices.

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.

Overall, the Society has a low tolerance to significant conduct risk events and restricts its activities to areas of established expertise, with any potential exposures being proportionate to the size and scale of its operations and not exceeding those quantified within its operational risk assessments.

To support the Society in achieving its objectives and responsibilities in relation to mitigating and managing conduct risk, a Conduct Risk Committee (CRC) has been established. The inaugural meeting was held in November, 2011, with representatives from the Executive and Senior Management Teams. The CRC will meet bi-monthly and will report to the Board.

Other Risks

In addition to the key areas of risk already noted above, the Board has identified a number of risks which stand alone from the core groupings. These include reputation and business risks. Whilst the Board is fully aware of the potential impact of such risks, particularly in times of economic uncertainty, they are peripheral to the Society's physical operations and, accordingly, senior management and the Board retain the ownership and responsibility for these exposures.

An emerging business risk facing the Society is its exposure to residential mortgages in Ireland, which are denominated in Euros. The Society has mitigated any sterling to Euro currency risk through the use of derivative instruments. However, there is the potential for a reduction in the value of the mortgage assets denominated in Euros, which are not matched by Euro liabilities, if Ireland either withdrew from the Euro or the Euro was disbanded and Ireland reverted to a local currency, which was then subsequently devalued. Accordingly, the Society has commenced mitigating action through raising offsetting Euro liabilities.

Uncertainties

With reference to 2012, the principal uncertainties facing the Group are associated with difficulties within the European Union (EU), the UK economy as a whole and the outlook for financial markets.

Directors' Report continued

For the year ended 31 December 2011

The Eurozone debt crisis, which persisted throughout 2011, shows no signs of being resolved in the short term and this has heightened the risk of default of sovereigns, principally Greece, and European financial institutions, particularly in Portugal, Ireland, Italy and Spain as well as Greece. The Society has no sovereign debt or counterparty exposure to Greece and has progressively reduced its exposure to all of these other countries. It now has only a small number of legacy positions, and following the realisation of one exposure in January 2012, all the remaining exposures amounting to £21m will mature by June 2012.

The difficulties in the EU have also resulted in continuing debates over the long term future of the Euro currency. The Society has less than 4% of its loans and advances to customers denominated in Euros and the currency risk is protected through derivative instruments. As noted under the other risks section, the Society is taking action to mitigate the impact of a devaluation of the Irish mortgage assets in the unlikely event that Ireland withdraws from the Euro or the Euro disbands.

The outlook for the UK economy over the coming year is for low growth in GDP, rising unemployment, a deterioration in household disposable income and broadly flat house price movements. These factors, which influence the level of residential arrears and impairment losses, have been offset, to an extent, by the historically low interest rate environment. As a consequence the Society does not expect a significant increase in the level of residential arrears or impairment losses in 2012. However, if there was a material increase in unemployment and/or large reductions in house prices and/or a rapid rise in interest rates, the level of arrears and losses could rise higher than anticipated.

The economic conditions outlined above also affect the performance of the Society's commercial loan portfolio with the potential for an increase in the number of borrowers unable to meet their obligations to the Society, due to increased tenant defaults. The Society ceased lending in this market, in 2008, and is now working closely with its existing borrowers to ensure that repayments are maintained satisfactorily. Where this is not possible, the Society will take the necessary action to mitigate its exposure. The Society has balance sheet provisions of £39m for impaired loans in the commercial portfolio but, as noted above, if there was a significant deterioration in the economic conditions, the level of arrears and losses could rise higher than anticipated.

The Eurozone debt crisis has resulted in some volatility in both the availability and price of wholesale funding, which, in turn, has led to increased competition for retail savings. The Society is planning a relatively small increase in the level of net mortgage lending in 2012 compared to 2011, however this will be dependent upon being able to raise the required net wholesale and retail funds on acceptable terms. If funding conditions deteriorate further, the Society may need to reconsider its lending aspirations.

The external regulatory framework continues to evolve, with changes covering the mortgage market, the ring-fencing of retail bank operations, the management of funding, liquidity risk and capital levels and the potential for pre-funding the Financial Services Compensation Scheme, all of which are likely to have a significant impact on the financial services sector. As noted in 2011, the Society's current regulator, the Financial Services Authority, is being split into two with a Prudential Regulation Authority, within the Bank of England, being responsible for the prudential regulation of financial institutions including building societies, and a Financial Conduct Authority regulating the provision of financial services to consumers.

All these changes are likely, to some extent, impact the way the Society and other banks and building societies operate. These developments continue to be monitored and assessed by Management and the Board to ensure that the Society remains compliant, effective, well capitalised and able to compete effectively in the changing environment.

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 from 8 August 2011)

Mr S. R. G. Booth (Vice Chairman until 8 August 2011) (resigned 23 September 2011)

Mr P. A. Hill (Chief Executive from 10 August 2011)

"The Society recognises the importance of effective communication with its members..."

Mr I. W. Ward (retired as Chief Executive 9 August 2011 and as a Director 23 September 2011)

Mr J. N. Anderson

Mr R. J. Ashton (appointed 26 April 2011)

Mrs C. M. Kavanagh

Mr D. Pickersgill (retired as Director 30 June 2011)

Mr L. M. Platts

Mr A. Rajguru

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

Mr I. Robertson

Details of the Directors of the Society at 31 December 2011 and who continue in office are shown on pages 12 and 13.

In accordance with the Rules, R. J. Ashton offers himself for election and A. Rajguru, I. Robertson and R. W. Stott offer themselves for re-election by the members at the Annual General Meeting.

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 18 to 20 and 23 respectively.

Auditors

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

Charitable and Political Donations

The Group made a donation of £112,000 to the Leeds Building Society Charitable Foundation. Our Caring Saver Account enabled further donations of £39,000 to be made to charities. Other charitable donations in the year amounted to £68,000. 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, and a 'Go Green' Team, which seek 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. Where available, the Society uses good quality combined heat and power which is considered to be more environmentally friendly than traditional methods of production. The Society works in partnership with its suppliers to manage and minimise carbon emissions.

Changes to the Society's printing strategy saw a reduction of 20% in the amount of paper utilised in 2010, compared to 2009, with a further reduction of 7.5% in 2011. Our environmental approach has been recognised by the award of the Carbon Trust Standard – the first building society to achieve this.

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.

Through its subsidiary, Leeds Financial Services Limited, the Society hosts a number of seminars for new and existing members to discuss their financial needs and this also provides an opportunity to discuss more general issues. 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 2012 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 2011, 16.0% 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.

Staff

The Society has maintained and developed systems during the year for effective communication with employees. The provision of information continues through the Intranet, e-mail, circulars, staff magazine, meetings, presentations and team briefings to ensure staff are aware of the Society's performance and objectives and the business environment in which it operates. There is a Staff Association, through which members of staff 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, staff 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 14 days at 31 December 2011 (2010: 10 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
Secretary
20 February 2012

Corporate Governance Report

For the year ended 31 December 2011

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 current version came into effect in July 2010. It applies to accounting periods beginning on or after 29 June 2010. 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.

Recent Developments in Corporate Governance

The FRC published updated guidance on improving board effectiveness, which has been incorporated into the Society's corporate governance framework, and has also consulted on revising the Code as recommended in Lord Davies of Abersoch's report on gender diversity on boards, and announced that these changes, along with any others to be consulted on over the next few months, will become effective from 1 October 2012.

The Board

At 31 December, 2011, the Board comprised two executive and seven 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 judgement. 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 12 and 13. 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 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 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 at monthly intervals, and its main committees which are detailed on pages 18 to 20. 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 FSA and must receive approval from the Financial Services Authority (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 2010 version of 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 who are familiar with the business, and that the current arrangements are appropriate. It will not therefore, propose, that all Directors are subject to re-election on an annual basis.

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.

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 UK Corporate Governance 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.

During the year, the Chairman of the Committee was Mr I. Robertson. The other members, for all or part of the year, were Mr R. J. Ashton, Mr L. M. Platts, Mr A. Rajguru, and Mr R.W Stott. 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 without executive management being present, at the beginning of each

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	Risk
R. A. Smith (Chairman)	10(10)	–	_	5(5)	–	–	3(4)
R. W. Stott (Vice Chairman from 8 August 2011)	10(10)	4(4)	5(5)	2(2)	–	11(12)	–
S. R. G. Booth (Vice Chairman until 8 August 2011, Director until 23 September 2011)	6(7)	–	2(2)	3(3)	–	–	–
P. A. Hill (Chief Executive from 10 August 2011)	10(10)	–	–	3(3)	5(5)	11(12)	4(4)
I. W. Ward (Chief Executive until 9 August 2011, Director until 23 September 2011)	7(7)	–	–	3(3)	3(3)	9(9)	3(3)
J. N. Anderson	10(10)	–	4(5)	–	–	–	–
R. J. Ashton (appointed 26 April 2011)	7(7)	1(1)	–	–	2(2)	7(8)	2(2)
C. M. Kavanagh	10(10)	–	5(5)	–	–	–	–
D. Pickersgill (Deputy Chief Executive, and Director. Retired as Director 30 June 2011)*	0(5)	–	–	0(2)	0(2)	0(6)	0(2)
L. M. Platts	10(10)	6(6)	5(5)	–	5(5)	–	–
A. Rajguru	10(10)	7(8)	–	–	–	11(12)	4(4)
K. L. Rebecchi (Sales and Marketing Director)	10(10)		–	–		10(12)	3(4)
I. Robertson	10(10)	8(8)	–	–	5(5)	–	4(4)

*Mr D. Pickersgill was absent from work, through illness for the period up to 30 June 2011.

meeting. The Board is satisfied that the composition of the Committee provides recent and relevant financial experience.

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 2011, 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.

Group Risk Committee

The Group Risk Committee, a sub-committee of the Board, met four times in 2011, 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. J. Greenwood, Chief Risk Officer & Secretary, until 13 September 2011, when he was succeeded by Mr A. Rajguru, following a review of membership in light of the FSA's Policy Statement on effective corporate governance The other Board members of the Committee during all or part of the year, were Mr I. W. Ward, Mr D. Pickersgill, Mr P. A. Hill, Ms. K. L. Rebecchi, Mr R. J. Ashton, Mr I. Robertson, and Mr R. A. Smith.

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 meets monthly, 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 Chairman of the Committee was Mr I. W. Ward, until 17 August 2011, when, following his retirement as Chief Executive, he was succeeded by Mr P. A. Hill. The other Board members of the Committee during all or part of the year, were, Ms. K. L. Rebecchi, Mr R. J. Ashton, Mr A. Rajguru, and Mr R. W. Stott.

Corporate Governance Report continued

For the year ended 31 December 2011

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 all or part of the year, were Mr I. W. Ward, Mr D. Pickersgill, Mr P. A. Hill, Mr S. R. G. Booth, and Mr R. W. Stott.

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 the 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 of 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 five occasions. Following a review of Board composition, it was decided to appoint a new non-executive Director, and after a thorough recruitment process, Mr R. J. Ashton joined the Board, following approval by the Financial Services Authority, on 26 April 2011. He will be offering himself for election at the 2012 Annual General Meeting.

All future appointments will follow a formal selection process, and will also be subject to approval by the FSA and election by the Society's members, at the AGM in the next financial year after appointment. The non-executive director appointment letter, which sets out the terms and conditions of appointment, is available on the Society's website.

In May 2010, it had been announced that Mr I. W. Ward would retire as Chief Executive on 31 December 2010, and be succeeded by Mr D. Pickersgill, the Deputy Chief Executive and Finance Director. Mr Pickersgill was absent from work through illness from 13 September 2010, and Mr Ward agreed to remain as Chief Executive after 31 December 2010, until the situation was resolved. In the event, Mr Pickersgill was unable to return to work, and a recruitment process for a new Chief Executive was undertaken, with consideration of both internal and external candidates. As a result, Mr P. A. Hill was appointed Chief Executive, and took office with effect from 10 August 2011, following approval by the Financial Services Authority.

The Committee also conducted a recruitment process for a Finance Director to succeed Mr D. Pickersgill, and appointed Mr R. S. P. Litten, following approval by the FSA. He took up his appointment on 10 January 2012, and was appointed to the Board on 23 January 2012. Mr Litten will offer himself for election by the members at the 2013 Annual General Meeting, as required by the Society's Rules.

As part of the Board succession plan, Mr J. N. Anderson, and Mrs C. M. Kavanagh have signalled their intention to retire from the Board at the conclusion of the 2012 Annual General Meeting. A selection process for new non-executive Directors is underway.

Credit Committee

The Credit Committee is a sub-committee of the Board, and in 2011 met on five 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 G. M. Mitchell, Acting Finance Director, until 19 October 2011, when he was succeeded by Mr R. J. Ashton. The other Board members of the Committee were Mr I. W. Ward, Mr D. Pickersgill, Mr P. A. Hill, Mr L. M. Platts, and Mr I. Robertson.

Remuneration Committee

Detailed information on the work and composition of the Remuneration Committee is set out in the Directors' Remuneration Report at pages 21 and 22.

Auditors

The Society has a policy on the use of the external auditor for non-audit work, which is implemented by the Audit Committee. The purpose of this policy is to ensure the continued independence and objectivity of the external auditor. The external auditor, Deloitte LLP, undertook a number of non-audit related assignments during 2010 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 the performance evaluation process, and documented in training plans. 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, 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

Andrew J. Greenwood
Secretary
20 February 2012

Directors' Remuneration Report

For the year ended 31 December 2011

Introduction

This report, together with the details in Note 9 to the Accounts, 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, insofar 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 2012 Annual General Meeting, who will have the opportunity to participate in an advisory vote on the report.

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 principles underlying the Remuneration Policy are that:

- it is in line with the business strategy, objectives, values, and the long term interests of the Society;
- the Policy, procedures, and practices are consistent with, and promote sound and effective risk management, and do not encourage risk taking which exceeds the level of the Society's risk appetite; and
- the Society should provide competitive and fair remuneration packages to attract and retain employees of appropriate calibre.

The Remuneration Policy also identifies management and staff who are considered "Code Staff", and "material risk takers", as defined by the Code. In addition to the Directors and General Managers, this includes senior managers in Mortgage Lending, Risk, Internal Audit, Conduct, HR, IT, Sales, Treasury, and Commercial Lending.

Composition and Scope of the Remuneration Committee

The Remuneration 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. During the year, the Chairman of the Committee was Mr S. R. G. Booth, until he stood down on 8 August 2011, and was succeeded by Mr L. M. Platts. The other members of the Committee were Mr J. N. Anderson, Mrs C. M. Kavanagh, and Mr R. W. Stott. 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. The Society's Deputy Secretary, Mr G. Jennings, acts as Secretary to the Committee.

The Committee considers remuneration for the Society's staff generally and, specifically, the remuneration of the Society's Chairman, executive Directors, senior executives, and Code Staff. Proposals for changes to the level of fees for non-executive Directors (excluding the Society's Chairman), reflecting the time commitment and responsibilities of the role, are received from the executive Directors. The Committee also reports to the Board on the terms of engagement of executive Directors, other members of senior management, and Code Staff, together with wider aspects of remuneration policy for all members of staff. 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.

In 2011, the issues considered by the Committee included the design of, and setting of objectives for, the 2011 executive performance-related pay scheme, an overview of the rewards and benefits for all members of the Society's staff, and the pay awards for the executive Directors, and the Society's Chairman. It agreed the severance payment of £30,000 to Mr D. Pickersgill who retired as a Director on 30 June 2011, following a lengthy period of ill-health. Mr Pickersgill will be covered under the Society's long-term health insurance until 5 April 2013 with the risk being borne by the Society, and the total costs of £589,000 being fully accrued in the 2011 accounts.

The Committee also reviewed the Society's Remuneration Policy in the context of the FSA Remuneration Code. As part of this review, Towers Watson was commissioned to carry out benchmarking of the Society's remuneration policy, including its compliance with the Remuneration Code, and the remuneration and benefits of senior staff. This has resulted in changes to the performance-related, and deferred pay arrangements, from 2012. It also considered changes to the tax relief rules, in relation to the Leeds Building Society Staff Pension Scheme, together with the Society's approach to the introduction of auto-enrolment from October 2013. In addition, the Committee's Terms of Reference were reviewed. In all matters discussed, consideration is always given to best practice.

Remuneration Policy for Executive Directors

Remuneration packages are set at a level to attract, motivate and retain executive Directors and senior management of a high standard and to reward them fairly and competitively for their responsibilities, performance and experience. This ensures that the skill levels appropriate to operate an organisation as complex as the Society are maintained. In making its assessment on remuneration and incentive schemes, the Committee has regard to the salaries and incentives payable to executives in similar roles in comparable organisations.

The executive Directors' remuneration currently comprises an annual salary, annual performance-related pay, a long-term incentive plan, pension scheme membership and health care insurance. The performance-related elements of remuneration are designed to recognise corporate and personal success on both an annual and longer term basis, whilst at the same time ensuring that any objectives agreed are aligned with both the principles of sound risk management and the risk appetite of the Society.

Each year, the Society sets a number of corporate objectives relating to financial and non-financial measures. They are based on business volume assumptions agreed as part of the annual planning process, which are themselves derived from the economic assumptions made at the time. These underscore the Society's overarching objectives, which include making profits which are sufficient to ensure adequate capital for strong financial security and growth, delivering good value through efficient operations, and providing excellent service to members. In addition the executive Directors are set personal objectives, which are consistent with the achievement of the corporate objectives, and the Society's risk appetite. All are designed to be stretching, and to ensure that the interests of senior management are aligned with the Society's members.

Under the annual performance-related pay scheme for executive Directors, an amount of up to 40% of basic salary may be awarded (there is no minimum award).

Directors' Remuneration Report continued

For the year ended 31 December 2011

Recommendations of the amount payable under the scheme, are made to the Board by the Committee following a detailed review of performance against the agreed corporate and personal objectives.

The executive Directors also participate in long-term (three year) incentive plans (LTIPs), the latest of which matured on 31 December, 2011. A maximum of 20% of basic salary may be accrued under each LTIP and a payment made only if a participant reaches the pre-determined performance level over the three year period.

In 2011, the Society performed strongly in an increasingly uncertain market, and delivered a significant increase in pre-tax profit, despite increased provisions, and a higher interest payment to the FSCS on the industry loans to reimburse customers of the failed banks. It delivered its lending and savings targets, whilst maintaining credit quality. In addition, the cost/income ratio fell to a record low.

As a result of the achievement of corporate and personal objectives, the Committee recommended awards to the Board under the performance-related pay, and LTIP schemes. The awards were subject to a risk adjustment assessment process, which was informed by a report prepared by the Chief Risk Officer.

As the financial crisis emerged in 2008, the Board asked Mr I. W. Ward to stay on beyond his normal retirement date to ensure that the Society had strong leadership through that difficult period. A revised retirement date of 31 December 2010 was agreed. When it subsequently became apparent, in November 2010, that the Deputy Chief Executive and Finance Director Mr D. Pickersgill would be unable to take over as Chief Executive on health grounds, the Board again requested that Mr Ward stay in post until either Mr Pickersgill had recovered, or an alternative successor was able to take office. As a result, Mr Ward did not retire from the Society until 23 September 2011, some three years after his original planned date.

The Board was deeply appreciative of Mr Ward for his flexibility in this regard, and his considerable contribution over the period. Accordingly, on the recommendation of the Remuneration Committee the Board awarded an additional discretionary payment of £100,000. To ensure compliance with the Remuneration Code, this payment, together with Mr Ward's other variable remuneration will be paid over a three year period, with appropriate malus provisions. The Board also agreed to the recommendation that his pension be enhanced by £7,733pa, in recognition that the accrual of his pension entitlement ceased at the end of January 2010, twenty months before his final retirement date, and with a lower pensionable salary compared to his final salary. To ensure compliance with the Code, Mr Ward will be unable to draw his enhanced pension entitlement until September 2016.

Because the Society has mutual status, it does not issue shares on the stock exchange. Accordingly, there is no share based remuneration available for either the executive Directors or employees.

Salaries and Benefits

The level of salaries and benefits 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. 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 (outside the executive Directors' annual salary review), either generally, or for any executive Director, except in relation to Mr I. W. Ward, as set out above.

Service Contracts

The Society's executive Director service contracts can be terminated on twelve months notice by either the Society or the Director. The non-executive Directors do not have service contracts with the Society.

Pensions

The former Deputy Chief Executive, and Sales and Marketing Director, in common with other employees who are members of the Society's defined benefits pension scheme, are entitled to pensions based on final salary and length of service with the Society, with a maximum pension of two-thirds of final salary. Following Government proposals to reduce the maximum annual and lifetime contributions to the pension scheme which qualify for tax relief, the Sales & Marketing Director elected to receive the equivalent contributions direct, and become a deferred member of the scheme. Pension entitlements for the executive Directors in the defined benefit scheme are accrued at a rate of 1/45th of the final year's basic salary for each year of service. The Chief Executive is a member of the defined contribution scheme, and has also elected to receive part of the Society's pension contributions directly. Only annual salary payments are pensionable.

Policy for Non-Executive Directors

The level of fees for non-executive Directors (excluding the Society's Chairman) is reviewed annually, by the executive Directors, with appropriate recommendations 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 fees paid in comparable mutual financial services organisations. Over the past few years, with the development of the FSA's more extensive regulatory approach, the time commitment for the Chairman has significantly increased. Following benchmarking, it was agreed that the Chairman's fees should be substantially increased, from £71,400pa to £125,000pa. The Board is satisfied that the revised remuneration is reflective of the work undertaken by the Chairman in the new environment. The Chairman and the non-executive Directors are only entitled to fees and do not participate in any performance-related pay scheme or receive any pension arrangements, or other benefits.

Directors' Remuneration – year ended 31 December 2011

Full details of Directors' remuneration for 2011 and prior year comparatives, all of which form part of the Report, are provided in Note 9 to the Accounts, on pages 39 and 40. Also disclosed is the aggregate fixed and variable remuneration of individuals whose actions have a material impact on the risk profile of the Society, as defined in the Remuneration Code. No employee of the Society receives remuneration which exceeds that of the individuals disclosed in Note 9.

L M Platts

Les M. Platts
Chairman of the Remuneration Committee
20 February 2012

Directors' Responsibilities

For the year ended 31 December 2011

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 25, 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.

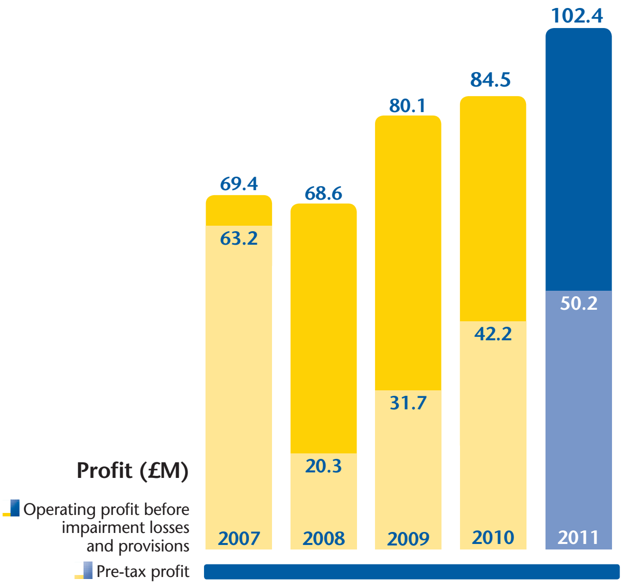
The Directors have general responsibility for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

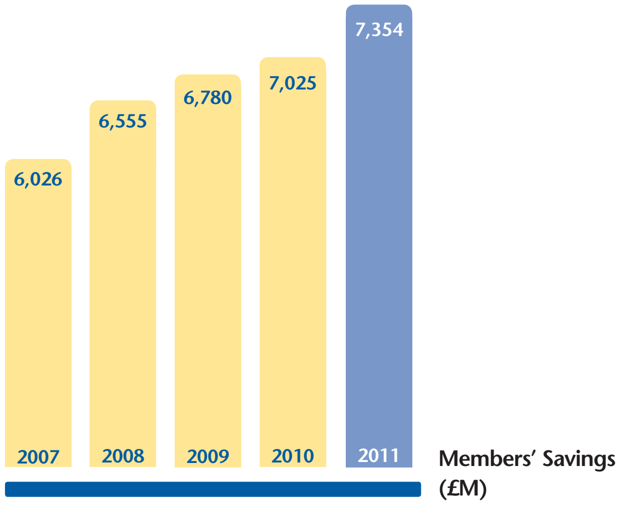
The Directors are responsible for the maintenance of the corporate and financial information included on the Society's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

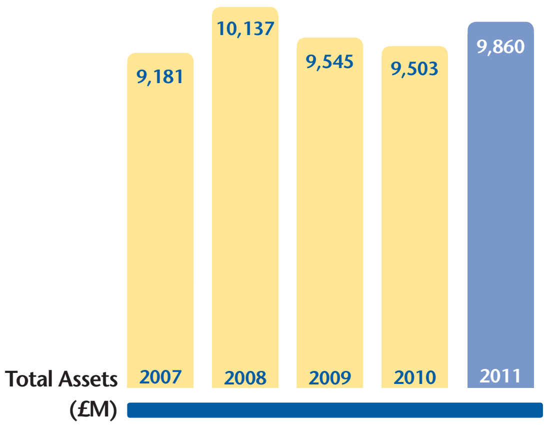
Robin Smith
Chairman
20 February 2012

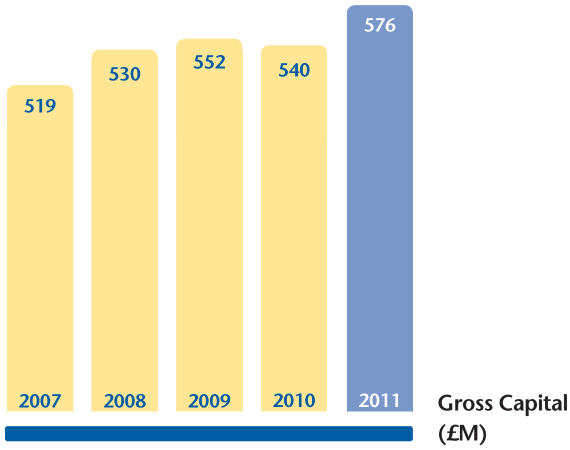
Five Year Highlights

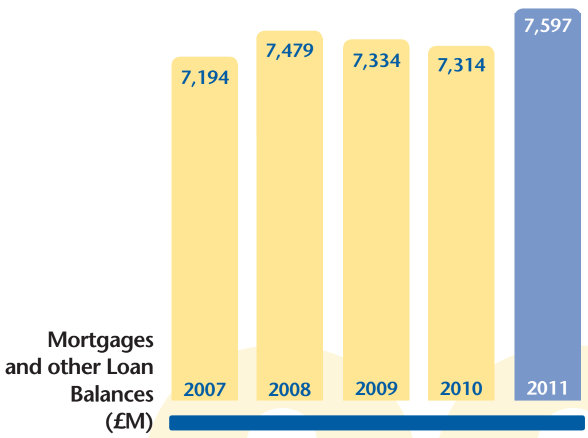
"... our sustainable business model places us in a very good position to grow and prosper"

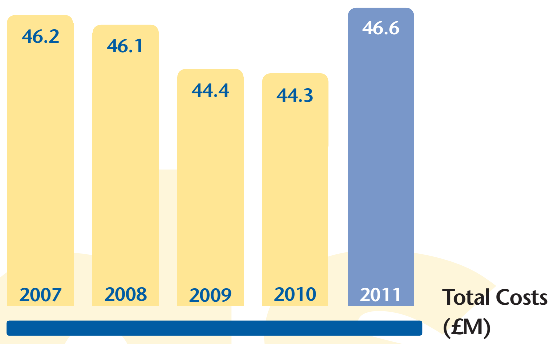












Independent Auditor's Report

To the Members of Leeds Building Society

We have audited the Group and Society financial statements of Leeds Building Society for the year ended 31 December 2011 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 36. 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 2011 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

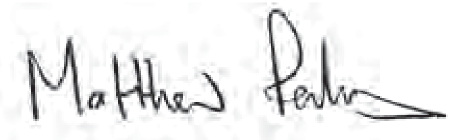
In our opinion:

- 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
20 February 2012

Income Statements

For the year ended 31 December 2011

	Notes	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Interest receivable and similar income	3	334.9	294.5	334.9	294.5
Interest payable and similar charges	4	(207.3)	(185.4)	(207.3)	(185.4)
Net interest receivable		**127.6**	**109.1**	**127.6**	**109.1**
Fees and commissions receivable	5	19.7	19.7	11.4	11.0
Fees and commissions payable	5	(0.1)	(0.1)	(0.1)	(0.1)
Fair value gains less losses from derivative financial instruments	6	0.1	(1.6)	(1.0)	(1.6)
Income from shares in subsidiary undertakings	17	–	–	18.9	–
Other operating income	7	1.7	1.7	0.6	0.8
Total income		**149.0**	**128.8**	**157.4**	**119.2**
Administrative expenses	8	(45.7)	(43.3)	(42.6)	(40.2)
Depreciation	18	(0.9)	(1.0)	(0.9)	(1.0)
Operating profit before impairment losses and provisions		**102.4**	**84.5**	**113.9**	**78.0**
Impairment losses on loans and advances to customers	11	(48.5)	(44.2)	(48.5)	(44.2)
Gains on securities available for sale		–	3.2	–	3.2
Provisions for liabilities and charges:					
Other	27	–	(0.2)	–	(0.3)
FSCS levy	27	(3.4)	(0.8)	(3.4)	(0.8)
Impairment losses on land and buildings		–	(0.3)	–	(0.3)
Investment property fair value movement	19	(0.3)	–	–	–
Operating profit and profit on ordinary activities before income tax		**50.2**	**42.2**	**62.0**	**35.6**
Income tax expense	12	(13.6)	(11.3)	(11.8)	(9.4)
Profit for the financial year		**36.6**	**30.9**	**50.2**	**26.2**

All amounts relate to continuing operations.

The notes on pages 31 to 78 are an integral part of these consolidated financial statements.

Statements of Comprehensive Income

For the year ended 31 December 2011

	Notes	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Profit for the financial year		36.6	30.9	50.2	26.2
Other comprehensive income					
Property revaluation		–	(5.3)	–	(5.3)
Available for sale investment securities					
Fair value changes taken to reserves		3.4	(1.1)	3.4	(1.1)
Amortisation/disposals post 1 July 2008		4.3	1.9	4.3	2.0
Cash flow hedges					
Loss taken to reserves		–	(1.9)	–	(1.9)
Actuarial (loss)/gain on retirement benefit obligations		(1.4)	0.9	(1.4)	0.9
Tax relating to components of other comprehensive income	34	(1.6)	1.7	(1.6)	1.7
Other comprehensive income net of tax	34	**4.7**	**(3.8)**	**4.7**	**(3.7)**
Total comprehensive income for the year		**41.3**	**27.1**	**54.9**	**22.5**

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 16.

Statements of Financial Position

As at 31 December 2011

	Notes	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Assets					
Cash in hand and balances with the Bank of England	13	186.9	115.9	186.9	115.9
Loans and advances to credit institutions		79.7	84.8	59.6	84.3
Derivative financial instruments	14	139.5	126.4	109.7	124.3
Loans and advances to customers	15				
Loans fully secured on residential property		6,906.1	6,607.3	6,905.9	6,606.9
Other loans		690.6	707.1	690.6	707.1
Investment securities	16				
Available for sale		1,475.1	1,296.6	1,475.1	1,296.6
Loans and receivables		238.1	434.8	238.1	434.8
Investments in subsidiary undertakings	17	–	–	28.5	19.6
Other investments	17	–	0.1	–	0.1
Property, plant and equipment	18	27.5	26.9	27.5	26.9
Investment properties	19	6.7	7.0	–	–
Deferred income tax assets	20	2.3	2.8	1.5	2.0
Other assets, prepayments and accrued income	21	107.2	93.4	105.1	91.5
Total Assets		**9,859.7**	**9,503.1**	**9,828.5**	**9,510.0**
Liabilities					
Shares	22	7,354.2	7,025.2	7,354.2	7,025.2
Derivative financial instruments	14	146.7	143.9	144.0	130.7
Amounts owed to credit institutions	23	355.6	482.6	355.6	482.6
Amounts owed to other customers	24	508.3	439.4	534.9	471.0
Debt securities in issue	25	815.7	760.1	787.3	772.6
Current income tax liabilities		7.1	4.2	5.4	2.0
Deferred income tax liabilities	20	1.3	2.0	1.2	2.0
Other liabilities and accruals	26	91.3	108.9	71.9	106.2
Provision for liabilities and charges	27	6.2	5.0	5.5	4.3
Retirement benefit obligations	32	0.9	0.7	0.9	0.7
Subordinated liabilities	28	0.9	0.9	0.9	0.9
Subscribed capital	29	25.0	25.0	25.0	25.0
		9,313.2	**8,997.9**	**9,286.8**	**9,023.2**
Reserves					
Available for sale reserve		(3.7)	(9.4)	(3.7)	(9.4)
Revaluation reserve		13.2	13.2	13.2	13.2
Other reserve		14.3	14.3	14.1	14.1
General reserve		522.7	487.1	518.1	468.9
		546.5	**505.2**	**541.7**	**486.8**
Total Reserves and Liabilities		**9,859.7**	**9,503.1**	**9,828.5**	**9,510.0**
Memorandum items					
Commitments: Irrevocable undrawn loan facilities	31	–	1.2	–	1.2

These financial statements were approved by the Board of Directors on 20 February 2012.
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 2011

Group	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**

	General Reserve £M	Available for Sale Reserve £M	Cash Flow Hedge Reserve £M	Revaluation Reserve £M	Other Reserve £M	Total Reserves £M
Balance at 1 January 2010	455.5	(10.0)	1.4	16.9	14.3	478.1
Comprehensive income for the year	31.6	0.6	(1.4)	(3.7)	–	27.1
Balance at 31 December 2010	**487.1**	**(9.4)**	**–**	**13.2**	**14.3**	**505.2**

Society	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**

	General Reserve £M	Available for Sale Reserve £M	Cash Flow Hedge Reserve £M	Revaluation Reserve £M	Other Reserve £M	Total Reserves £M
Balance at 1 January 2010	441.9	(10.0)	1.4	16.9	14.1	464.3
Comprehensive income for the year	27.0	0.6	(1.4)	(3.7)	–	22.5
Balance at 31 December 2010	**468.9**	**(9.4)**	**–**	**13.2**	**14.1**	**486.8**

Statements of Cash Flows

For the year ended 31 December 2011

	Notes	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Profit before tax		50.2	42.2	62.0	35.6
Adjustments for changes in:					
Impairment provision		22.4	6.3	22.4	6.6
Provisions for liabilities and charges		1.2	(1.5)	1.2	(1.6)
Depreciation and amortisation		0.9	1.0	0.9	1.0
Change in value of investment property		0.3	–	–	–
Interest on subscribed capital		3.3	3.3	3.3	3.3
Cash generated from operations		**78.3**	**51.3**	**89.8**	**44.9**
Changes in operating assets and liabilities:					
Loans and advances to customers		(304.7)	12.9	(304.9)	12.9
Derivative financial instruments		(10.3)	16.0	27.9	4.9
Loans and advances to credit institutions		(0.7)	(1.5)	(1.1)	(1.2)
Investment in subsidiaries		–	–	(8.8)	–
Other operating assets		(13.8)	15.9	(13.4)	16.9
Shares		329.0	245.2	329.0	245.2
Credit institutions and other		(58.1)	(326.3)	(63.1)	(325.5)
Debt securities		61.3	85.4	20.4	97.9
Other operating (liabilities)/assets		(18.4)	(29.1)	(35.2)	(29.3)
Taxation paid		(10.8)	(10.8)	(8.8)	(7.7)
Net cash inflow from operating activities		**51.8**	**59.0**	**31.8**	**59.0**
Returns on investments and servicing of finance		(11.0)	(6.4)	(11.0)	(6.4)
Purchase of securities		(3,645.7)	(4,045.1)	(3,645.7)	(4,045.1)
Proceeds from sale and redemption of securities		3,671.6	3,688.6	3,671.6	3,688.6
Purchase of property and equipment		(1.5)	(0.9)	(1.5)	(0.9)
Proceeds from the sale of property and equipment		–	0.4	–	0.4
Net cash flows from investing activities		**13.4**	**(363.4)**	**13.4**	**(363.4)**
Redemption of subordinated liabilities		–	(39.1)	–	(39.1)
Net cash flows from financing activities		**–**	**(39.1)**	**–**	**(39.1)**
Net increase/(decrease) in cash and cash equivalents		**65.2**	**(343.5)**	**45.2**	**(343.5)**
Cash and cash equivalents at beginning of year		**195.8**	**539.3**	**195.8**	**539.3**
Cash and cash equivalents at the end of year	30	261.0	195.8	241.0	195.8

Notes to the Accounts

For the year ended 31 December 2011

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 2011 and relevant to the Society and Group:

Amendment to IFRS 7 Financial Instruments: Disclosures. The Group has amended its disclosures to comply with the new requirements.

IAS 24 Revised (2009): Related Party Disclosures. This update did not have a material impact on the Group's financial statements.

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

IAS 19 (revised): Employee Benefits

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 procuration 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 2011

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 as substantially all the risks and rewards are retained by the Group. 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 2011

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 occured. 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.

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, including VAT. All revenue arises in the United Kingdom.

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 recognised 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 2011

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.

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.

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.

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.

Financial Services Compensation Scheme (FSCS)

The Society has a provision for a levy of £5.4m (2010: £4.2m) covering the period from March 2011 to March 2013. 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 interest rate applicable for the levy for the period to March 2013 has not yet been agreed. In the absence of an agreement, the Society has used a rate of twelve months LIBOR + 100 basis points. This is within a range of rates suggested by the FSA.

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Notes to the Accounts continued

For the year ended 31 December 2011

3. Interest Receivable and Similar Income

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
On loans fully secured on residential property	342.6	335.0	342.6	335.0
On other loans	34.0	36.1	34.0	36.1
On debt securities				
Interest and other income	17.5	16.5	17.5	16.5
On other liquid assets				
Interest and other income	2.4	2.5	2.4	2.5
Net expense on financial instruments	(61.6)	(95.6)	(61.6)	(95.6)
Total interest income	**334.9**	**294.5**	**334.9**	**294.5**
Interest received on amounts included in the cost of qualifying assets:				
From instruments held at fair value through profit and loss	17.3	15.9	17.3	15.9
From instruments not held at fair value through profit and loss	317.6	278.6	317.6	278.6
Total interest income	**334.9**	**294.5**	**334.9**	**294.5**

Included within interest receivable and similar income is interest accrued on impaired financial assets of £6.1m (2010 – £7.8m).

4. Interest Payable and Similar Charges

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
On shares held by individuals	188.6	192.4	188.6	192.4
On other shares	–	–	–	–
On subscribed capital	3.3	3.3	3.3	3.3
On subordinated debt	0.1	0.5	0.1	0.5
On deposits and other borrowings	34.4	14.1	34.4	14.1
Net income on financial instruments	(19.1)	(24.9)	(19.1)	(24.9)
Total interest expense	**207.3**	**185.4**	**207.3**	**185.4**
Interest expense on amounts included in the cost of qualifying assets:				
From instruments held at fair value through profit and loss	(19.1)	(24.4)	(19.1)	(24.4)
From instruments not held at fair value through profit and loss	226.4	209.8	226.4	209.8
Total interest expense	**207.3**	**185.4**	**207.3**	**185.4**

Notes to the Accounts continued

For the year ended 31 December 2011

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 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Fees and commission receivable – at fair value	3.5	3.7	–	–
Fees and commission receivable – at amortised cost	16.2	16.0	11.4	11.0
Fees and commission payable	(0.1)	(0.1)	(0.1)	(0.1)
	19.6	**19.6**	**11.3**	**10.9**

6. Fair Value Gains Less Losses from Derivative Financial Instruments

The fair value accounting volatility gain of £0.1m (2010: £1.6m loss) 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 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Change in fair value of financial assets designated at fair value through profit and loss	25.0	9.4	25.0	9.4
Change in fair value of financial liabilities designated at fair value through profit and loss	(25.3)	(8.6)	(25.3)	(8.6)
Derivatives in designated fair value hedge accounting relationships	81.7	6.3	42.8	19.4
Adjustment to hedged items in designated fair value hedge accounting relationships	(81.3)	(9.7)	(43.5)	(22.0)
Derivatives in designated cashflow hedge accounting relationships	–	(1.9)	–	(1.9)
Adjustments to hedged items in cashflow hedge accounting relationships	–	1.9	–	1.9
Cross currency swap	–	1.0	–	0.2
	0.1	**(1.6)**	**(1.0)**	**(1.6)**

The net position on the cross currency swap is composed of a fair value loss on a cross currency swap of £50.2m (2010: £22.0m loss) and an exchange gain of £50.2m (2010: £23.0m 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 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Rent receivable	1.6	1.4	0.5	0.5
Pension fund income	0.4	0.4	0.4	0.4
Net loss on exchange rate movements	(0.3)	(0.1)	(0.3)	(0.1)
	1.7	**1.7**	**0.6**	**0.8**

Notes to the Accounts continued

For the year ended 31 December 2011

8. Administrative Expenses

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Staff costs				
Wages and salaries	23.2	21.8	21.3	19.6
Social Security costs	2.2	2.1	2.1	1.9
Other pension costs	3.2	2.9	3.1	2.8
Remuneration of auditor (see below)	0.3	0.3	0.3	0.3
Other administrative expenses	16.8	16.2	15.8	15.6
	45.7	**43.3**	**42.6**	**40.2**

There are 32 directors, senior management and members of staff, whose actions have a material impact on the risk profile of the Society, with fixed remuneration of £3.1m and variable remuneration of £0.8m (2010: 31 individuals £2.7m and £0.7m).

The analysis of auditor's remuneration is as follows:

	Group & Society 2011 £'000	Group & Society 2010 £'000
Fees payable to the Society's auditor for the audit of the Society's annual accounts	111	106
Fees payable to the Society's auditor for the audit of the Society's subsidiaries pursuant to legislation	10	10
Total audit fees	**121**	**116**
Other services pursuant to legislation	–	–
Tax services	72	20
Further assurance services	30	28
Corporate services	19	–
Other services	60	67
Total non-audit fees	**181**	**115**
Fees payable to the Society's auditor and its associates in respect of associated pension schemes	4	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.

Leeds

Notes to the Accounts continued

For the year ended 31 December 2011

9. Directors' Emoluments

(a) Remuneration of Directors

A separate Report of the Remuneration Committee setting out remuneration policy for directors is on pages 21 to 22. Emoluments of the Society's directors, from the Society and its subsidiary undertakings, are detailed below.

	Salary £'000	Performance Related Pay £'000	Long Term Incentive £'000	Sub-total £'000	Increase in accrued pension(2) £'000	Society's contribution to pension scheme(1) £'000	Total £'000
Executive Directors – 2011							
I. W. Ward – retired 23 September 2011	265	179	88	532	8(3)	–	540
D. Pickersgill – retired as a Director 30 June 2011	133	–	–	133	4(4)	–	137
P. A. Hill	247	73	45	365	–	58	423
K. L. Rebecchi	183	57	28	268	(4)(4)	–	264
	828	**309**	**161**	**1,298**	**8**	**58**	**1,364**

Mr Pickersgill's emoluments have been calculated to 30 June 2011, the date on which he ceased to be a director of the Society. In line with his service contract he is eligible to long term health insurance cover payable until April 2013, amounting in total to £0.6m. See the Director's Remuneration Report for further details. Mr Ward's emoluments include an additional £50,490 under the Long Term Incentive Plan following retirement.

	Salary £'000	Performance Related Pay £'000	Long Term Incentive £'000	Sub-total £'000	Increase in accrued pension £'000	Society's contribution to pension scheme(1) £'000	Total £'000
Executive Directors – 2010							
I. W. Ward	333	107	34	474	6(3)	–	480
D. Pickersgill	237	67	24	328	7	–	335
P. A. Hill	177	57	18	252	–	35	287
K. L. Rebecchi	161	52	16	229	19	–	248
	908	**283**	**92**	**1,283**	**32**	**35**	**1,350**

Notes:
1. Defined contribution pension scheme.
2. No Directors received any benefits in 2011 (2010 nil).
3. This Director ceased pensions accrual in 2010.
4. These Directors ceased to be active members of the scheme in 2011.

Non-executive Directors	**2011 Fees £'000**	**2010 Fees £'000**
R. A. Smith (Chairman)	94	71
S. R. G. Booth (Vice Chairman) – resigned 23 September 2011	36	50
C. M. Kavanagh	38	37
J. N. Anderson	38	37
A. Rajguru	39	37
I. Robertson	44	42
R. W. Stott	44	37
L. M. Platts – appointed 26 October 2010	40	7
R. J. Ashton – appointed 26 April 2011	27	–
I. Marshall – resigned 12 February 2010	–	5
	400	**323**

Notes to the Accounts continued

For the year ended 31 December 2011

9. Directors' Emoluments continued

(b) Pension benefits earned by Executive Directors

	Defined benefit scheme				
	Increase/ (Decrease) in accrued penson 2011[2]	Accrued pension as at 31 December 2011[3]	Transfer value of accrued pension at 31 December 2010[4]	Transfer value of accrued pension at 31 December 2011[4]	Increase/ (Decrease) in transfer value over the year net of Directors' Contributions
	£'000	£'000	£'000	£'000	£'000
I. W. Ward[5]	8	104	2,615	2,569	(46)
D. Pickersgill[6]	4	117	2,519	3,113	597
K. L. Rebecchi[6]	(4)	74	895	1,140	237

Notes:

1. The accrued pensions and transfer values set out in the table include benefits that are to be provided through an unfunded Employer Financed Retirement Benefit Scheme as well as those 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 pensions are the amounts which the directors would be entitled to from normal retirement age if they left service at the relevant date.
4. The transfer values have been calculated in accordance with Transfer Values Amendment Regulations 2008.
5. This Director ceased to accrue benefits in 2010.
6. These Directors ceased to accrue benefits in the Registered Pension Scheme in 2011.

(c) Directors' Loans, Transactions and Related Business Activity

The aggregate amount outstanding at 31 December 2011 in respect of loans from the Society or a subsidiary undertaking to Directors of the Society or persons associated with Directors was £278,600 being three mortgages to Directors and persons connected to Directors and one mortgage to a person connected with a Director (2010: £217,800 being two 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.

10. Staff Numbers

	Group 2011 No	Group 2010 No	Society 2011 No	Society 2010 No
The average number of persons employed during the year was as follows:				
Head office	511	495	511	495
Branch offices	415	425	377	383
	926	**920**	**888**	**878**

Leeds

Notes to the Accounts continued

For the year ended 31 December 2011

11. 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 2011				
Collective impairment	9.0	10.0	0.9	19.9
Individual impairment	17.7	24.4	3.4	45.5
	26.7	**34.4**	**4.3**	**65.4**
Income and expenditure account				
Charge for the year				
Collective impairment	7.4	7.9	(0.5)	14.8
Individual impairment	23.1	11.7	–	34.8
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(0.6)	(0.5)	–	(1.1)
	29.9	**19.1**	**(0.5)**	**48.5**
Amount written off during the year				
Individual impairment	(11.3)	(14.1)	(0.7)	(26.1)
At 31 December 2011				
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**

Society	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loans £M	Total £M
At 1 January 2011				
Collective impairment	9.0	10.0	0.9	19.9
Individual impairment	17.7	24.4	3.4	45.5
	26.7	**34.4**	**4.3**	**65.4**
Income and expenditure account				
Charge for the year				
Collective impairment	7.4	7.9	(0.5)	14.8
Individual impairment	23.1	11.7	–	34.8
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(0.6)	(0.5)	–	(1.1)
	29.9	**19.1**	**(0.5)**	**48.5**
Amount written off during the year				
Individual impairment	(11.3)	(14.1)	(0.7)	(26.1)
At 31 December 2011				
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**

Notes to the Accounts continued

For the year ended 31 December 2011

12. Income Tax Expense

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Analysis of charge in the year				
Current tax				
UK corporation tax on profits of the year	13.4	12.0	11.7	10.1
Adjustments in respect of previous years	(0.1)	(0.6)	(0.1)	(0.6)
Total current tax	13.3	11.4	11.6	9.5
Deferred tax				
Origination and reversal of timing differences	0.2	(0.1)	0.1	(0.1)
Adjustments in respect of previous years	0.1	–	0.1	–
Total deferred tax	0.3	(0.1)	0.2	(0.1)
Tax on profit on ordinary activities	**13.6**	**11.3**	**11.8**	**9.4**
Factors affecting current tax charge for the year:				
Profit on ordinary activities before tax	50.2	42.2	62.0	35.6
Profit on ordinary activities multiplied by standard rate of corporate tax in the UK of 26.5% (2010: 28%)	13.3	11.8	16.5	10.0
Effects of:				
Expenses not deductible for tax purposes	0.2	0.1	0.4	0.1
Adjustment in respect of prior years	–	(0.6)	–	(0.7)
Affects of rate change	0.1	–	0.1	–
Group relief surrendered	–	–	(0.1)	–
Income not taxable	–	–	(5.1)	–
	13.6	**11.3**	**11.8**	**9.4**

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 2011, which was substantively enacted in July 2011, included provisions to reduce the rate of corporation tax to 26% with effect from 1 April 2011 and 25% with effect from 1 April 2012. Accordingly, deferred tax balances have been revalued to the lower rate of 25% in these accounts.

The government has announced that it intends to further reduce the rate of corporation tax to 24% with effect from 1 April 2013 and 23% from 1 April 2014. As this legislation was not substantively enacted by 31 December 2011, 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 25% to 23% 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.

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

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Cash in hand	2.3	2.1	2.3	2.1
Balances with the Bank of England	184.6	113.8	184.6	113.8
Included in cash and cash equivalents (see note 30)	**186.9**	**115.9**	**186.9**	**115.9**

Balances with the Bank of England do not include mandatory reserve deposits of £7.7m (2010: £7.4m) 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 2011

14. 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	Cross currency interest rate swaps and foreign 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 2011

14. Derivative Financial Instruments continued

The Group utilises the following derivative instruments for hedging purposes:

	Group 2011			Group 2010		
	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	3,127.7	52.3	(90.4)	3,885.4	20.2	(110.4)
Derivatives designated as cash flow hedges:						
Interest rate swaps	–	–	–	20.0	–	–
Other derivatives held at fair value:						
Quanto swaps	59.0	–	(0.3)	89.3	0.1	(0.3)
Inflation linked swaps	–	–	–	3.0	0.1	–
Equity swaps	439.5	36.4	(52.3)	416.6	35.2	(30.1)
Cross currency swaps	900.6	50.6	(2.7)	738.8	70.8	(2.9)
Floating swaps	306.2	0.2	(1.0)	41.7	–	–
Options	2.2	–	–	7.9	–	(0.2)
Total	1,707.5	87.2	(56.3)	1,297.3	106.2	(33.5)
Total derivative assets/(liabilities) held for hedging	**4,835.2**	**139.5**	**(146.7)**	**5,202.7**	**126.4**	**(143.9)**

	Society 2011			Society 2010		
	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	2,627.7	23.8	(90.4)	3,635.4	20.2	(97.3)
Derivatives designated as cash flow hedges:						
Interest rate swaps	–	–	–	20.0	–	–
Other derivatives held at fair value:						
Quanto swaps	59.0	–	(0.3)	89.3	0.1	(0.3)
Inflation linked swaps	–	–	–	3.0	0.1	–
Equity swaps	439.5	36.4	(52.3)	416.6	35.2	(30.1)
Cross currency swaps	817.0	49.3	–	738.8	68.7	(2.8)
Floating swaps	306.2	0.2	(1.0)	41.7	–	–
Options	2.2	–	–	7.9	–	(0.2)
Total	1,623.9	85.9	(53.6)	1,297.3	104.1	(33.4)
Total derivative assets/(liabilities) held for hedging	**4,251.6**	**109.7**	**(144.0)**	**4,952.7**	**124.3**	**(130.7)**

The Society no longer has any cash flow hedges (2010: nil).

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 2011

15. Loans and Advances to Customers

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
(a) Loans and receivables				
Loans fully secured on residential property	6,808.9	6,466.7	6,808.7	6,466.3
Other loans				
Loans fully secured on land	504.9	544.7	504.9	544.7
Other loans	3.7	5.9	3.7	5.9
Fair value adjustment for hedge risk	81.2	73.3	81.2	73.3
	7,398.7	**7,090.6**	**7,398.5**	**7,090.2**
(b) At fair value through profit and loss				
Loans fully secured on residential property	61.7	94.4	61.7	94.4
Other loans	173.3	168.3	173.3	168.3
Fair value adjustment for hedge risk	50.8	26.5	50.8	26.5
	285.8	**289.2**	**285.8**	**289.2**
Less:				
Impairment losses (see note 11)	(87.8)	(65.4)	(87.8)	(65.4)
	7,596.7	**7,314.4**	**7,596.5**	**7,314.0**

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 £24.4m (2010: £5.4m loss) for both the Group and Society.

Loans and advances to customers include £1.1bn (2010: £1.5bn) for both the Group and Society which have been transferred from the Society to Leeds Building Society Covered Bonds LLP, a limited Liability Partnership which is consolidated by the Group. The loans secure £0.6bn (2010: £0.9bn) of covered bonds issued by the Society. The covered bonds have been used to enable the Group to participate in the Bank of England's Special Liquidity Scheme, the loans of which were fully repaid in 2011, and secure long term funding from other counterparties. The loans are retained on the Society's balance sheet as the Society substantially retains the risk and reward relating to the loans.

Loans and advances to customers include an unlisted equity investment of 628,089 shares which originated from a restructure of a commercial loan and which has been fair valued at nil (2010: nil).

16. Investment Securities

	Group & Society 2011 £M	Group & Society 2010 £M
Debt securities		
Listed	1,330.9	1,296.4
Unlisted	382.3	435.0
Total investment securities	**1,713.2**	**1,731.4**

Investment securities increased by £7.7m in 2011 (2010: increased by £1.2m) 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 2011 (2010: nil).

Notes to the Accounts continued

For the year ended 31 December 2011

16. Investment Securities continued

The movement in investment securities is summarised as follows:

	Available for sale £M	Loans and receivables £M	Total £M
Group and Society			
At 1 January 2011	1,296.6	434.8	1,731.4
Additions	3,645.7	–	3,645.7
Disposals (sale and redemption)	(3,470.6)	(201.0)	(3,671.6)
Change in fair value	3.4	4.3	7.7
At 31 December 2011	**1,475.1**	**238.1**	**1,713.2**

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 2011 was £238.1m (2010: £434.8m) and this compares with the market value of £218.2m (2010: £427m).

The fair value gain that would have been recorded directly in reserves if the assets had not been reclassified was £13m (2010: £22m 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 £248m (2010: £460m).

The net loss, after deferred tax, of £3.7m (2010: £9.3m) 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 and floating rate note assets was 1.19% and 1.34% respectively (2010: 0.90% and 0.91%).

At 31 December 2011, £403.9m (2010: £221.6m) of investment securities were pledged as collateral under sale and repurchase agreements.

Notes to the Accounts continued

For the year ended 31 December 2011

17. Investments in subsidiary undertakings

	Society 2011 £M	Society 2010 £M
(a) Shares held in subsidiary undertakings		
Cost		
At 1 January 2011	19.6	19.6
At 31 December 2011	**19.6**	**19.6**
(b) Loans to subsidiary undertakings		
Cost		
At 1 January 2011	–	–
Additions	8.9	–
Repayments	–	–
At 31 December 2011	**8.9**	**–**
Total investments in subsidiary undertakings	**28.5**	**19.6**

(c) Other investment

	Group & Society	
	2011 £M	2010 £M
Investments in Mutual Vision Technologies Ltd	–	0.1

The Society sold all of its interest in Mutual Vision Technologies Ltd during the year for a profit of £nil. The Society has no other investments.

(d) 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	*	*

* 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 dividends totalling £15m from Leeds Financial Services Ltd and £3.9m from Mercantile Asset Management Ltd during 2011 (2010: £nil).

Notes to the Accounts continued

For the year ended 31 December 2011

18. 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 2011	23.1	0.3	1.4	23.1	0.1	48.0
Additions	–	–	–	1.5	–	1.5
Disposals	–	–	–	–	–	–
At 31 December 2011	**23.1**	**0.3**	**1.4**	**24.6**	**0.1**	**49.5**
Depreciation and impairment						
At 1 January 2011	0.3	–	1.3	19.4	0.1	21.1
Charged in year	–	–	–	0.9	–	0.9
Disposals	–	–	–	–	–	–
At 31 December 2011	**0.3**	**–**	**1.3**	**20.3**	**0.1**	**22.0**
Net book value						
At 31 December 2011	**22.8**	**0.3**	**0.1**	**4.3**	**–**	**27.5**
At 31 December 2010	**22.8**	**0.3**	**0.1**	**3.7**	**–**	**26.9**
(b) Society						
Cost or valuation						
At 1 January 2011	23.1	0.3	1.4	23.1	–	47.9
Additions	–	–	–	1.5	–	1.5
Disposals	–	–	–	–	–	–
At 31 December 2011	**23.1**	**0.3**	**1.4**	**24.6**	**–**	**49.4**
Depreciation						
At 1 January 2011	0.3	–	1.3	19.4	–	21.0
Charged in year	–	–	–	0.9	–	0.9
Disposals	–	–	–	–	–	–
At 31 December 2011	**0.3**	**–**	**1.3**	**20.3**	**–**	**21.9**
Net book value						
At 31 December 2011	**22.8**	**0.3**	**0.1**	**4.3**	**–**	**27.5**
At 31 December 2010	**22.8**	**0.3**	**0.1**	**3.7**	**–**	**26.9**

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 2011

18. Property, Plant and Equipment continued

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £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 £0.7m (2010: £0.7m). The related cumulative depreciation of £0.7m (2010: £0.7m) includes £nil charged during the year (2010: £nil).

19. Investment Properties

	Group 2011 £M	Society 2011 £M
At 1 January 2011	7.0	–
Net fair value movement	(0.3)	–
At 31 December 2011	**6.7**	**–**

The investment property was acquired on 31 December 2009 for £7.0m. The investment property was valued as at 31 December 2011 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.

20. Deferred Income Tax

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Deferred tax				
At 1 January 2011	0.8	(0.2)	–	(1.0)
Amount recognised directly in equity	0.5	0.9	0.5	0.9
Income and expenditure movement during the year	(0.3)	0.1	(0.2)	0.1
At 31 December 2011	**1.0**	**0.8**	**0.3**	**–**

Notes to the Accounts continued

For the year ended 31 December 2011

20. Deferred Income Tax continued

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Deferred income tax liabilities				
Gain on revaluation	0.6	0.6	0.6	0.6
Cash flow hedges	–	0.6	–	0.6
Other temporary differences	0.7	0.8	0.6	0.8
	1.3	**2.0**	**1.2**	**2.0**

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Deferred income tax assets				
Pensions and other post retirement benefits	0.2	0.2	0.2	0.2
Excess of capital allowances over depreciation	0.2	0.3	0.2	0.3
Other provisions	1.9	2.3	1.1	1.5
	2.3	**2.8**	**1.5**	**2.0**

21. Other Assets, Prepayments and Accrued Income

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
	107.2	**93.4**	**105.1**	**91.5**

Other assets include £94.9m (2010: £81.7m) owed by credit institutions on cash collateralisation of swaps.

22. Shares

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Held by individuals	7,296.1	6,977.4	7,296.1	6,977.4
Other shares	8.9	10.4	8.9	10.4
Fair value adjustment for hedge risk	49.2	37.4	49.2	37.4
	7,354.2	**7,025.2**	**7,354.2**	**7,025.2**

Shares have either variable or fixed interest rates.

Notes to the Accounts continued

For the year ended 31 December 2011

23. Amounts Owed to Credit Institutions

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
	355.6	**482.6**	**355.6**	**482.6**

All amounts owed to credit institutions have fixed interest rates.
Amounts owed to credit institutions include £nil (2010: £297.9m) for both the Group and Society for which the underlying security was the covered bond programme secured on certain loans and advances to customers.

24. Amounts owed to other customers

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Amounts owed to subsidiary undertakings	–	–	26.6	31.6
Other deposits	508.3	439.4	508.3	439.4
	508.3	**439.4**	**534.9**	**471.0**

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

25. Debt Securities in Issue

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Certificates of deposit	154.4	63.3	154.4	63.3
Floating rate notes	17.1	426.6	17.1	426.6
Covered bonds	644.2	270.2	615.8	282.7
	815.7	**760.1**	**787.3**	**772.6**

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.

26. Other Liabilities and Accruals

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Income tax	8.9	7.8	9.1	7.8
Accruals	11.0	9.3	10.5	9.0
Other creditors	71.4	91.8	52.3	89.4
	91.3	**108.9**	**71.9**	**106.2**

Included within other creditors is a liability for financial guarantee contracts of £3.2m (2010: £3.2m).

Other creditors includes £56.4m (2010: £73.8m) owed to credit institutions on cash collateralisation of swaps.

Notes to the Accounts continued

For the year ended 31 December 2011

27. Provisions for Liabilities and Charges

Group	FSCS levy £M	Customer redress and other related provisions £M	Commission Clawback £M	Total £M
At 1 January 2011	4.2	0.3	0.5	5.0
Amounts paid during the year	(2.2)	–	–	(2.2)
Provision increase in the year	3.4	–	–	3.4
At 31 December 2011	**5.4**	**0.3**	**0.5**	**6.2**
Society				
At 1 January 2011	4.2	0.1	–	4.3
Amounts paid during the year	(2.2)	–	–	(2.2)
Provision increase in the year	3.4	–	–	3.4
At 31 December 2011	**5.4**	**0.1**	**–**	**5.5**

Financial Services Compensation Scheme (FSCS) Levy

The levy represents the balance of the estimated amount payable under the FSCS for the periods to March 2012 and to March 2013 calculated with reference to the protected deposits held at 31 December 2010 and 2011. Refer to note 31 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.

28. Subordinated Liabilities

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £M
Subordinated debt notes 2015	**0.9**	**0.9**	**0.9**	**0.9**

The subordinated debt has a fixed interest rate of 4.34% (2010: 4.34%) and a maturity date of 9 March 2015. The debt is subordinated to the claims of members and all other creditors.

29. Subscribed Capital

	Group 2011 £M	Group 2010 £M	Society 2011 £M	Society 2010 £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 2011

30. 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	
	2011 £M	2010 £M	2011 £M	2010 £M
Cash in hand and balances with the Bank of England (note 13)	186.9	115.9	186.9	115.9
Loans and advances to credit institutions	74.1	79.9	54.1	79.9
	261.0	**195.8**	**241.0**	**195.8**

31. 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. Due to the inherent uncertainty in respect to this matter, the ultimate liability for the Society is presently unknown. 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 2011 (2010: nil) contracted but not provided for.

Notes to the Accounts continued

For the year ended 31 December 2011

31. 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	
	2011 £M	**2010 £M**
Land and buildings		
Commitment expiring:		
Within one year	0.2	0.3
Between two and five years inclusive	0.5	0.4
After five years	0.9	1.1
	1.6	**1.8**
Other operating leases		
Commitment expiring:		
Within five years	1.0	1.4
	1.0	**1.4**
(e) Irrevocable loan facility commitments	–	1.2

32. Retirement Benefit Obligations

The Society operates both defined benefit and defined contribution schemes including the Mercantile Building Society Retirement and Death Benefit Plan. The total cost charged to income during the year relating to defined contribution schemes was £0.9m (2010: £0.8m). As at 31 December 2011, contributions of £0.1m (2010: £0.1m) due in respect of the current reporting period had not been paid over to the 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				
	2011	**2010**	**2009**	**2008**	**2007**
Rate of increase in salaries	4.80%	5.70%	5.80%	5.30%	5.40%
Rate of increase for pensions in payment*	3.00%	3.60%	3.69%	3.25%	3.40%
Rate of increase for deferred pensions*	3.05%	3.70%	3.80%	3.30%	3.40%
Discount rate	4.85%	5.55%	5.85%	6.20%	5.80%
Inflation assumption RPI	3.05%	3.70%	3.80%	3.30%	3.40%
Inflation assumption CPI	2.05%	3.20%	n/a	n/a	n/a
Expected return on assets	4.65%	6.07%	6.65%	5.86%	7.00%

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

Notes to the Accounts continued

For the year ended 31 December 2011

32. 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 including the medium cohort effect and a 0.5% (2010: 0.5%) underpin for members. 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.

	2011		2010		2009	
	Pensioner	**Non-pensioner**	**Pensioner**	**Non-pensioner**	**Pensioner**	**Non-pensioner**
Male	23	24	23	24	23	24
Female	25	27	25	27	25	27

	Group & Society				
Category of assets	**2011**	**2010**	**2009**	**2008**	**2007**
Equities	51.7%	53.7%	63.2%	54.4%	59.0%
Property	5.4%	5.5%	5.8%	6.8%	3.5%
Government bonds	21.3%	20.2%	20.1%	26.0%	24.9%
Corporate bonds	21.0%	19.9%	10.1%	12.6%	11.6%
Cash/other	0.6%	0.7%	0.8%	0.2%	1.0%

	Group & Society				
Reconciliation of funded statement	**2011 £M**	**2010 £M**	**2009 £M**	**2008 £M**	**2007 £M**
Present value of pension scheme's liabilities	(78.6)	(74.6)	(71.9)	(60.7)	(64.3)
Assets at fair value	77.7	73.9	68.9	57.7	62.8
Deficit	**(0.9)**	**(0.7)**	**(3.0)**	**(3.0)**	**(1.5)**

The amounts recognised in the Income Statements are as follows:

	Group & Society	
	2011 £M	**2010 £M**
Current service cost	2.1	2.0
Prior service cost	0.2	0.2
Interest cost	4.1	4.2
Expected return on plan assets	(4.5)	(4.6)
Total cost – defined benefit scheme	**1.9**	**1.8**

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 2011

32. Retirement Benefit Obligations continued

Experience recognised in the Statements of Comprehensive Income (SOCI)

	Group & Society				
	2011 £M	**2010 £M**	**2009 £M**	**2008 £M**	**2007 £M**
Experience gain/(loss) on pension scheme liabilities	0.3	(2.3)	(7.2)	7.6	2.7
Percentage of scheme liabilities (%)	0.4%	(3.1%)	(10.0%)	12.4%	4.2%
Experience (loss)/gain on assets	(1.7)	3.2	6.1	(11.7)	(1.5)
Percentage of scheme liabilities (%)	(2.2%)	4.3%	8.9%	(18.6%)	(2.4%)
Total (losses)/gains recognised in SOCI during the year	**(1.4)**	**0.9**	**(1.1)**	**(4.1)**	**1.2**

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

	Group & Society	
	2011 £M	**2010 £M**
At 1 January 2011	74.6	71.9
Current service cost	2.1	2.0
Interest cost	4.1	4.2
Prior service cost	0.2	0.2
Employee contributions	–	–
Actuarial (gain)/loss	(0.3)	2.3
Benefits paid	(2.1)	(6.0)
At 31 December 2011	**78.6**	**74.6**

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

	Group & Society	
	2011 £M	**2010 £M**
At 1 January 2011	73.9	68.9
Expected return	4.5	4.6
Actuarial (loss)/gain	(1.7)	3.2
Contribution by employer	3.1	3.2
Employee contributions	–	–
Benefits paid	(2.1)	(6.0)
At 31 December 2011	**77.7**	**73.9**

The cumulative amount of actuarial gains and losses recognised in the other comprehensive income statement since the date of transition to IFRSs is £6.3m (2010: £4.8m).

Estimated contributions for 2012 financial year

	2012 £M
Estimated contributions in Financial Year 2012	3.1
Estimated employee contributions in Financial Year 2012	–
Estimated Total contributions in Financial Year 2012	**3.1**

Notes to the Accounts continued

For the year ended 31 December 2011

33. 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 17.

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	
	2011 £M	2010 £M	2011 £M	2010 £M
Loans payable to the Society				
Loans outstanding at 1 January 2011	–	–	0.2	0.3
Net movement during the year	8.9	–	0.1	(0.1)
Loans outstanding at 31 December 2011	**8.9**	**–**	**0.3**	**0.2**
Deposits payable by the Society				
Deposits outstanding at 1 January 2011	31.6	30.8	2.8	2.2
Net movement during the year	(5.0)	0.8	(1.2)	0.6
Deposits outstanding at 31 December 2011	**26.6**	**31.6**	**1.6**	**2.8**
Net interest income				
Interest receivable	–	–	–	–
Interest expense	–	–	–	0.1

	2011 £M	2010 £M
Directors' emoluments (see note 9)		
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 (2010: three).
One Director is a member of the defined contribution section of the Leeds Building Society Pension Scheme (2010: one).

Notes to the Accounts continued

For the year ended 31 December 2011

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

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 on retirement benefit obligations	(1.4)	0.5	(0.9)
Other comprehensive income	**6.3**	**(1.6)**	**4.7**

2010
Group & Society

	Before tax Amount £M	Tax benefit/ (expense) £M	Net of tax Amount £M
Revaluation reserve	(5.3)	1.6	(3.7)
Available for sale investment securities	0.8	(0.2)	0.6
Cash flow hedges	(1.9)	0.5	(1.4)
Actuarial gain on retirement benefit obligations	0.9	(0.2)	0.7
Other comprehensive income	**(5.5)**	**1.7**	**(3.8)**

35. 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, and liquidity 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 Directors and other senior managers.

Notes to the Accounts continued

For the year ended 31 December 2011

35. 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, there has been a change in the way credit risk concentrations are identified within a portfolio of assets following the change in economic stresses exhibited by some European countries. Assets held in Ireland or Spain are, in some cases, considered to exhibit different risk characteristics to similar assets in the same portfolio.

The table below shows the split of the Group's loans and advances.

	Group 2011		Group 2010	
	£M	%	£M	%
Retail lending:				
Secured on residential property	6,870.6	91.0	6,561.1	90.1
Of which: Irish loan book	*179.1*	*2.4*	*186.0*	*2.6*
Other loans	177.0	2.3	174.2	2.4
Commercial lending	504.9	6.7	544.7	7.5
Gross balances	**7,552.5**	**100.0**	**7,280.0**	**100.0**
Impairment provisions	(87.8)		(65.4)	
Of which: Irish loan book	*(15.2)*		*(5.7)*	
Fair value adjustment	132.0		99.8	
	7,596.7		**7,314.4**	

35. 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 unsecured personal 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 2011. The balances exclude the fair value adjustment for hedge risk and impairment losses. The table includes £25.2m (2010: £14.4m) of loans and advances secured on residential property in Ireland that are past due and £1.6m (2010: £0.8m) in possession. The table also includes £229m of residential loans classified as neither past due nor impaired that have switched to interest only, extended the mortgage term or been subject to some other forbearance measures during the year. Comparatives are not available.

	Group & Society Residential		Group & Society Other[1]	
	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	0.6	0.3
– Past due 6 to 12 months	70.3	1.0	–	–
– Past due over 12 months	46.6	0.7	–	–
– Possessions	28.3	0.4	–	–
	6,874.1	**100.0**	**177.0**	**100.0**

Note:

1) Other loans include lifetime mortgages (£173.3m) and unsecured personal loans (£3.7m).

	Group & Society Residential		Group & Society Other	
	2010 £M	2010 %	2010 £M	2010 %
Not impaired:				
– neither past due nor impaired	6,074.3	92.6	170.6	97.9
– Past due up to 3 months but not impaired	271.3	4.1	–	–
Impaired:				
– Past due 3 to 6 months	86.8	1.3	–	–
– Past due 6 to 12 months	68.0	1.0	3.6	2.1
– Past due over 12 months	42.9	0.7	–	–
– Possessions	17.8	0.3	–	–
	6,561.1	**100.0**	**174.2**	**100.0**

£84m (2010: £66m) of loans that would be past due or impaired have had their terms renegotiated in 2011.

Loans in the analysis above which have 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 2011

35. Risk Management and Control continued

Fair value of collateral held for residential loans:

	Group & Society Residential 2011 £M	Group & Society Residential 2010 £M
Not individually impaired	13,049.3	12,659.4
Impaired	250.4	262.5
Possessions	24.9	18.8
	13,324.6	**12,940.7**

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 2011 %	Group & Society 2010 %
Secured on residential property		
<70%	51.8	54.3
70% – 80%	17.8	15.9
80% – 90%	15.0	14.6
>90%	15.4	15.2
	100.0	**100.0**

The overall indexed loan-to-value of the residential portfolio is 51% (2010: 50%).

The indexed loan-to-value on the lifetime mortgage portfolio is 32% (2010: 30%). The collateral held amounts to £529m (2010: £560m).

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 2011. The balances exclude the fair value adjustment for hedge risk and impairment losses.

	Group & Society Commercial		Group & Society Commercial	
	2011 £M	2011 %	2010 £M	2010 %
Not impaired:				
– neither past due nor impaired	460.2	91.1	483.3	88.7
– Past due up to 3 months but not impaired	1.8	0.4	11.2	2.1
Impaired:				
– Past due 3 to 6 months	–	–	3.4	0.6
– Past due 6 to 12 months	0.2	–	–	–
– Past due over 12 months	7.0	1.4	20.1	3.7
– Possessions	35.7	7.1	26.7	4.9
	504.9	**100.0**	**544.7**	**100.0**

No loans (2010: £13.3m) that would be past due or impaired have had their terms renegotiated during 2011.

Loans in the analysis above which have 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.

Notes to the Accounts continued

For the year ended 31 December 2011

35. Risk Management and Control continued

Fair value of collateral held:

	Group & Society 2011 £M	Group & Society 2010 £M
Not individually impaired	502.2	513.6
Impaired	3.5	21.6
Possessions	32.2	17.0
	537.9	**552.2**

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 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	
	2011 £M	2011 %	2010 £M	2010 %
Leisure and Hotel	12.1	2.4	11.6	2.1
Retail	153.5	30.4	164.5	30.2
Offices	205.4	40.7	210.6	38.7
Commercial investment and industrial units	92.0	18.2	102.0	18.7
Miscellaneous	41.9	8.3	56.0	10.3
	504.9	**100.0**	**544.7**	**100.0**

c) Wholesale lending

At 31 December 2011 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.

93.9% (2010: 94.8%) 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 2011:

	Group & Society		Group & Society	
	2011 £M	2011 %	2010 £M	2010 %
Aaa	1,440.7	72.8	1,246.5	64.6
Aa1	8.3	0.4	10.0	0.5
Aa2	13.0	0.7	14.5	0.8
Aa3	96.5	4.9	269.3	13.9
A1	51.7	2.6	193.6	10.0
A2	154.9	7.8	61.6	3.2
A3	93.2	4.7	34.8	1.8
Baa1	33.6	1.7	35.7	1.8
Baa2	4.0	0.2	26.8	1.4
Baa3	–	–	21.5	1.1
Ba1	14.5	0.7	–	–
Ba2	10.9	0.5	–	–
Caa2	11.7	0.6	–	–
Unrated:				
UK Building Societies	26.0	1.3	5.8	0.3
Other	20.8	1.1	12.0	0.6
	1,979.8	**100.0**	**1,932.1**	**100.0**

The Society investment portfolio mirrors the Group except in its holdings of Aaa rated investments where the value held is £1,421.1m (2010: £1,246.5m) and in its holdings of Aa2 rated investments where the value held is £12.5m (2010: £14.0m).

Notes to the Accounts continued

For the year ended 31 December 2011

35. Risk Management and Control continued

Geographical exposure:

	Group & Society 2011 £M	Group & Society 2011 %	Group & Society 2010 £M	Group & Society 2010 %
UK	1,734.0	87.6	1,512.0	78.3
Rest of Europe	181.9	9.2	345.9	17.8
Of which:				
Greece	–	–	–	–
Portugal	–	–	*1.7*	*0.1*
Ireland	*21.1*	*1.1*	*21.3*	*1.1*
Italy	–	–	*19.3*	*1.0*
Spain	*3.4*	*0.2*	*25.2*	*1.3*
France	–	–	–	–
North America	48.5	2.4	32.2	1.7
Australasia	15.4	0.8	36.9	1.9
Far East	–	–	5.1	0.3
Total	**1,979.8**	**100.0**	**1,932.1**	**100.0**

The Society's geographical exposure is equal to the Group's except it holds £1,714.0m (2010: £1,511.7m) in the UK.

£0.2m (2010: £0.2m) of the exposures to Ireland relates to Mandatory Deposits held with the Central Bank of Ireland.

The market value of assets held in European countries affected significantly by the Eurozone crisis is shown in the table below. None of the assets have been impaired in the year and the Society's intention is to hold them until maturity.

	Group & Society 2011 £M
Ireland	19.0
Spain	2.8
Total	**21.8**

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 2011

35. Risk Management and Control continued

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

	Group 2011			Group 2010		
	Notional principal amount £M	Credit risk weighted amount £M	Replacement cost £M	Notional principal amount £M	Credit risk weighted amount £M	Replacement cost £M
Interest rate swaps	4,434.6	34.7	122.6	4,463.8	81.6	55.6
Cross currency swaps	400.6	4.1	16.9	738.9	78.8	70.8
	4,835.2	**38.8**	**139.5**	**5,202.7**	**160.4**	**126.4**
Under one year	1,059.1	3.1	22.7	2,236.6	86.0	78.6
Between one and five years	2,162.6	11.5	53.5	1,823.7	55.8	46.4
Over five years	1,613.5	24.2	63.3	1,142.4	18.6	1.4
	4,835.2	**38.8**	**139.5**	**5,202.7**	**160.4**	**126.4**

	Society 2011			Society 2010		
	Notional principal amount £M	Credit risk weighted amount £M	Replacement cost £M	Notional principal amount £M	Credit risk weighted amount £M	Replacement cost £M
Interest rate swaps	3,934.6	27.2	94.1	4,213.8	77.9	53.5
Cross currency swaps	317.0	3.6	15.6	738.9	78.8	70.8
	4,251.6	**30.8**	**109.7**	**4,952.7**	**156.7**	**124.3**
Under one year	1,059.1	3.1	22.7	2,236.6	86.0	78.6
Between one and five years	2,079.0	11.0	52.2	1,823.7	55.8	46.4
Over five years	1,113.5	16.7	34.8	892.4	14.9	1.4
	4,251.6	**30.8**	**109.7**	**4,952.7**	**156.7**	**126.4**

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 2011

35. 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 2011. 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 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)	–

Notes to the Accounts continued

For the year ended 31 December 2011

35. Risk Management and Control continued

31 December 2010	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	1,156.7	378.6	173.2	210.1	4.7	–	8.8	1,932.1
Loans fully secured on residential property and other loans	3,921.3	647.2	339.7	1,872.5	430.1	–	103.6	7,314.4
Property, plant and equipment	–	–	–	–	–	–	26.9	26.9
Investment properties	–	–	–	–	–	–	7.0	7.0
Other assets	–	–	–	–	–	–	222.7	222.7
Total assets	**5,078.0**	**1,025.8**	**512.9**	**2,082.6**	**434.8**	**–**	**369.0**	**9,503.1**
Liabilities								
Shares	3,777.8	364.4	555.3	2,123.1	70.1	–	134.5	7,025.2
Amounts owed to credit institutions, other customers and debt securities in issue	1,370.5	54.6	20.3	3.0	228.1	–	5.6	1,682.1
Other liabilities	–	–	–	–	–	–	264.7	264.7
Subordinated debt	–	–	–	0.9	–	–	–	0.9
Subscribed capital	–	–	–	–	–	25.0	–	25.0
Reserves	–	–	–	–	–	–	505.2	505.2
Total liabilities	**5,148.3**	**419.0**	**575.6**	**2,127.0**	**298.2**	**25.0**	**910.0**	**9,503.1**
Effect of derivative items	598.6	(759.7)	236.3	80.7	(155.9)	–	–	–
Interest rate sensitivity gap	528.3	(152.9)	173.6	36.3	(19.3)	(25.0)	(541.0)	–

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 2011 £M	Group & Society –100bps 2011 £M	Group & Society +100bps 2010 £M	Group & Society –100bps 2010 £M
Impact on equity reserves	12.4	(26.3)	8.9	(17.2)
Impact on profit and loss	2.9	(2.7)	3.2	(4.9)

Notes to the Accounts continued

For the year ended 31 December 2011

35. 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	
	2011 £M	2010 £M	2011 £M	2010 £M
Euro	439.5	789.1	439.5	789.1

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) 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.

35. Risk Management and Control continued

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.

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 (2010: £90m with two banks) of which £nil (2010: £nil) was drawn at the year end. The weighted average period until maturity of those facilities was nil years (2010: 0.4 years).

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

	Group & Society		Group & Society	
	2011	2011	2010	2010
	£M	%	£M	%
Cash in hand and balances with the Bank of England	184.6	9.3	113.8	5.9
Deposits with Financial Institutions	72.4	3.7	69.4	3.6
UK Government Securities	975.2	49.2	810.3	41.9
Certificates of deposit	382.3	19.3	435.1	22.5
Floating rate notes	46.3	2.3	154.8	8.0
Fixed rate bonds	92.4	4.7	51.4	2.7
UK RMBS	198.4	10.0	279.9	14.5
Covered bonds	17.1	0.9	–	–
Other	11.1	0.6	17.4	0.9
	1,979.8	**100.0**	**1,932.1**	**100.0**

The Society's liquidity portfolio is equal to the Group's except it has £59.6m (2010: £68.9m) 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 82.9% (2010: 95.3%) are in AAA rated tranches with the remainder in AA 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 $13^3/_8$% payable semi-annually for an indeterminate period.

Notes to the Accounts continued

For the year ended 31 December 2011

35. 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**

31 December 2010	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	4,708.5	175.6	556.1	1,654.9	68.4	7,163.5
Amounts owed to credit institutions, other customers and debt securities in issue	427.5	670.3	97.9	352.2	310.9	1,858.8
Subordinated debt	–	–	–	0.9	–	0.9
Other liabilities	120.8	–	–	–	–	120.8
Subscribed capital	–	–	–	–	25.0	25.0
Reserves	–	–	–	–	505.2	505.2
Total liabilities	**5,256.8**	**845.9**	**654.0**	**2,008.0**	**909.5**	**9,674.2**

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.

Notes to the Accounts continued

For the year ended 31 December 2011

35. Risk Management and Control continued

	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 2011					
Swap contracts	10.3	8.9	16.6	77.2	12.0
31 December 2010					
Swap contracts	18.4	15.3	28.0	55.8	17.6

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.

		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**

Notes to the Accounts continued

For the year ended 31 December 2011

35. Risk Management and Control continued

		Group 2010		Society 2010	
		Carrying value £M	Fair value £M	Carrying value £M	Fair value £M
Financial assets					
Cash in hand and balances with the Bank of England		115.9	115.9	115.9	115.9
Loans and advances to credit institutions	i)	84.8	84.8	84.3	84.3
Derivative financial instruments	ii)	126.4	126.4	124.3	124.3
Loans and advances to customers					
Loans fully secured on residential property	iii)	6,607.3	6,751.0	6,606.9	6,750.6
Other loans		707.1	719.7	707.1	719.7
Investment Securities	iv)				
Available for sale		1,296.6	1,296.6	1,296.6	1,296.6
Loans and receivables		434.8	417.1	434.8	417.1
Investment in subsidiary undertakings	v)	–	–	19.6	19.6
Other investments		0.1	0.1	0.1	0.1
Property, plant and equipment		26.9	26.9	26.9	26.9
Investment properties		7.0	7.0	–	–
Deferred income tax assets		2.8	2.8	2.0	2.0
Other assets, prepayments and accrued income		93.4	93.4	91.5	91.5
		9,503.1	**9,641.7**	**9,510.0**	**9,648.6**
Financial liabilities					
Shares	iii)	7,025.2	7,123.9	7,025.2	7,123.9
Derivative financial instruments	ii)	143.9	143.9	130.7	130.7
Amounts owed to credit institutions	vi)	482.6	482.6	482.6	482.6
Amounts owed to other customers	iii)	439.4	439.4	471.0	471.0
Debt securities in issue	iv)	760.1	827.8	772.6	815.3
Current income tax liabilities		4.2	4.2	2.0	2.0
Deferred income tax liabilities		2.0	2.0	2.0	2.0
Other liabilities and accruals		108.9	108.9	106.2	106.2
Provisions for liabilities and charges		5.0	5.0	4.3	4.3
Retirement benefit obligations		0.7	0.7	0.7	0.7
Subordinated liabilities	vii)	0.9	0.9	0.9	0.9
Subscribed capital	vii)	25.0	25.0	25.0	25.0
Total Reserves		505.2	505.2	486.8	486.8
		9,503.1	**9,669.5**	**9,510.0**	**9,651.4**

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:

i) 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.

ii) 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.

iii) 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.

iv) 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.

Notes to the Accounts continued

For the year ended 31 December 2011

35. Risk Management and Control continued

v) The fair value of investments in subsidiary undertakings is assumed to approximate their carrying amounts.

vi) 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.

vii) The fair value of subordinated liabilities and subscribed capital are obtained from market prices.

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 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 2011

35. Risk Management and Control continued

31 December 2010	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	115.9	–	–	–	–	115.9
Loans and advances to credit institutions	–	79.9	2.2	–	2.7	84.8
Derivative financial instruments	–	0.9	77.7	46.4	1.4	126.4
Loans and advances to customers:						
Loans fully secured on residential property	5.1	51.8	111.3	772.6	5,666.5	6,607.3
Other loans	–	50.9	58.4	215.5	382.3	707.1
Investment securities	–	536.0	613.6	297.3	284.5	1,731.4
Other investments	0.1	–	–	–	–	0.1
Property, plant and equipment	26.9	–	–	–	–	26.9
Investment properties	7.0	–	–	–	–	7.0
Deferred income tax assets	2.8	–	–	–	–	2.8
Other assets, prepayments, accrued income and current tax	93.4	–	–	–	–	93.4
Total assets	**251.2**	**719.5**	**863.2**	**1,331.8**	**6,337.4**	**9,503.1**
Liabilities						
Shares	4,543.2	345.1	553.5	1,517.6	65.8	7,025.2
Derivative financial instruments	–	2.4	12.2	41.0	88.3	143.9
Amounts owed to credit institutions	–	427.6	55.0	–	–	482.6
Amounts owed to other customers	40.1	302.7	94.6	2.0	–	439.4
Debt securities in issue	–	63.6	402.2	67.4	226.9	760.1
Current income tax liabilities	4.2	–	–	–	–	4.2
Deferred income tax liabilities	2.0	–	–	–	–	2.0
Provision for liabilities, accruals and deferred income	113.9	–	–	–	–	113.9
Retirement benefit obligations	0.7	–	–	–	–	0.7
Subordinated liabilities	0.9	–	–	–	–	0.9
Subscribed capital	–	–	–	–	25.0	25.0
Available for sale reserve	(9.4)	–	–	–	–	(9.4)
Revaluation reserve	13.2	–	–	–	–	13.2
General and other reserves	501.4	–	–	–	–	501.4
Total reserves and liabilities	**5,210.2**	**1,141.4**	**1,117.5**	**1,628.0**	**406.0**	**9,503.1**

Notes to the Accounts continued

For the year ended 31 December 2011

35. 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 2011	Financial assets at fair value through Income Statement £M	Financial assets at available for sale £M	Financial assets at held to 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	–	–	–	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**

Notes to the Accounts continued

For the year ended 31 December 2011

35. Risk Management and Control continued

31 December 2010	Financial assets at fair value through Income Statement £M	Financial assets at available for sale £M	Financial assets at held to 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	–	–	–	115.9	–	–	–	115.9
Loans and advances to credit institutions	–	–	–	84.8	–	–	–	84.8
Derivative financial instruments	126.4	–	–	–	–	–	–	126.4
Loans and advances to customers:								
Loans fully secured on residential property	1,229.9	–	–	5,377.4	–	–	–	6,607.3
Other loans	289.8	–	–	417.3	–	–	–	707.1
Investment securities	–	1,296.6	–	434.8	–	–	–	1,731.4
Other investments	–	–	0.1	–	–	–	–	0.1
Non financial assets	–	–	–	–	–	–	130.1	130.1
Total assets	**1,646.1**	**1,296.6**	**0.1**	**6,430.2**	**–**	**–**	**130.1**	**9,503.1**
Liabilities								
Financial liabilities:								
Shares	–	–	–	–	691.3	6,333.9	–	7,025.2
Derivative financial instruments	–	–	–	–	143.9	–	–	143.9
Amounts owed to credit institutions	–	–	–	–	–	482.6	–	482.6
Amounts owed to other customers	–	–	–	–	–	439.4	–	439.4
Debt securities in issue	–	–	–	–	270.3	489.8	–	760.1
Subordinated liabilities	–	–	–	–	–	0.9	–	0.9
Subscribed capital	–	–	–	–	–	25.0	–	25.0
Non financial liabilities	–	–	–	–	–	–	120.8	120.8
General and other reserves	–	–	–	–	–	–	505.2	505.2
Total Reserves and Liabilities	**–**	**–**	**–**	**–**	**1,105.5**	**7,771.6**	**626.0**	**9,503.1**

Notes to the Accounts continued

For the year ended 31 December 2011

35. Risk Management and Control continued

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 2011 was £205.5m (2010: £219.1m), which is equal to the carrying value of the assets. Maximum credit risk exposure at 31 December 2011 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 £81.2m (2010: increase of £73.3m) 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.

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 £95m (2010: £82m), 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.

2011 Group and Society	Level 1 £M	Level 2 £M	Level 3 £M	Total £M
Financial assets				
Investment securities – available for sale	422.5	1,052.6	–	1,475.1
Designated as such upon initial recognition	–	–	–	–
Derivative financial instruments	–	139.5	–	139.5
Financial liabilities				
Derivative financial instruments	–	–	–	–
Designated as such upon initial recognition	–	95.9	50.8	146.7

2010 Group and Society	Level 1 £M	Level 2 £M	Level 3 £M	Total £M
Financial assets				
Investment securities – available for sale	283.3	1,013.3	–	1,296.6
Derivative financial instruments	–	126.4	–	126.4
Financial liabilities				
Derivative financial instruments	–	117.4	26.5	143.9

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.

Notes to the Accounts continued

For the year ended 31 December 2011

35. Risk Management and Control continued

Reconciliation of Level 3 fair value measurements of financial liabilities

	Fair value through profit and loss £M
Balance at 1 January 2011	26.5
Total losses in the Income Statement	24.3
Balance at 31 December 2011	**50.8**

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 losses for the year included in the Income Statement, £24.3m (2010: £5.8m) related to derivatives included within the Level 3 fair value category. These losses are included in fair value gains less losses from derivative financial instruments in the Income Statement.

Unlisted equity investments are also included in Level 3, but as stated in note 15, these are fair valued at zero at the balance sheet date.

In the Directors' view, changing any of the assumptions used in the valuation of the derivatives or the unlisted equity investments included in Level 3, would not have a significant impact on the Income Statement, or total assets and liabilities.

36. 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:

Residential loan portfolio

Commercial loan portfolio

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

Notes to the Accounts continued

For the year ended 31 December 2011

36. Operating Segments continued

Segment Income Statement

The following is an analysis of the Group's interest income and operating profit by reportable segment:

	2011 £M	2011 £M	2010 £M	2010 £M
Interest receivable and similar income				
Interest receivable				
Residential Loan Portfolio	354.3		346.4	
Commercial Loan Portfolio	22.2		24.4	
Other	0.1		0.3	
		376.6		371.1
Other interest income		19.9		19.0
Net expense/income on financial instruments		(61.6)		(95.6)
Total interest receivable and similar income		**334.9**		**294.5**
Operating profit and profit on ordinary activities before income tax				
Operating profit before impairment losses and provisions		102.4		84.5
Impairment losses and provisions on loan and advances				
Residential Loan Portfolio	(29.9)		(15.8)	
Commercial Loan Portfolio	(19.1)		(27.8)	
Other	0.5		(0.6)	
Impairment losses on loans and advances to customers		(48.5)		(44.2)
Other gains		(0.3)		2.9
Provision for liabilities and charges		(3.4)		(1.0)
Operating profit and profit on ordinary activities before income tax		50.2		42.2
Income tax		(13.6)		(11.3)
Profit for the financial year		**36.6**		**30.9**

Segment loans and advances to customers

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

	2011 £M	2011 £M	2010 £M	2010 £M
Loans and advances to customers				
Loans and advances to customers				
Residential Loan Portfolio	6,808.9		6,466.6	
Commercial Loan Portfolio	504.9		544.8	
Other	3.7		5.9	
		7,317.5		7,017.3
At fair value through profit and loss		285.8		289.2
Less: impairment provisions				
Residential Loan Portfolio	(45.7)		(27.1)	
Commercial Loan Portfolio	(39.0)		(34.0)	
Other	(3.1)		(4.3)	
		(87.8)		(65.4)
Fair value adjustment for hedge risk		81.2		73.3
Total loans and advances to customers		**7,596.7**		**7,314.4**

No geographical analysis is presented because substantially all activity is in the UK, and all material exposures are UK resident.

Annual Business Statement

For the year ended 31 December 2011

1. Statutory Percentages

	31 December 2011	Statutory Limit
Lending limit	13.4%	25%
Funding limit	19.2%	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 2011	31 December 2010
As a percentage of shares and borrowings:		
Gross capital	6.38%	6.21%
Free capital	6.38%	6.05%
Liquid assets	21.92%	22.19%
Profit for the financial year as a percentage of mean total assets	0.38%	0.32%
Management expenses as a percentage of mean total assets	0.48%	0.47%

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 2011

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
S. R. G. Booth (Vice Chairman until 8 August 2011, Director until 23 September 2011)	Company Director	18.04.43	01.12.00
Chief Executive			
*P. A. Hill	Chief Executive	28.07.61	01.08.06
*I. W. Ward (Chief Executive until 9 August 2011, Director until 23 September 2011)	Chief Executive	04.05.49	25.09.95
Directors			
J. N. Anderson	Company Director	20.08.45	01.08.06
C. M. Kavanagh	Company Director	30.03.62	13.12.05
*D. Pickersgill (resigned 30 June 2011)	Deputy Chief Executive	05.04.53	18.12.95
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 & Marketing Director	31.03.66	07.12.09
I. Robertson	Company Director	10.08.47	08.12.08
*R. J. Ashton	Company Director	19.01.58	26.04.11

(*Executive Directors)

The Society's Executive Director service contracts can be terminated on twelve months' notice by either the Society or the Director.

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 (Limited by Guarantee) Hinsley Properties Ltd Hinsley Properties No. 2 Ltd Yorkshire County Cricket Club Ltd
J. N. Anderson	Alpha Radio Limited City Hospitals Sunderland Foundation Trust Leeds Building Society Staff Pension Scheme Ltd Milltech Training Ltd Normand Trustees Ltd North East Business Innovation Centre Ltd North East of England Business and Innovation Centre Ltd Sun FM Ltd Sunderland Arc Ltd Tyne & Wear Education Business Link Organisation Ltd

Annual Business Statement continued

For the year ended 31 December 2011

P. A. Hill	Countrywide Rentals 1, 2, 3, 4, 5 Ltd (Dormant)* Headrow Commercial Property Services Ltd* Leeds Mortgage Funding Ltd* Leeds Overseas (Isle of Man) Ltd* Mercantile Asset Management Ltd*
C. M. Kavanagh	Benchmarx Kitchens and Joinery Limited CCF Limited City Plumbing Supplies Holdings Limited Keyline Builders Merchants Limited Leeds Building Society Staff Pension Scheme Ltd Travis Perkins Trading Company Ltd Wickes Building Supplies Limited
L. M. Platts	A J Bell Holdings Limited
A. Rajguru	Alexander Rosse Ltd Kettering Hospital NHS Foundation Trust Arcadium Capital Partners Ltd Northampton College
K. L. Rebecchi	Leeds Building Society Staff Pension Scheme Ltd Leeds Financial Services Ltd*
I. Robertson	Homes and Communities Agency for England
R. W. Stott	First Milk Ltd Frank Roberts & Sons Limited RFL (Governing Body) Limited The Greyhound Board of Great Britain Limited The Rugby Football League Limited Yorkshire County Cricket Club Charitable Youth Trust
R. J. Ashton	Shawbrook Bank Limited

Executive Management

Name	Occupation	Directorships (*Society Subsidiary)
Mark Stevens	Director of Strategy	Headrow Commercial Property Services Ltd*
Andrew J. Greenwood	Chief Risk Officer & Secretary	Leeds Financial Services Ltd*
Paul M. Kaye	General Manager	Headrow Commercial Property Services Ltd* Leeds Financial Services Ltd*
Gary 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*
Martin J. Richardson	General Manager	Mercantile Asset Management Ltd*
Paul Riley	General Manager	Leeds Building Society Staff Pension Scheme Ltd
Geoffrey Turnbull	General Manager	Headrow Commercial Property Services Ltd* Mutual Vision Technologies Ltd
Karen Wint	General Manager	None

Glossary of Terms

For the year ended 31 December 2011

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.

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.

Glossary of Terms continued

For the year ended 31 December 2011

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.

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.

Glossary of Terms continued

For the year ended 31 December 2011

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.

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.

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

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Tel: 01482 224892

Kendal
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Tel: 01539 724460

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665 Dewsbury Road, Beeston,
Leeds LS11 5LF
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181a High Street, Boston Spa,
Wetherby LS23 6AA
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3 Stainbeck Corner, Chapel Allerton,
Leeds LS7 3PG
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Crossgates
57 Station Road, Crossgates,
Leeds LS15 8DT
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Garforth
38 Main Street, Garforth LS25 1AA
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Harehills Road
13 Harehills Road, Leeds LS8 5HR
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Headingley
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Headingley, Leeds LS6 2UE
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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)
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Manchester
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9 North Road, Durham DH1 4SH
Tel: 0191 384 0561

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34 Bridge Street, Morpeth NE61 1NL
Tel: 01670 514083

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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

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