Skipton Building Society

Summary Financial Statement 2013

SKIPTON
MY BUILDING SOCIETY

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Summary Financial Statement 2013

This financial statement is a summary of information from the audited Annual Report and Accounts, which will be available to members and depositors online at www.skipton.co.uk/performance or free of charge on demand at every office of Skipton Building Society from 1 April 2014.

Summary Directors' Report

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

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

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

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

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in every branch, through our subsidiary Skipton Financial Services Limited, at a time when many other providers have withdrawn this service.

Continued growth

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

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

Profitability

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

Financial strength

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

Listening to our members and investing in our people

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

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

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

Support for savers

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

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

However, we are acutely aware that UK savers have continued to suffer as a result of measures taken by the authorities to support growth and stave off any threat of deflation and economic contraction. Savers are vital to the UK's continued recovery, providing the funds which can then be lent to borrowers to support a sustainable housing market and economy.

Promoting homeownership

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

Subsidiary performance

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

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

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

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

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

Cost control

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

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

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

Conclusion and outlook

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

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

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

Group results for the year ended 31 December	**2013** **£m**	2012 Restated* £m
Net interest receivable	**142.6**	84.2
Other income and charges	**429.9**	402.7
Profit on disposal of subsidiary undertakings	**24.7**	-
Fair value gains on financial instruments	**3.9**	3.6
Administrative expenses and provisions for liabilities	**(475.9)**	(438.8)
Impairment losses	**(22.7)**	(16.3)
Profit for the year before taxation	**102.5**	35.4
Taxation	**(26.2)**	(8.8)
Profit for the financial year	**76.3**	26.6
Non-controlling interests	**(1.1)**	1.0
Profit for the financial year attributable to members	**75.2**	27.6

Group financial position at 31 December	**2013** **£m**	2012 £m
Assets		
Liquid assets	**2,381.1**	2,531.8
Residential mortgages	**11,017.6**	10,070.9
Commercial and other loans	**499.3**	522.6
Derivative financial instruments	**148.8**	202.7
Fixed and other assets	**439.9**	432.2
Total assets	**14,486.7**	13,760.2
Liabilities and Reserves		
Shares	**10,260.1**	9,462.4
Borrowings	**2,531.8**	2,536.2
Derivative financial instruments	**287.6**	370.8
Other liabilities	**259.5**	235.3
Subordinated liabilities	**124.4**	223.9
Subscribed capital	**94.1**	96.1
Non-controlling interests	**2.9**	1.8
Reserves	**926.3**	833.7
Total liabilities and reserves	**14,486.7**	13,760.2

Group statement of movement in reserves	**2013** **£m**	2012 Restated* £m
Reserves at 1 January	**833.7**	813.7
Net income / (expense) for the year not recognised in the Income Statement	**17.4**	(7.6)
Profit for the year	**75.2**	27.6
Reserves at 31 December	**926.3**	833.7

This Summary Financial Statement was approved by the Board of Directors on 25 February 2014 and was signed on its behalf by:

M H Ellis Chairman
D J Cutter Group Chief Executive
R J Twigg Group Finance Director

Summary of key financial ratios	**2013 %**	2012 %
Gross capital as a percentage of shares and borrowings	**8.97**	9.63
Liquid assets as a percentage of shares and borrowings	**18.61**	21.10
Group profit after tax for the year as a percentage of mean total assets	**0.54**	0.19
Group management expenses as a percentage of mean total assets	**3.22**	2.96
Society management expenses as a percentage of mean total assets	**0.50**	0.44

* During the period the Group has adopted IAS 19 (revised 2011), *Employee Benefits*. Further details can be found in note 1a) and 41 in the full Annual Report and Accounts. If the revised standard had applied in 2012, other income would have been £1.0m lower than previously reported, with an equivalent increase in income recognised directly in reserves. The 2012 comparatives have been restated accordingly.

Gross capital represents the general reserve together with the available-for-sale reserve, cash flow hedging reserve, translation reserve, subordinated liabilities, subscribed capital, and non-controlling interests, as shown in the Group Statement of Financial Position. The gross capital ratio measures the proportion which the Group's capital bears to the Group's liabilities to holders of shares, depositors and other providers of funds, that is, its investors.

Liquid assets represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities. Liquid assets are generally readily realisable, enabling the Group to meet its general liabilities during the year.

The profit ratio measures the proportion that the Group's profit after tax for the year bears to the average of the Group's total assets during the year. Mean total assets are calculated as the average of the 2013 and 2012 total assets as shown in the Group Statement of Financial Position. A reasonable level of profit is required each year to maintain the gross capital ratio at a suitable level to protect investors' funds.

The management expenses ratio measures the proportion that the administrative expenses bear to the average of the mean total assets during the year.

Independent auditor's statement to the members and depositors of Skipton Building Society

We have examined the Summary Financial Statement of Skipton Building Society for the year ended 31 December 2013 set out on pages 2 to 6.

This auditor's statement is made solely to the Society's members, as a body, and to the Society's depositors, as a body, in accordance with section 76 of the Building Societies Act 1986. Our work has been undertaken so that we might state to the Society's members and depositors those matters we are required to state to them in such a statement and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body and the Society's depositors as a body, for our work, for this statement, or for the opinions we have formed.

Respective responsibilities of directors and auditor

The directors are responsible for preparing the Summary Financial Statement, in accordance with applicable United Kingdom law.

Our responsibility is to report to you our opinion on the consistency of the Summary Financial Statement with the full Annual Accounts, Annual Business Statement and Directors' Report and its conformity with the relevant requirements of section 76 of the Building Societies Act 1986 and regulations made under it.

Basis of opinion

We conducted our work in accordance with Bulletin 2008/3 'The auditor's statement on the Summary Financial Statement in the United Kingdom' issued by the Auditing Practices Board. Our report on the Group's full Annual Accounts describes the basis of our opinions on those Annual Accounts, the Annual Business Statement and Directors' Report.

Opinion on Summary Financial Statement

In our opinion the Summary Financial Statement is consistent with the full Annual Accounts, the Annual Business Statement and Directors' Report of Skipton Building Society for the year ended 31 December 2013 and conforms with the applicable requirements of section 76 of the Building Societies Act 1986 and regulations made under it.

John Ellacott
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
Leeds
25 February 2014

Summary Directors' Remuneration Report

Introduction from the Chairman of the Remuneration Committee

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

This report is a summary of the full report which can be found in our Annual Report and Accounts. The full version of the report can be found on our website at skipton.co.uk/remuneration, or on request from the Secretary of the Society. The full report contains some more details including:

- our remuneration principles, which underpin the policy presented to you in this summary report;
- more detail on how we pay our 'Code Staff' – those senior managers who have a material impact on the risk profile of the business;
- the history of the Group Chief Executive's remuneration over the last five years; and
- details on the Remuneration Committee and its advisers.

This summary report is split into two sections:

- The Remuneration Policy part of the report on pages 9 to 12 explains how we will pay Directors in the future.
- The Annual Report on Remuneration part of the report on pages 12 to 14 explains how we put our policy into practice in 2013 and how we intend to apply it for 2014.

Key decisions taken in 2013

2013 was a strong year for the business and Group pre-tax profit increased to £102.5m with the core Mortgages and Savings division pre-tax profit reaching £50.4m.

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

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

Conclusion

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

Nimble Thompson
Chairman of the Remuneration Committee
25 February 2014

Directors' Remuneration Policy

The Board's policy is designed to ensure that Executive Directors' remuneration reflects performance and enables the Group to attract, retain and motivate a sufficient number of high calibre individuals to lead and direct the organisation and deliver continually improving business performance and long term sustainability for our members.

Remuneration Policy for Executive Directors

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

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

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

Notes to the table

Performance measures

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

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

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

Changes from remuneration arrangements operated in 2013

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

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

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

Remuneration policy for Non-Executive Directors

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

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

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

Approach to recruitment remuneration

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

Newly recruited Executive Directors are eligible to receive the same remuneration elements as existing Executive Directors as set out in the policy table on pages 9 to 10.

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

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

Directors' service contracts and notice periods

The Executive Directors are employed on rolling service contracts which can be terminated by either the Society or the Director giving one year's notice. Unless notice to terminate is given by either party, the contracts continue automatically.

Non-Executive Directors do not have service contracts.

Policy on termination payments

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

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

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

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

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

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

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

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

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

Statement of implementation of Remuneration Policy in 2014

The introduction of the MTI scheme, set out in the policy table on page 10, increases the variable pay of each participant by introducing a medium term award which is a third of the value of the 2013 STI scheme. In order to create the desired balance in overall variable pay between the short and medium term, the Remuneration Committee determined that some value should transfer from the STI scheme to the MTI scheme to achieve an equal balance between the two elements of variable pay.

From 2014, on-target performance will result in 30% of basic salary accruing to Directors in both the STI and MTI schemes and the maximum available to be earned under each scheme is 50% of basic salary.

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

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

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

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

The operation of the short term incentive scheme is expected to remain as outlined in the policy.

Annual Report on Remuneration in 2013

Executive Directors' remuneration

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

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

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

Notes

1. Benefits comprise the provision of a car or car allowance, and private medical insurance contributions. Mr Fleet's 2013 benefits include £44,717 in relation to relocation costs.
2. £332,172 of the 2013 annual performance pay has been deferred under the rules of the scheme (2012: £72,000).
3. The Incentive Scheme rules include the requirement to defer over three years a portion of the amount earned by any individual if the total amount earned by that individual is greater than £500,000, or the amount earned under the Incentive Scheme is more than 33% of his or her total remuneration.
4. Mr Cornelius was appointed as an Executive Director on 11 June 2012 and the above table includes his remuneration, annual performance pay and benefits as a Director of the Society from that date.
5. The increase in basic salary for the Executive Directors was in the range of 2.4% to 5.1%. This compares with an average annual pay award in 2013 of 3.8% for all other Society employees.

Non-Executive Directors' remuneration

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

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

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

Notes

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

The Committee and its advisers

The Remuneration Committee is responsible for determining, on behalf of the Board, the Group's Remuneration Policy, reviewing its adequacy, effectiveness and compliance with regulatory requirements. The terms of reference of the Remuneration Committee are available, on request, from the Secretary. More details on the Committee and its advisers are included in the Directors' Remuneration Report in the Annual Report and Accounts.

Nimble Thompson

Nimble Thompson
Chairman of the Remuneration Committee
25 February 2014

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