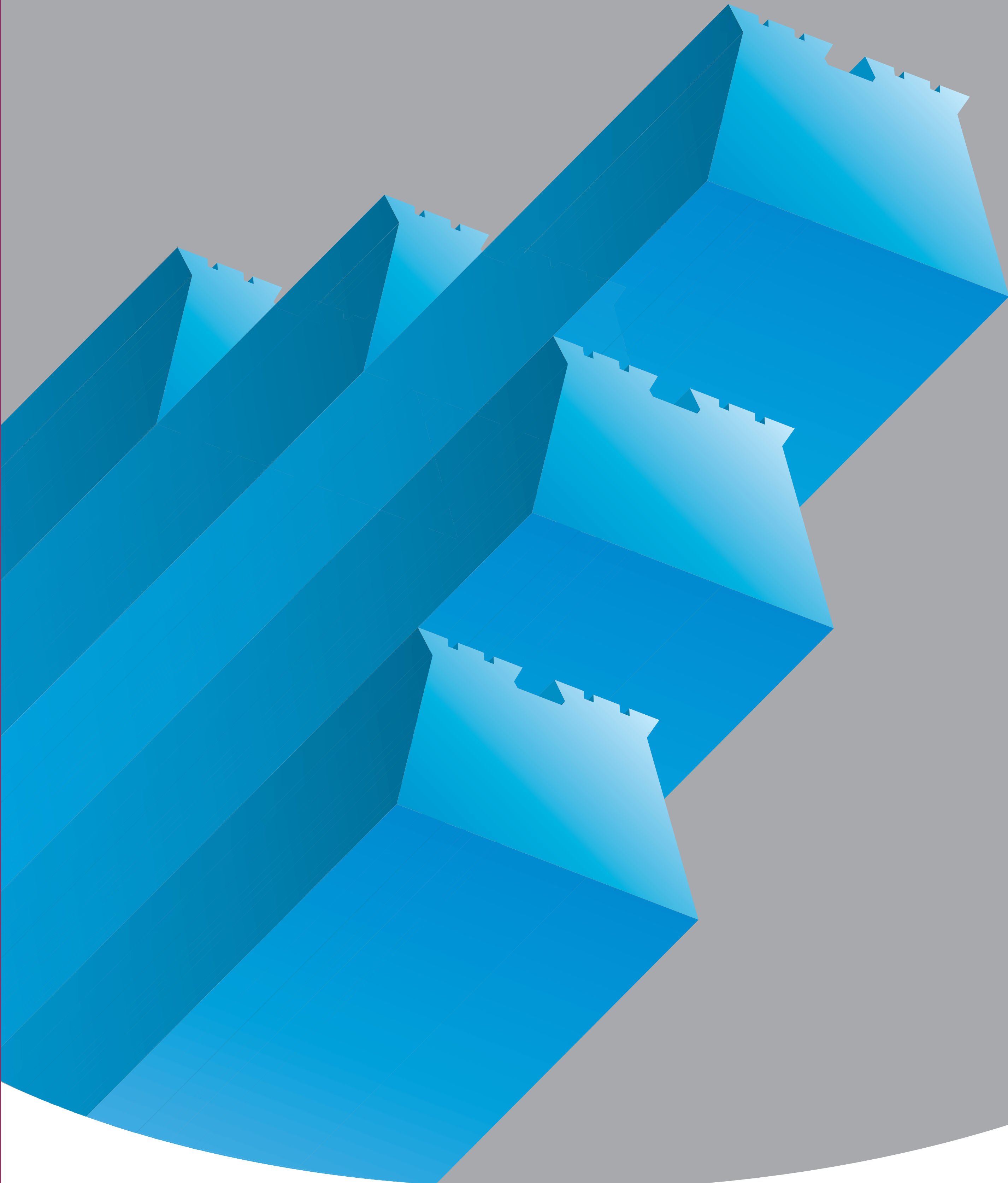
Skipton Building Society

Annual Report & Accounts

2008



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mutual**matters** SKIPTON BUILDING SOCIETY

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- **Group total assets up 8.9% to £13.6 billion**
- **Group mortgage assets up 1.7%**
- **Group retail share funding up 12.9% to £8.1 billion**
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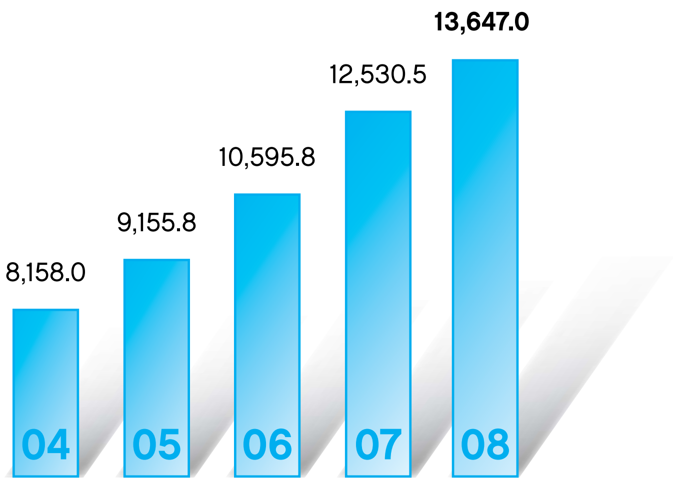
- **Liquid assets up 19.0% to £3,178.3 million**

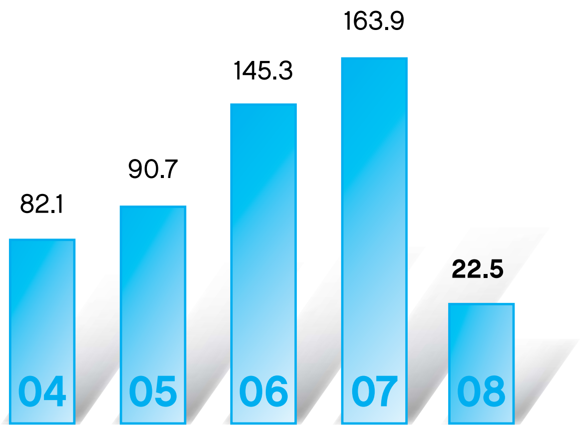
“We have further reduced our reliance on wholesale markets, although it is comforting to know that many of our long-standing counterparties in that market have the confidence to continue to place their funds with us.”

Jacqueline and John Barrett, customers of Barnoldswick branch

Group Income Statements	2004 £m	2005 £m	2006 £m	2007 £m	**2008 £m**
Net interest receivable	91.5	93.3	98.1	109.7	**86.0**
Other operating income	326.5	349.5	434.7	461.7	**401.1**
Total operating income	418.0	442.8	532.8	571.4	**487.1**
Share of profits from joint ventures and associates	0.2	1.3	1.0	3.7	**3.9**
Profit on disposals	-	-	15.7	36.0	**31.4**
Administrative expenses	(333.9)	(345.9)	(397.0)	(441.0)	**(433.0)**
Impairment losses on loans and advances	0.3	(7.9)	(5.6)	(5.4)	**(34.6)**
Impairment losses on debt securities	-	-	-	-	**(11.5)**
Provisions for liabilities	(2.5)	0.4	(1.6)	(0.8)	**(20.8)**
Profit before tax	82.1	90.7	145.3	163.9	**22.5**
Tax (expense) / income	(24.3)	(24.8)	(32.2)	(37.3)	**1.3**
Profit for the financial year	57.8	65.9	113.1	126.6	**23.8**
Attributable to:					
Members of Skipton Building Society	56.7	62.8	111.7	125.5	**22.8**
Minority interests	1.1	3.1	1.4	1.1	**1.0**
	57.8	65.9	113.1	126.6	**23.8**
As at 31 December					
Total assets	8,158.0	9,155.8	10,595.8	12,530.5	**13,647.0**
Gross capital	572.0	640.5	813.0	935.2	**917.5**
Free capital	417.1	479.6	557.4	631.0	**605.6**



Total assets (£m)



Pre-tax profit for the year (£m)

Introduction

In a year of unprecedented turmoil in global financial markets it is encouraging to be able to report to members that your Society has focused successfully on maintaining its financial strength and liquidity.

We know what most members want above anything else in these uncertain times is the security and availability of their savings.

Inevitably our profits are substantially down on the record results we posted in 2007. This is due not just to dreadful conditions in the housing and mortgage markets but also to exceptional costs which include a charge of £16.3 million being our contribution to the next three years' levies from the Financial Services Compensation Scheme and one direct investment loss of £11 million arising from the collapse of the Icelandic banking system. We have also devoted great energy to securing the funding sources of our business and this too has had a significant cost. We have further reduced our reliance on wholesale markets, although it is comforting to know that many of our long-standing counterparties in that market have the confidence to continue to place their funds with us.

However, we end the year with strong liquidity and a healthy capital position, and are well placed to face the undoubted challenges that lie ahead.

The credit crunch

Our financial results should also be put in the context of the colossal losses suffered by many very large international banks and the rather smaller losses which we expect a number of our colleagues in the building society sector to report. Once again the diversification strategy of your Society has shown its value: in the good years the profits from our investments have enabled us to grow safely at a fast pace while in a tough year like 2008 the ability to realise some of these investments has helped us maintain our capital strength and report a profit.

How did the financial system end up in this mess? It would be a mistake to ascribe all our woes to greedy bankers let alone the market economy which has brought many years of increasing living standards. While the major international and investment banks must bear their share of responsibility, I have no doubt that the seeds of the present crisis lie in the attempts of Western governments, particularly in the US and UK, to prolong economic growth year after year through a policy of very low interest rates and easy credit, in order to encourage the consumer spending on which this economic growth depended. The boom could only be sustained by ever-increasing debt, both public and private, and a consequent bubble in asset prices, especially housing. Of course there were many other contributory factors which exacerbated the situation, notably the failure of Boards and regulators to take action to curb some of the wilder excesses.

Because of the pivotal role of the US in the world financial system this has become an international financial crisis on a scale not seen since the 1930s. The continuing volatility of all markets does not bode well for an early resolution of the difficulties, despite the efforts of governments and central banks to throw money on a gargantuan scale at the problem. While deflation may be avoided by these methods, it seems to me that the longer-term inflationary consequences of current policy may turn out to be the fire we enter once we are out of the current frying pan.

Mutuality

Coming closer to home it is sobering to consider that so many of the building societies which rushed to convert to public companies in the 1990s are no longer with us, at least as thriving entities: nationalisation, liquidation, forced mergers or absorption by foreign owned businesses have taken their toll on some of the biggest. This does not prove in any sense that mutuality is inherently a superior corporate structure but it does demonstrate that the pressure to produce ever-improving quarterly results for shareholders has serious downsides. We are fortunate that, as a mutual, our members are our customers and we can plan and implement our strategy in a longer-term time frame.

Financial Services Compensation Scheme (FSCS)

As noted above, our results this year are impacted by a significant charge for our share of the costs of the FSCS, triggered following the UK government's decision to transfer Bradford & Bingley's savings business to the Abbey National and the failure of Icelandic banks operating as deposit takers in the UK. Your Society, together with all other building societies, is therefore required to pay levies in respect of those claims based upon its share of UK protected deposits.

Whilst we recognise the value of a deposit protection scheme in maintaining savers' confidence and stability in the banking system, we are frustrated that the prudent building society sector, with a traditionally (and legally required) higher proportion of its funding being from retail customers, and a historically more prudent risk profile, is being asked to bear a disproportionate amount of this cost. We believe therefore that Skipton members are being disadvantaged by the basis of allocation of liabilities that does not reflect the risks that individual entities pose to the banking system. Nevertheless, we support the continued presence of the scheme and welcome the recent increase in the scheme limit to £50,000 per qualifying depositor.

Merger

Apart from the seismic shocks to the financial system, 2008 will be remembered at Skipton for two other events. The first is our proposed merger with Scarborough Building Society. I look forward to welcoming Scarborough members to Skipton once the complex legal formalities have been concluded and am optimistic about being able to do so at our Annual General Meeting in April. Skipton and Scarborough have much in common: both based in North Yorkshire and with similar cultures of commitment to mutuality and service to members. We remain on track to have implemented the merger by 30 March 2009 and are impressed by the dedication and quality of the Scarborough staff.

New leadership

The other event I must flag is the retirement of our Chief Executive, John Goodfellow. John was in charge for 17 years, having joined Skipton as far back as 1984. He took over the reins in 1991 at a time of the worst recession in living memory - that is until now. His period coincided with many years of economic growth and he leaves the Society immeasurably stronger than when he became Chief Executive. Our reserves have gone from £98 million in 1991 to £704 million this year and our assets from £2.7 billion to £13.6 billion.

John was the architect of the Society's diversification strategy which has differentiated Skipton from other building societies and has underpinned the deep commitment to mutuality and outstanding customer service on which he placed such emphasis. It is this same strategy which has delivered considerable value to members and security for their deposits.

We – and I mean Society staff, the Directors, our subsidiaries and of course our members - will miss him and we wish him every success in the future. We are fortunate that he remains Chairman of the Building Societies Association for the time being, where he has worked energetically in these difficult months to promote the mutual cause and ensure the ongoing stability of the sector.

Our new Chief Executive, David Cutter, was appointed by the Board after a rigorous search process and we were delighted to be able to select not just an internal candidate but, although that was not a requirement for the job, someone born and bred locally. None of us, least of all those of us without a Yorkshire passport, can forget where the Society has its roots and David will naturally ensure the importance of your Society to the town of Skipton and local communities continues to be recognised.

Charities and community support

In a time of financial difficulties charities will find life harder and the help we can give through the Society and the Skipton Charitable Foundation will play, I hope, some part in assisting many smaller organisations to cope with these challenges. I would like to thank all the members of staff who have, once again, devoted their time to various community projects and other charitable causes. One such example is the people who work with a local primary school as part of the national Numbers Partners initiative, where they visit pupils each week to help them improve their numeric skills. Further afield, an orphanage in Tanzania has benefited from the fundraising efforts of two staff members, who have been making a difference for over four years.

Finally, I should note that, since its launch in 1997, members investing in our NSPCC ISA have now raised over £1.5 million for this incredibly worthwhile cause.

The Board

With so many difficult decisions to be made I am fortunate in having a Board comprised of skilled and thoughtful colleagues with considerable experience of past downturns. Our Board is renewed continually and the consequence of this is that, from time to time, we sadly have to say goodbye to Non-Executive Directors who have served their term. Last year, Richard Marriott, another local lad, retired from the Board having served for over nine years. He brought to the Society great common sense, judgement and enthusiasm for all aspects of the business. We thank him sincerely and wish him well in the future.

In addition, in December 2008, Steve Haggerty resigned from his role as Managing Director of the Society. Steve had been with the Skipton Group for many years and contributed to its success in a variety of roles, in particular through his leadership of HML, and we wish him every success in his future career.

Our members

Finally I need to thank you, our members, for your loyalty. Each of you is important to us. Of course we want you to be pleased with what we do for you as you are a part-owner of the Society. Our greater aim would be for you to tell family, friends and acquaintances that you know at least one financial institution that can be trusted, that will treat you fairly and with whom doing business is a pleasure.

J B Rawlings

Chairman

24 February 2009

> "...since its launch in 1997, members investing in our NSPCC ISA have now raised over £1.5 million for this incredibly worthwhile cause."

The Atkins Family, customers of Colne branch

Introduction

Having worked for the Society for 15 years, it is a great honour to write my first Chief Executive's Report. By tradition, this reports on the year just ended, but I start with where my mind is focused: on 2009 and beyond. There is no doubt we are in the midst of an uncompromising recession and the ability to forecast its severity and ending is made difficult, if not impossible, by the continuing shortage of credit in the UK markets.

For this reason, our business plans for 2009 are likely to adopt a similar vein to 2008: to limit balance sheet growth, to hold above-normal levels of liquidity, reduce further our reliance on wholesale funding and increase our cost control.

Skipton, in common with all building societies, has a substantial and stable retail funding base. However, unlike other building societies, we also have a Group of subsidiaries with a diversified portfolio of investments, which generate higher returns (even in this difficult economic climate).

Another benefit of the Group is its ability to gauge the health of the UK housing and mortgage market; with 85 building society branches, 472 estate agency branches, a credit reference agency, and a servicer of £47 billion of other lenders' mortgages, Skipton is well placed to determine when it is appropriate to increase its lending. In the meantime, we will continue to steer through choppy waters and position the Group to take advantage of any upturn.

Financial performance

Looking to how the Society fared in 2008, as the Chairman said, the challenging economic environment has meant inevitably our profits are down. However, once the banking sector and our building society peers have reported their figures, I'm confident the added context will show what a solid set of results these are.

- Group total assets £13.6bn (up 8.9%)
- Group mortgage assets up 1.7% (2007: up 15.9%)
- Group retail share funding £8.1bn (up 12.9%)
- Group pre-tax profit £22.5m (2007: £163.9m)
- Society management expenses ratio 47p (2007: 49p) per £100 assets
- Society interest rate margin 0.54% (2007: 0.74%)
- Group interest rate margin 0.66% (2007: 0.95%)
- Solvency ratio Basel II - 12.28% (2007: Basel I - 12.30%)

By far the biggest element of the reduction in profits is attributable to our estate agency group, Connells, where operating profits fell from £59.7 million to £10.4 million. However, when you consider 2008 was the worst housing market in living memory and UK property transactions were down approximately 40% on 2007, this is in fact a very creditable performance, achieved via strong cost control and the benefit of Connells' own diversified model.

In 2008, the Society's net interest margin reduced by £12.2 million to £69.8 million. This was partly as a result of the competitive rates enjoyed by savers (as demonstrated by a growth in retail balances of 12.9%) and partly due to the high cost of securing longer-term funding and carrying above-normal levels of liquidity during the credit crunch. These costs were necessary to ensure we stayed in the game whilst others exited.

In addition to the Society's own exposure of £11.0 million to the Icelandic banking system, we have also provided £16.3 million for our share towards the next three years' levy to be imposed by the Financial Services Compensation Scheme in relation to the rescue of savers in Bradford and Bingley and other banks. This charge relates to our estimate of the charges for the first three years but it remains unclear whether there will be further charges beyond then. Group profits in 2008 are almost half what they would have been had the FSCS provision not been required. We believe it unjust that the building society sector, which has an inherently safer business model, is bearing a disproportionate cost for the troubles of some banks which had far riskier models. Not only do we feel aggrieved about the unfairness of the FSCS levy, but we will monitor closely the process whereby the FSCS recovers the loans it has made to the Bradford & Bingley and other banks.

Mortgage loss provisions are also much higher in 2008, principally in our specialist lending subsidiary, Amber Homeloans, whose borrowers were the first to feel the impact of the economic conditions. Following a review of the risks surrounding this business, Amber ceased new lending in March 2008 and is now concentrating on managing its portfolio of loans. Much of Amber's business was in trading mortgage assets, which was heavily affected by the closure of the markets.

Lending

2008 was a year of turmoil in the wholesale markets, which started with uncertainty over Northern Rock's future and ended with the demise of many financial institutions, and in which UK house prices fell by over 15%. As such, our lending plans were always going to be modest and the Society's gross lending was down a third from £2.2 billion to £1.3 billion. The uncertainties of the credit crunch meant we were naturally cautious in committing funds and, where we did, they tended to be to borrowers of higher quality. By lending in this way we can avoid the stresses on funding which have been the undoing of others in the industry.

Also, at this time of limited funds for borrowers, it is our members who we give priority to, recognising our existing relationship and their track record with the Society.

The drop in lending has not only been on the residential side but on our commercial book too, where we made the decision in November 2008 to stop any new commercial lending and instead manage our existing portfolio of loans to maintain our low level of arrears.

As the economy deteriorated, we have seen an increase in arrears. In the Society, the number of mortgages that were three months or more in arrears increased during the year from 0.20% to 0.38%. At a Group level, the figure increased from 0.41% to 1.14%, but remained well below the Council of Mortgage Lenders' industry figure of 1.89% at the year end.

Looking externally, the Government's hopes of kick-starting the lending and money markets through rate cuts and a variety of funding schemes have yet to bear fruit. Stagnancy remains as financial institutions keep their reins firmly pulled in. The result is, whilst those borrowers who already have mortgages are benefiting, those on whom the housing market relies - new homebuyers – have found it increasingly hard to get a mortgage. This continues to be the case even though affordability is improving.

Savings

During its 155 year history, the Society has always tried to balance the needs of savers with the wishes of borrowers, but never have interest rates fallen so low to make this so difficult. As a mutual, our natural inclination is to pass on in full any reduction in rates to our borrowers whilst protecting the returns for our savers. But with the Base Rate having fallen to such a low level, we are in a unique environment which challenges our best intentions. We are conscious of the impact on our savers, and with Base Rate predicted to fall further this may become even more acute. We find it perverse that UK savers, who are the bedrock for the funding of mortgages, are being penalised to help correct the fundamental imbalances in the economy. We will continue to lobby central policy makers on behalf of our savers.

On the positive side, the credit crunch has done much to benefit mutuals like Skipton who are now seen as stable homes for investors' money – especially with the increased cover offered by the FSCS. This, coupled with a range of competitive products (in particular, our Branch Access Account and limited edition Fixed Rate Bonds) has meant retail balances have increased from £7,191.1 million to £8,158.2 million. In addition, Skipton's investor numbers grew from 521,000 to 565,000 during 2008 and will increase further to over 700,000 following the proposed merger with Scarborough.

Distribution

Skipton has long swum against the tide with regard to its branch network; while others closed branches, 2008 saw the Society open five new ones, plus another in early 2009, taking our total to 85. This will grow further with the branches inherited through the Scarborough merger.

The merger with Scarborough will also bring with it investors who transact by telephone. This is a channel Skipton has not explored before and, whilst we will initially limit this to existing products, we will evaluate its effectiveness for future expansion.

This will be balanced with the fact we have spent 2008 expanding our online offering, with new savings products added to this channel and the launch of our eMortgage service, where mortgage brokers submit applications using one of the industry's best online systems. The online channel is a great way to gain cost efficiencies and we will continue to look at ways of using this to deliver new services, whilst still offering the face-to-face contact that so many of our members' desire.

Wholesale funding and capital

A key reason for the healthy state of Skipton's business, in relation to many in the banking sector, is our limited reliance on the money markets, as approximately 70% of our funding comes from retail balances. However, the challenge has been in managing our non-retail funding, with an emphasis on extending the term of our loans for greater stability in our funding profile.

The Society has maintained its level of funding through already well diversified channels, supplemented by a covered bonds programme, established during the year, which will enable it to access further medium term funding whilst the credit crunch continues. In addition, the Society was the first in the sector to have a call date on a tranche of its subordinated debt during the current market, and it is testament to our security and strength, the hard work of our Treasury team and our strong relationship with the investment community that we were able to renew this capital on acceptable terms in December 2008.

The Skipton Group

For a long time, the Society has extolled the benefits of having a group of subsidiaries to complement its core business of savings and loans. During good times they provide dividends to the Society which enables it to deliver better pricing to our members. In more stressed conditions they are assets that allow us to crystallise value to protect the overall Group performance.

As a result, in 2008 the Society sold two of its subsidiaries - Direct Life & Pensions and Amber Select - generating a profit of £9.1 million. This was part of our strategy to concentrate on the Group's five key pillars: savings and lending, mortgage servicing, estate agency, financial advice and data provision. In addition, Connells disposed of its remaining holding in the property website, Rightmove, creating a profit of £22.3 million.

I have already paid testament to the performance of Connells, which made an operating profit despite the most difficult trading conditions for the sector in a generation, helped by good results in lettings, auctions, survey and valuation, and asset management of repossessed properties on behalf of lenders.

Callcredit is another Group company with a positive story to tell. Profits have grown again in 2008, and we are forecasting continued growth, not only in the supply of traditional credit checking products but also in account management, monitoring and over-indebtedness products (particularly relevant right now).

Homeloan Management (HML) is also embracing the opportunities the downturn has presented, especially by improving its range of services in the collections arena to support its portfolio of clients. This is another counter-cyclical business with good prospects.

New to the Group in early 2008, but not faring as well in the present climate, are two financial advisory companies – Torquil Clark, based in the Midlands, and Thomson Shepherd, based in Scotland. They were acquired as part of our strategy to strengthen our financial advice offering and longer-term, when the investment market volatility finally subsides, I'm confident they will deliver a strong performance.

The future

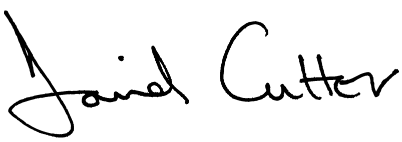
I started my report by referring to a deep recession, which I believe will exist throughout 2009 and well into 2010. An extremely low interest rate environment will prevail, to the benefit of borrowers, but savers will see a very noticeable difference in the lower levels of interest they receive. For those borrowers who do succumb to the economic fallout, we will endeavour to work fairly with them.

In a year of continued subdued activity we will continue to focus on operating the Society as efficiently as possible, whilst ensuring it is best placed to take advantage of the opportunities that arise when economic growth resumes. With so many uncertainties continuing in the general economy, we will not return to the levels of profit seen in 2006 and 2007 for a while, but I am confident that our prudent management of both the core business and our subsidiaries should see us deliver another solid performance.

We remain on track to complete the proposed merger with Scarborough Building Society on 30 March 2009. Our experience during the project has reconfirmed our belief that the two organisations are a close fit, in terms of commitment to mutuality, business diversification and of course geography. The reward will be a stronger mutual with the opportunity to serve a larger audience, which can only be good news for our customers and staff.

With regard to future mergers, I believe that the current economic climate will provide such opportunities and Skipton, with a strong capital base, remains ideally placed to take an active part in any further consolidation. We will consider future mergers so long as our existing members are not compromised and there is a long-term benefit for the combined business.

Finally, I would like to take this opportunity to thank our staff for their commitment and support during the last year. I would also like to pay tribute to my predecessor, John Goodfellow, who retired at the end of 2008 after 17 years as Chief Executive. I welcome the opportunity to continue and build on his legacy.



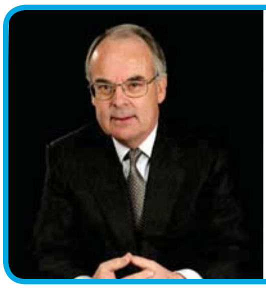
D J Cutter

Chief Executive

24 February 2009

Cheryl Roberts, customer of Chester branch

The Board of Directors



John Rawlings (age 62) – *Chairman*

John Rawlings joined the Board as a Non-Executive Director in 1995 and became Chairman of the Society in 2005. He is also Chairman of the Nominations Committee and a member of the Remuneration Committee. Since 1994 he has been a Non-Executive Director of a number of companies, chiefly in the financial sector, including the Financial Ombudsman Service. His earlier career was spent at the Foreign Office and the merchant bank, Morgan Grenfell & Co Ltd, where he became Deputy Chairman.

David Cutter (age 47) – *Chief Executive*

David Cutter, a Chartered Accountant, joined the Society as Head of Audit in 1993, was appointed to the Board in 2000 and became Chief Executive on 1 January 2009. David was Chairman of the Society's Operational Board from 2002 until 2005 and had Board responsibility for the Group's subsidiary businesses from 2005 until December 2008. He is chair of both the Group Senior Management and Asset & Liability Committees and a member of the Group Retail Credit Committee and Operational Risk Committee.

Alastair Findlay (age 56) – *Vice Chairman*

Alastair Findlay, a Chartered Accountant, joined the Board as a Non-Executive Director in June 2006 and was appointed Vice Chairman in May 2008. He is Chairman of the Audit Committee and a member of the Nominations Committee. After a number of years experience in the corporate finance department of a City investment bank, providing advice and capital raising services to companies and other organisations (in particular in the financial sector), he joined the Mersey Docks and Harbour Company in 1996 where he was Group Finance Director until he left the company at the end of 2005. Alastair is also Vice Chairman of the Countess of Chester Hospital NHS Foundation Trust and an independent Director of the trustees of the main AMEC plc pension funds.

Peter Hales (age 62) – *Non-Executive Director*

Peter Hales joined the Board as a Non-Executive Director in May 2007 and is also a member of the Audit Committee. Prior to joining the Board he was Sales & Marketing Director of Norwich Union, having previously been a Director of General Accident and CGU. He was President of the Chartered Insurance Institute, the professional body for the insurance industry in 2006. He is also a Director of Just Retirement Plc and Unum Ltd, a member of the Accenture Insurance Advisory Board and a member of the Advisory Board of Simply Biz plc.

Paula Hay-Plumb (age 48) – *Non-Executive Director*

Paula Hay-Plumb, a Chartered Accountant, joined the Board as a Non-Executive Director in June 2006. She is a member of the Audit Committee and the Remuneration Committee. Paula's previous roles include Group Treasurer and then Group Financial Controller for Olympia & York Canary Wharf. She was then appointed Finance Director and subsequently Chief Executive of English Partnerships before rejoining Marks & Spencer (where she started her career) in 2003 as Corporate Finance and Group Reporting Director. Paula is a Non-Executive Director of the Forensic Science Service and Chairman of the National Australia Bank Common Investment Fund. She chaired the Coalfields Taskforce, set up by the Government in 1998, and was a founding trustee of The Coalfields Regeneration Trust, completing a nine year term in December 2008.

Noel Hutton (age 59) – *Non-Executive Director*

Noel Hutton joined the Board as a Non-Executive Director in July 2004. He is Chairman of the Remuneration Committee and a member of the Nominations Committee. Before his retirement in 2004, he was a partner of Hammonds, the international law firm, where he specialised in corporate finance. He remains a member of the Law Society.

William Jack (age 64) – *Non-Executive Director*

William (Bill) Jack was appointed to the Board as a Non-Executive Director in early 2001. He is a member of the Remuneration Committee. Prior to joining the Board, Bill was Managing Director of CGU Life, with responsibility for all UK life and associated companies. Before this he was Managing Director of General Accident Life Assurance for eight years, preceding its merger with Commercial Union in 1998 to form CGU Life. Whilst there, he was responsible for a business with a £2.5 billion annual turnover and 3,500 employees.

Alexandra Kinney (age 50) – *Non-Executive Director*

Alexandra (Sandy) Kinney joined the Board as a Non-Executive Director in July 2003 and is a member of the Audit Committee and the Nominations Committee. During her career as an accountant, Sandy was a partner of PricewaterhouseCoopers and was previously a Director at KPMG. In June 2005, she was appointed by the FSA as a Non-Executive Director of the Financial Services Compensation Scheme.

Richard Twigg (age 44) – *Group Finance Director*

Richard Twigg is a Chartered Accountant who joined the Skipton Group in 1993. Having previously been Finance Director of both Homeloan Management and Connells, he was appointed to the Board in 2002. A member of the Group Senior Management Committee, Richard is responsible for finance, treasury, planning and risk management, chairs the Group Retail Credit Committee and is a member of the Asset & Liability Committee and Operational Risk Committee. He is a member of the Society's Operational Board and chairs the Operational Boards of a number of the Group's subsidiary companies. Richard is a trustee of the Society's Charitable Foundation and is a governor of Ermysted's Grammar School, Skipton, and Menston Primary School.

The Skipton Group is pleased to report a solid financial performance in the light of extremely difficult and volatile market conditions. Whilst both our reported and underlying profits are down on the level achieved in 2007, we believe that our business model, based on a traditional and prudent building society supplemented by other income generated through investment in subsidiary companies, demonstrates the long-term stability of the business. Our balance sheet remains healthy and we continue to hold strong levels of liquidity and capital.

Financial overview

The Group achieved pre-tax profits of £22.5m in 2008, down from £163.9m in 2007 with the Society recording a pre-tax profit of £11.3m compared to £136.8m in 2007. The Group and Society results for both 2008 and 2007 include a number of items which management consider to be exceptional, some of which arise as a result of this continuing period of market turbulence.

The following table seeks to adjust the reported profit to exclude such items, to provide a clearer representation of the performance of the Group.

	2008 £m	2007 £m
Reported profit before tax	**22.5**	163.9
Adjustments:		
Profit on sale of subsidiary companies	**(9.1)**	-
Profit on sale of investment in associate	**(22.3)**	(36.0)
Financial Services Compensation Scheme levy	**16.3**	-
Impairment of investment securities	**11.5**	-
Curtailment gain on closure of pension schemes	**(6.3)**	-
Impairment of goodwill	**5.9**	0.9
Net losses from fair value volatility	**3.3**	3.9
Merger expenses	**0.7**	-
Profit before tax after adjustments	**22.5**	132.7

The adjustments above are as a result of the following:

- During the year we disposed of two small subsidiaries, Amber Select Limited and Direct Life & Pensions Limited, realising a net profit of £9.1m;
- We also sold our remaining shareholding in Rightmove PLC in December 2008 (a smaller holding was also sold in 2007) generating a profit of £22.3m (2007: £36.0m);
- The provision for the Financial Services Compensation Scheme levy represents our share of the costs of the scheme following the collapse of Bradford & Bingley and the Icelandic banks;
- Impairment of investment securities includes a charge of £11.0m as a result of the failure of Kaupthing Singer & Friedlander Limited together with a provision of £0.5m against a small investment in a tranche of commercial mortgage backed securities;
- During the year, Connells Limited closed three of the Group's defined benefit pension schemes to future accrual, resulting in a curtailment gain of £6.3m recognised in the income statement;
- In light of performance in current market conditions, the Group provided £5.9m (2007: £0.9m) against the carrying value of goodwill in subsidiary companies;
- Net movements in fair value volatility arise from changes in the value of certain financial instruments resulting largely as a result of fluctuations in interest rates, and these timing differences reverse over time;
- Merger expenses represent the initial legal and other expenses following the announcement of the merger with Scarborough Building Society.

Whilst both the reported and adjusted pre-tax profits are down on the record levels achieved in 2007, the Group has, nevertheless remained profitable during the unprecedented market conditions that persisted throughout the year. A further analysis of the income statement, excluding the above exceptional items, is as follows:

	2008 £m	2007 £m
Net interest income	**86.0**	109.7
Other income	**404.4**	465.6
Share of profits from joint ventures and associates	**3.9**	3.7
Total income	**494.3**	579.0
Administrative expenses	**(432.7)**	(440.1)
Regulatory and other provisions	**(4.5)**	(0.8)
Impairment losses on loans and advances	**(34.6)**	(5.4)
Adjusted profit before tax	**22.5**	132.7

Interest income has fallen year-on-year as, in response to the ongoing turbulence in the financial markets, we continued to carry historically high liquidity levels and attract retail funding, both of which were costly and put further pressure on margins.

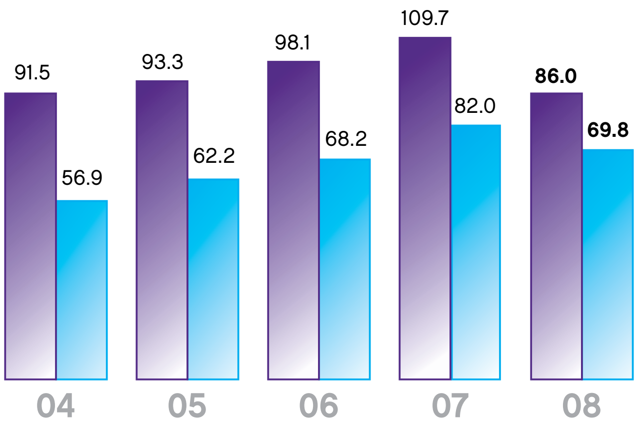
Other income also fell in 2008 with our largest subsidiary, the estate agency Connells, experiencing a fall of 40% in total house sales during the year. Consequently its operating profit is down from £59.7m to £10.4m, however we are pleased that this business continues to trade profitably despite these housing transaction volumes.

Management expenses are marginally down from last year, despite a number of additional subsidiaries. Good cost control across the Group has seen the management expense ratio as a percentage of mean assets fall to 331bps from 381bps in 2007.

The large increase in impairment losses emanates from increased delinquency rates in our specialist lending subsidiary, Amber Homeloans.

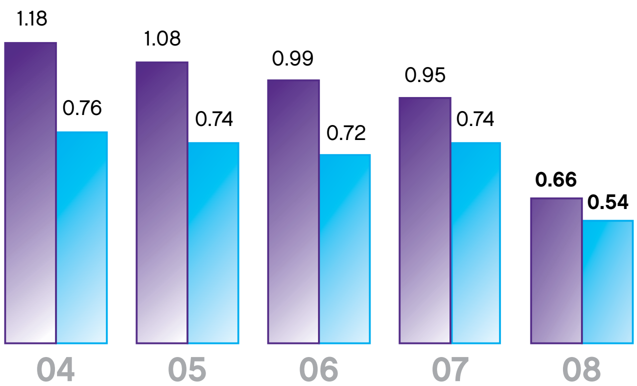
Net interest income

The Group's net interest income reduced by 21.6% during the year to £86.0m (2007: £109.7m), a reduction from 0.95% to 0.66% in terms of margin. Our response to the lack of availability of longer-term funding in the wholesale markets has been to continue to hold a significantly higher level of liquid assets, and by ensuring such liquidity is held in low risk and highly liquid securities. Additionally, during the year, we procured, via commercial third parties, £350m of wholesale funding for durations up to three years, secured on some of our less liquid treasury assets, again at a cost to margin. The consequence of these prudent wholesale funding actions was to reduce our margin by approximately 0.26% during the year.



Net interest income (£m)

Additionally, we remained successful in growing our retail funding during 2008, but this too came at a cost, which was only partially offset by an increase in mortgage margins. We estimate the net cost to the Group's retail margin to be a further 0.03%.



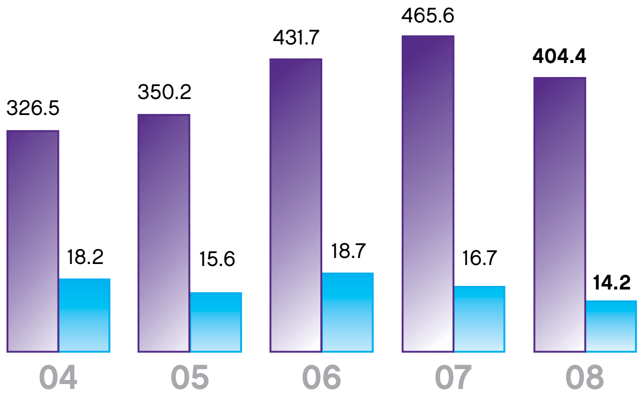
Interest margin (%)

Other income

The Society other income represents income earned from the sale of insurance and investment products together with fees not included within margin. At a Group level, other income also represents the turnover of our trading subsidiaries.

The Group's underlying other income for the year was £404.4m, down 13.1% from £465.6m in 2007. The major reason for this fall was from Connells, which contributed 44.0% (2007: 54.1%) of the Group's other income, following the significant downturn in the housing market.

At a Society level, lower volumes of mortgage and investment commissions, as a result of lower volumes of transactions, together with a reduction in the dividends received from subsidiaries, contributes to its other income, also being below that earned in 2007.



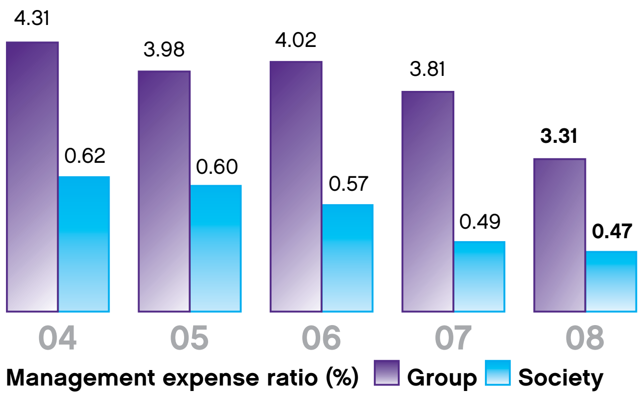
Other income (£m)

Administrative expenses

Total administrative expenses, excluding exceptionals, fell by 1.7% to £432.7m from £440.1m in 2007 as a result of a lower cost base pursuant to lower transaction levels, particularly within some of our subsidiary businesses. The Group recognises the importance of maintaining efficient operations, particularly in these difficult times, and we continue to focus on our cost base to ensure we reap the benefits of efficiency savings in future years.

Despite the Society opening five branches in 2008, and opening a further branch in January 2009 bringing the total number of branches to 85, the Society has managed, once again, to reduce its ratio of administrative expenses to mean assets which fell for a fifth consecutive year to 0.47% (2007: 0.49%), which we are confident will remain one of the lowest in the building society sector.

At a group level, this management expense ratio is less comparable, given the investments we have made in our trading businesses both historically and during the year. However the cost reductions achieved have resulted in this ratio also falling to 3.31% in 2008 from 3.81% in 2007.



Impairment losses on loans and advances

The Group's impairment losses on loans and advances increased to £34.6m (2007: £5.4m), with the majority of the charge emanating from the specialist residential mortgage loans held in Amber Homeloans. Difficult market conditions, and an increase in unemployment, have resulted in an increased number of arrears and possessions within this portfolio; however we are confident that our pro-active arrears management strategy will contain the charge for impairment losses in 2009. The core residential, buy-to-let and commercial loan portfolios in the Society continue to perform well, and the charge for impairment losses on those loans remains low.

The loan books in our offshore mortgage subsidiary, Skipton Guernsey, and our debt factoring business, Skipton Business Finance remain of high quality and the charge for impairment losses on these loans remains negligible.

Taxation

As a result of tax free profits arising on the disposal of subsidiary companies and shareholding in Rightmove PLC, the Group reported a statutory income tax credit for the year of £1.3m (2007: charge of £37.3m). This represents an effective tax rate of negative 5.8% (2007: positive 22.8%), substantially lower than the statutory UK corporation rate of 28.5% (2007: 30%).

Balance sheet

Loans and advances to customers

The majority of the Group's loans and advances to customers represent residential mortgage lending carried out through the Society, specialist lending through Amber Homeloans and lending in Jersey and Guernsey by Skipton Guernsey. Skipton Business Finance has a small portfolio of factored debt.

Following record volumes of lending in 2006 and 2007, our strategy for 2008 was to concentrate on maintaining liquidity. We have therefore concentrated on limiting mortgage growth and managing the performance of the mortgage portfolio. Consequently, as the risks in specialist lending increased, we took the decision to cease lending through Amber Homeloans in March 2008. The Society also reduced its lending aspirations and tightened its lending criteria to attract only the best quality borrowers. As a result, total Group residential mortgage lending was £1,501.8m (2007: £2,764.7m), comprising £1,253.7m (2007: £1,937.4m) of completions in the Society, £160.1m (2007: £731.1m) by Amber Homeloans and £88.0m (2007: £96.2m) by Skipton Guernsey.

The Society's residential lending is backed up by excellent customer service. Fixed rate products remained the most popular, attracting 59% of all applications, as customers try and protect themselves from uncertainty.

Our lending continues to be well diversified by product type and geographical distribution and provides inherent low credit risk, with 36% of the Group's new lending having an LTV of less than 75%. This well managed spread of risk ensures that the quality of the Group's mortgage lending remains high.

We also assessed the risks surrounding buy-to-let lending, and again strengthened our criteria such that buy-to-let advances, included in the residential lending figures above, reduced to £202m (2007: £259m). We manage the risks attached to buy-to-let lending by prudent consideration of the level of equity in the property, where generally lower LTV ratios are required compared to residential lending, and an appropriate rental income to mortgage payments ratio is also required. Pursuant to our prudent stance on criteria, we have maintained our strong asset quality in this area of lending.

As a result of the credit crunch the whole loan portfolio trading market remains closed and there has been minimal portfolio trading within Amber Homeloans with only a pre-agreed acquisition of £8.1m (2007: £412.6m) and no sales (2007: £427.1m).

Having considered the risks inherent in this class of lending, the Society ceased commercial lending to new customers in November 2008. Commercial lending completions were £121.5m (2007: £160.5m), with commercial lending balances at 31 December 2008 standing at £527.8m (2007: £465.3m).

In previous years, the Group has seen increasing levels of redemptions, fuelled by the buoyant mortgage market in which borrowers reaching the end of a mortgage product period searched the market and sought to move onto the most attractive rate. However, with the availability of mortgage products declining in the current market, we have seen this reflected in the level of redemptions across the Group which have fallen to £1,221.6m (2007: £1,470.6m) during the year.

Overall, the Group has increased its loans and advances by 1.3% to £9,424.5m (2007: £9,300.4m) as set out in the table below:

	2008		2007	
	£m	%	£m	%
Total residential mortgages	**8,815.7**	**93.6**	8,698.2	93.5
Commercial loans	**527.8**	**5.6**	465.3	5.0
Other lending:				
Debt factoring loans	**30.8**	**0.3**	34.4	0.4
Premium finance loans	**-**	**-**	63.4	0.7
Other loans	**50.2**	**0.5**	39.1	0.4
Gross balances	**9,424.5**	**100.0**	9,300.4	100.0
Impairment provisions	**(44.1)**		(17.0)	
Fair value adjustment	**187.3**		8.5	
	9,567.7		9,291.9	

The Group continues to take all appropriate action to minimise losses on non-performing accounts and actively monitors the prudence of its lending policies, taking account of economic and other market conditions.

The performance of the Society's residential mortgages remains good with only a modest increase in arrears during 2008. At the year end only 297 cases (0.38%) were three months or more in arrears, compared with 149 cases (0.20%) a year ago. During the year the Society took 74 cases (2007: 40) into possession, of which 37 cases (2007: 12) remained in possession at the year end.

Amber Homeloans' arrears levels are higher than the Society's due to the specialist nature of their mortgages, and it is inevitable that this market would show the most marked reaction to the deterioration in the economic environment. Consequently, we have seen a sharp rise in arrears in the Amber portfolio and at the year end 752 cases (6.61%) were three months or more in arrears, compared with 218 cases (1.76%) at 31 December 2007. Total new possessions within Amber Homeloans were 238 cases (2007: 97), and 184 cases (2007: 45) remained in possession at the year end.

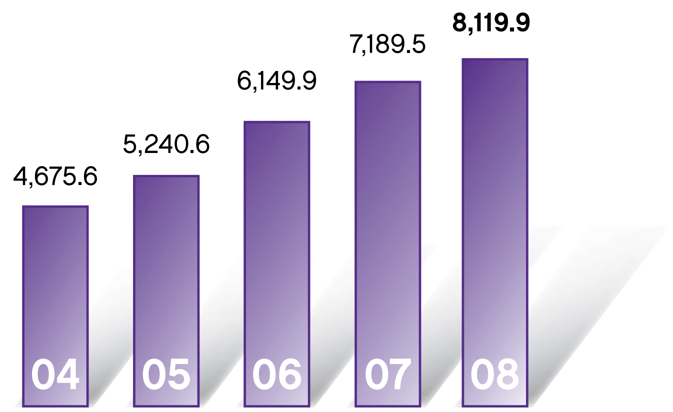
At a consolidated Group level 1,051 cases (1.16%) were three months or more in arrears, compared with 367 cases (0.40%) at 31 December 2007, compared to the CML average of 1.89%.

Our portfolio of commercial loans continues to perform well despite the current economic backdrop. This lending comprises secured advances on a well diversified portfolio of commercial investment and small business loans, and there are no individually significant balances. There were 6 cases (2007: 10) three or more months in arrears at 31 December 2008 representing 0.32% (2007: 0.57%) of the portfolio. There remain no commercial cases in possession (2007: Nil).

Funding

Retail

As a mutual, the Group is required to obtain the majority of its funding through retail member deposits. 68.98% (2007: 66.24%) of our funding comes from retail savings and we attracted a total of £967.1m (2007: £1,041.2m) of net retail inflows during the year. Against the backdrop of intense competition in this market, as lenders increasingly turned their focus to the retail markets for funding, we increased our market share and saw growth of 12.9% (2007: 16.9%) in our savings accounts. Our continued success in attracting retail deposits is due to our strategy of offering members consistently good value on their savings. The growth in share balances from £7,189.5m to £8,119.9m was driven principally by our range of competitively priced Fixed Rate Bonds and the ongoing popularity of our Branch Access account which continue to receive regular Best Buy mentions.



Retail balances (£m)

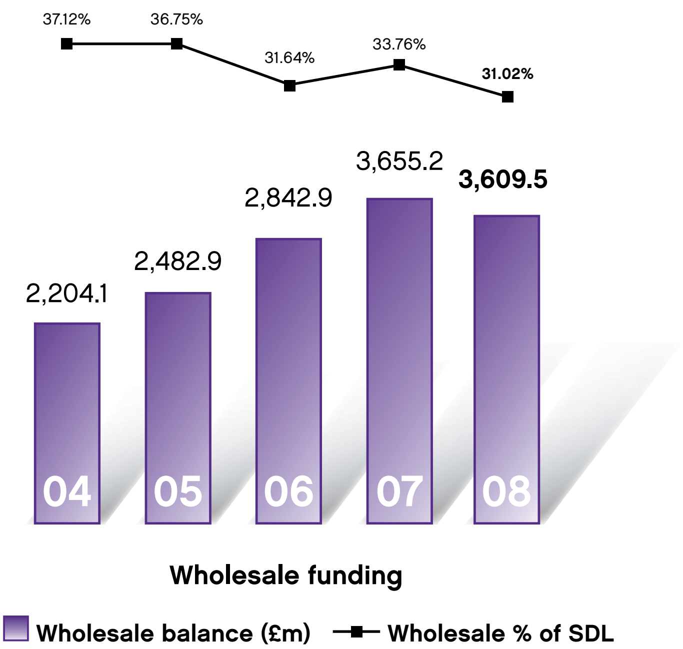
In addition to our UK retail funding, the Group also accepts deposits through our 100% owned subsidiary Skipton Guernsey. The Guernsey retail deposits market suffered a setback in October 2008, when Landsbanki Guernsey Limited collapsed. In the absence of a depositor protection scheme on the island, savers in Landsbanki stand to lose a proportion of their savings. Consequently, we, in common with similar savings institutions on the island, saw an immediate and significant fall in deposits as customers sought to move their funds to jurisdictions backed by a depositor safety net. However, we are pleased to report that, following the welcome introduction of such a scheme by the States of Guernsey, we saw balances increase again to end the year at £468.3m (2007: £488.9m), a fall of only 4.2% year-on-year.

Wholesale

The remainder of the Group's funding comes from the wholesale markets. At 31 December 2008, wholesale funding balances amounted to £3,609.5m (2007: £3,655.2m), a decrease of £45.7m. Our strong retail savings inflows allowed us to reduce our reliance on the wholesale funding markets as our wholesale funding ratio fell from 33.76% in 2007 to 31.02% at 31 December 2008.

Wholesale credit markets have remained tight since the economic downturn began in August 2007 and the long-term public issuance markets remain effectively closed. As a result, retaining maturing deposits and lengthening the duration of our wholesale funding have been key goals to protect against a continuation of current market conditions. We have been successful in doing this and have used our repo (secured borrowing) capabilities to provide additional wholesale funding of £487.1m (2007: £220.7m), split between the Bank of England's Open Market Operations and transactions with a number of market counterparties providing funding for periods up to three years. As a result of these actions the proportion of our wholesale funding with a maturity of over one year increased to 24.3% at 31 December 2008 (2007: 23.1%).

We have also continued with our strategic aim of further diversifying our funding sources and during November made our inaugural issue off our Covered Bonds programme which was established during the year. This will enable the Society to raise funding backed by its prime residential mortgage portfolio. At the year end £750m had been issued off the programme and in the absence of a public market these securities will be used to generate funding from the Bank of England's Special Liquidity Scheme.



The following table analyses the change in the make up of our wholesale funding and demonstrates the shift towards secured funding during the year.

	2008		2007	
	£m	**%**	£m	%
Repo and other secured agreements	**487.1**	**13.5**	220.7	6.0
Deposits	**1,748.0**	**48.4**	1,901.9	52.0
Certificates of deposits	**341.1**	**9.5**	696.3	19.1
Medium term notes	**894.9**	**24.8**	816.3	22.4
Fair value adjustments	**138.4**	**3.8**	20.0	0.5
Total	**3,609.5**	**100.0**	3,655.2	100.0

During the course of the year, the rating agencies have been extremely active in reviewing the relative credit worthiness of all financial institutions. The ratings assigned are a key determinant of the funding markets we are able to access and the cost of funding. As at the end of the year, our credit ratings, provided by Moody's and Fitch, were as follows:

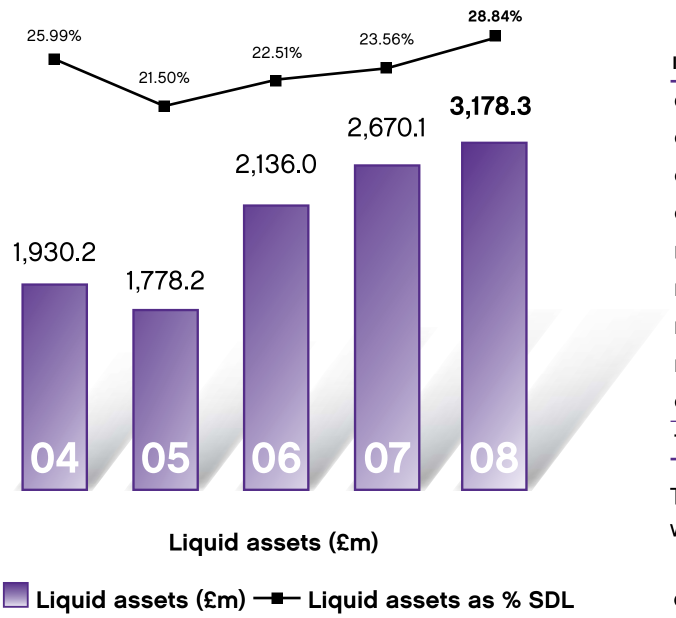
	Fitch	**Moody's**
Long-term	A	A2
Short-term	F1	P-1
Subordinated	A-	A3

Whilst both ratings agencies have placed the Society on negative outlook at 31 December 2008, pending completion of the merger with Scarborough Building Society, we are pleased to have retained our current ratings during these turbulent times.

Liquidity

Liquidity is held primarily for the protection of depositors and in responses to these challenging market conditions, we are pleased that we have increased our liquidity balances to £3,178.3m at 31 December 2008 (2007: £2,670.1m); expressed as a proportion of our combined shares and deposit liabilities this represents 28.84% (2007: 23.56%).

However, in addition to the absolute level of liquidity held, we have also increased the proportion of liquidity which is accessible within a short period of time. The core 8-day liquidity ratio is managed to a level well in excess of the building society regulatory limit of 3.5% of funding liabilities and at 31 December 2008, this ratio was 17.6% (2007: 11.4%) representing 65.3% of the total liquidity portfolio (2007: 46.3%).



As the credit crunch continues, focus remains on the type and valuation of investments held by financial institutions. The Group has no exposure to US mortgages, hedge funds or leveraged loans. The Group's treasury investments are held to provide prudential liquidity and all are highly rated; 96.9% (2007: 95.1%) of the Group's treasury investments are rated A or better.

	2008		2007	
Rating	**£m**	**%**	£m	%
Aaa	**843.8**	**26.5**	653.2	24.5
Aa1	**766.3**	**24.1**	442.3	16.6
Aa2	**461.0**	**14.5**	488.7	18.3
Aa3	**453.3**	**14.3**	520.5	19.5
A1	**180.0**	**5.7**	105.5	3.9
A2	**270.0**	**8.5**	266.1	10.0
A3	**102.7**	**3.2**	64.0	2.4
Baa1	**19.0**	**0.6**	-	-
Baa2	**25.5**	**0.8**	-	-
Unrated:				
Building societies	**53.0**	**1.7**	73.1	2.7
Local authorities	**3.7**	**0.1**	56.7	2.1
Total	**3,178.3**	**100.0**	2,670.1	100.0

The Group employs a rigorous credit assessment process and considers the risks of all assets before they are acquired and throughout the period they are held. Credit approval, along with monitoring the Group's exposure concentrations against a variety of criteria including industry sector and country of risk, is carried out by an independent Treasury Risk function.

	2008		2007	
Industry sector / asset class	**£m**	**%**	**£m**	**%**
Cash in hand and balances with the Bank of England	**359.4**	**11.3**	136.0	5.1
Cash with banks and building societies	**1,064.4**	**33.5**	370.2	13.9
Gilts	**111.0**	**3.5**	75.0	2.8
Certificates of deposit	**946.5**	**29.8**	1,213.9	45.5
Local authority investments	**3.7**	**0.1**	56.7	2.1
Fixed rate bonds	**1.7**	**0.1**	25.0	0.9
Floating rate notes	**390.0**	**12.3**	400.7	15.0
Residential mortgage backed securities	**243.0**	**7.6**	328.9	12.3
Commercial mortgage backed securities	**58.6**	**1.8**	63.7	2.4
Total	**3,178.3**	**100.0**	2,670.1	100.0

The Group does not hold any mortgage backed securities with US mortgages or loans as collateral.

	2008		2007	
Geographical exposure	**£m**	**%**	£m	%
UK	**1,724.5**	**54.3**	1,243.5	46.6
Rest of Europe	**1,043.4**	**32.8**	1,351.5	50.6
North America	**106.3**	**3.3**	5.1	0.2
Australasia	**214.1**	**6.7**	70.0	2.6
Far East	**90.0**	**2.9**	-	-
Total	**3,178.3**	**100.0**	2,670.1	100.0

Treasury assets are valued using quoted market prices or prices obtained from counterparties. Where reliable market prices are not available, discounted cash flow models are used. Until 1 July 2008, under International Accounting Standards (IAS), all our treasury investments were held as available-for-sale (AFS) assets and fair value movements recorded in the AFS reserve. Following a revision of IAS 39, *Financial Instruments: Recognition and Measurement*, we have reclassified certain treasury investments, where there is currently no reliable active market, from AFS assets to Loans and Receivables. These assets are now reported on an amortised cost basis from that date.

The adverse fair value adjustments of AFS assets have largely been driven by widening credit spreads pursuant to liquidity issues in the wholesale markets rather than a deterioration in the underlying performance of the assets. At 31 December the negative balance on the AFS reserve was £13.2m (2007: £5.7m), representing 0.4% (2007: 0.2%) of the total liquidity portfolio.

During the year, an impairment loss of £11.5m has been recognised in the Income Statement; £11.0m relates to a senior unsecured exposure to Kaupthing Singer & Friedlander Limited, which went into receivership in October 2008. We have prudently provided the full amount of our investment, but remain hopeful that at least some of this amount will be recovered in the future. The additional impairment charge of £0.5m relates to our assessment of the recoverability of a small investment in a Commercial Mortgage Backed Security, where full recoverability appears doubtful.

All treasury assets are regularly reviewed for impairment and, with the exception of the amounts set out above, we currently expect to obtain full value from them all on maturity.

Capital structure

The Group is regulated by and is required to manage its capital in accordance with the rules and guidance issued by the FSA. The capital requirements of the Group are monitored on a monthly basis and the results of this monitoring are reported to the Asset and Liability Committee (ALCO) and the Board. Capital is ultimately held for the protection of retail depositors, and the internal level of capital is set with the aim of ensuring the minimum regulatory objective is met, whilst facilitating the growth aspirations of the business as defined annually as part of the Group's corporate planning process. Consequently, the Board limits on capital adequacy are set at a level higher than the regulatory minimum. The Group has, throughout the year, operated comfortably in excess of the minimum capital levels set by both the Society's regulator and the Board.

Prior to 1 January 2008, the Group complied with the requirements of the Capital Accord (Basel I); from that date we are regulated under the EU Capital Requirements Directive (Basel II).

The Group continues to calculate its capital requirements for retail mortgage assets under the standardised approach.

The following table shows the composition of the Group's capital at the year end. Total regulatory capital amounted to £731.2m (2007: £731.4m) with the Basel II total solvency ratio remaining strong at 12.28% (2007 Basel I: 12.30%).

	Basel II 2008 £m	Basel I 2007 £m
Tier 1		
Reserves	**703.6**	721.7
Permanent interest bearing shares (note 1)	**25.0**	25.0
Pension fund deficit add back (note 2)	**16.7**	13.6
Deductions from Tier 1 capital (note 3)	**(242.5)**	(230.4)
Unrealised losses on available-for-sale debt securities	**13.2**	5.7
Unrealised losses on cash flow hedges	**21.2**	4.9
Total Tier 1 capital	**537.2**	540.5
Tier 2		
Subordinated debt (note 1)	**180.0**	180.0
Collective impairment allowance	**14.0**	10.9
Total Tier 2 capital	**194.0**	190.9
Total capital	**731.2**	731.4
Risk weighted assets – Pillar 1 (note 5)		
Retail mortgages	**3,569.0**	4,425.7
Commercial loans	**464.7**	464.0
Treasury	**601.2**	613.4
Other	**462.3**	444.4
Operational risk	**846.1**	-
Market risk	**9.0**	-
	5,952.3	5,947.5
Core Tier 1 (%) (note 4)	**8.61%**	8.67%
Tier 1 ratio (%) (note 4)	**9.03%**	9.09%
Total capital (%) (note 4)	**12.28%**	12.30%
Tier 2 to Tier 1 ratio (%)	**36.11%**	35.32%

Notes

1. Under FSA rules permanent interest bearing shares and subordinated debt are included in the solvency calculation in accordance with UK GAAP rather than IFRS.
2. The regulatory capital rules allow the pension fund deficit to be added back to regulatory capital and a deduction taken instead for an estimate of the additional contributions to be made in the next 5 years, less associated deferred tax.
3. Intangible assets must be deducted from regulatory capital.
4. Calculated as relevant capital divided by risk weighted assets. Core Tier 1 relates to Tier 1 capital excluding permanent interest bearing shares.
5. The measurement of risk weighted assets differs significantly under Basel II so the stated figures for 31 December 2008 are not directly comparable with those for 31 December 2007. An example is that under Basel II retail mortgages which are considered to be secured and not past due are weighted at 35% compared with 50% under Basel I. Furthermore there is no risk weighted asset requirement for operational or market risk under Basel I.

For statutory purposes, under Basel II, we are required to calculate our capital ratios for both the solo consolidation group and the UK consolidation group. The solo consolidation group comprises the Group's UK based mortgage lending bodies whilst the UK consolidation group consists of the entire Group except a small number of entities whose activities are not deemed to be closely aligned with the core business, in accordance with BIPRU 8.5.1.

The table below sets out the capital resources of the solo and the UK consolidation groups, together with the associated capital resource requirements as at 31 December 2008. Both ratios are comfortably above the regulatory threshold.

	UK consolidation group	Solo consolidation group
Total capital resources (£m)	707.1	660.0
Total capital resource requirement (£m)	436.3	400.0
Capital ratio (%)	162.1%	165.0%

Financial Services Compensation Scheme (FSCS)

Following the UK government's decision to transfer Bradford & Bingley's savings business to the Abbey National and the failure of Icelandic banks, claims have been triggered against the FSCS. The Society, together with all other building societies, will therefore be required to pay levies in respect of those claims based upon its share of UK protected deposits.

Whilst we have yet to receive formal notification of our liability under the scheme, we have provided a total of £16.3m during 2008, based on our estimate of our liability for the first three scheme years' liability. We believe that this represents a prudent approach but note that any subsequent liability will be dependent on a number of factors outside our control, including the amount the FSCS is able to recover from the failed banks and, indeed, whether there are any future claims on the scheme.

Further details are set out in note 36 to the Accounts.

Pension funds

The Group operates four defined benefit schemes as described in note 39, in addition to defined contribution stakeholder schemes open to the remaining employees who are not members of these schemes.

The aggregate valuation of the four funds at 31 December 2008 resulted in a deficit of £37.9m (2007: £22.3m) using the methodology set out in IAS19. We have taken steps to actively manage the deficit, including the following:

- The Skipton Building Society Pension & Life Assurance Scheme is closed to new members and existing members now accrue future benefits on a Career Averaged Revalued Earnings basis;
- The Connells Limited Pension & Life Assurance Scheme, the Sequence (UK) Limited (1997) Pension & Life Assurance Scheme and the Sequence (UK) Limited (South) Staff Pension Scheme were closed to new members throughout the year and existing members accrued benefits on a Career Average Revalued Earnings basis. During the year, it was agreed that future pension accrual would cease in these schemes with effect from 1 January 2009 for all members who would then be eligible to participate in stakeholder schemes;
- Employee contributions have been increased;
- Special contributions totalling £25.2m have been paid between 2006 and 2008 and plans have been agreed with the Trustees for the elimination of the remaining deficit.

We will continue to monitor the deficit on the schemes to manage the funds in a responsible manner, with the aim of eliminating the actuarial funding deficit within the next three to seven years.

Performance by business area

The Group operates in five main business areas as follows:

- Mortgage and savings – principally the Society, but also includes specialist mortgage lending in Amber Homeloans and lending in Jersey and Guernsey through Skipton Guernsey;
- Estate agency – including survey and valuations, conveyancing, asset management and mortgage broking carried out through Connells;
- Mortgage servicing – mortgage administration services, principally Homeloan Management, also includes Baseline Capital;
- Data provision – provision of credit reference agency and database services by Callcredit Information Group;
- Financial services – provision of financial advice and broking services through five separate financial adviser companies.

Whilst inevitably the results of many of the Group's business areas were impacted by the deteriorating economic conditions during the year, we are pleased that the strength of our business model has allowed the Group to achieve profitable results.

Business area	Profit / (loss) before tax (£m)	
	2008	2007
Profit before exceptional items		
Mortgages and savings	**3.6**	41.8
Estate agency	**10.4**	59.7
Mortgage servicing	**8.3**	15.6
Data provision	**4.7**	2.9
Financial services	**(1.0)**	0.9
Other businesses	**(1.4)**	10.7
Inter-company adjustments	**(2.1)**	1.1
Sub-total	**22.5**	132.7
Exceptional items, net	**-**	31.2
Reported profits	**22.5**	163.9

Mortgages and savings

The Group's mortgage and savings businesses comprise the Society, Amber Homeloans, Skipton Guernsey and, latterly, Skipton Covered Bonds LLP, the vehicle through which covered bonds are issued.

The Society's underlying operating profit fell to £20.1m from £37.3m principally as a result of the falling interest margin as the business invested in maintaining high levels of liquid assets and increased its funding from expensive retail sources. Despite the opening of five new branches during the year, the management expenses ratio fell by a further 2bps to 47bps. Whilst much of the Society's focus was on maintaining a prudent balance sheet, it also continued to put its customers at the heart of its operations by retaining the Customer First accreditation.

As documented elsewhere, Amber Homeloans results were impacted by impairment losses as its higher risk borrowers fared less well in the onset of the recession. The impairment charge in Amber during 2008 was £30.1m, up from £3.3m in 2007 as both arrears and possessions volumes grew. Amber continues pro-actively to manage its arrears and has applied further resources and a variety of targeted techniques, including the use of behavioural data, in order to contain the emergence of losses moving into 2009. Amber incurred a pre-tax loss of £17.2m (2007 profit: £1.6m) primarily as a result of increased arrears charges. Following the decision to stop lending, Amber's mortgage balances have fallen to £1,442.0m from £1,511.6m in 2007 and are expected to decrease substantially in 2009.

Skipton Guernsey made a profit of £1.9m in 2008, down from £2.9m. Throughout the year, competition for savings remained fierce, yet, until the Landsbanki failure in October, we successfully increased savings, albeit at a cost to margin. Following the loss of over 15% of savings balances in a two week period as investors panicked realising their capital was not guaranteed by a depositor protection scheme, some confidence was restored and balances have begun steadily increasing again. As with the Society, mortgage lending was constrained to preserve liquidity, such that the mortgage book grew by only £33.9m in the year to £356.7m, but the quality remains good with no loans being identified as impaired. During the year, Skipton Guernsey also implemented a foreign currency option, allowing savers to invest in Sterling, Euro or US Dollar accounts, which has proved popular with customers.

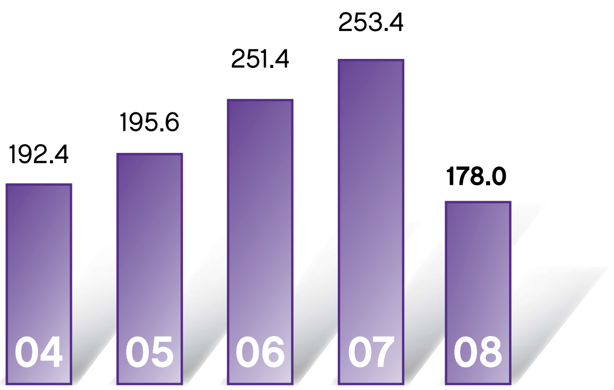
Estate agency

The buoyant housing market experienced over the past few years ended dramatically in late 2007, in the wake of the onset of the credit crunch. Consequently, the volume of UK housing transactions has fallen considerably, with Connells' volumes of second hand property sales being down 40% on 2007 and consequently core estate agency revenues fell to £124.9m from £205.5m.

Nevertheless, Connells benefits from its own diversification and, through The Asset Management Group and Connells Asset Management, is now the UK's leading provider of asset recovery services to lenders, which has proved to be a natural mitigant in these times when core estate agency business is depressed. These asset management services have seen an increase in revenues of 63.4% in 2008, and a consequent increase in profits of 29.2%. Further diversification of Connells' income comes from its survey and valuation business, lettings and mortgage and insurance broking operations.

With the downturn in housing transactions being deeper than for many decades, Connells has undertaken rigorous cost reduction; 26 branches were closed during 2008, reducing the size of the network to 472 from 498; staff numbers fell to 4,217 from 5,117; and total costs for the year fell by 12.1% to £176.4m (2007: £200.7m). Consequently, despite these conditions, the Connells Group achieved an operating profit of £10.4m (2007: £59.7m), a truly remarkable performance.

Having trimmed the cost base, Connells is in a good position to weather the storm, and whilst second hand property sales volumes appear to have now hit the bottom of the trough, the business should remain profitable.



Connells total fee income (£m)

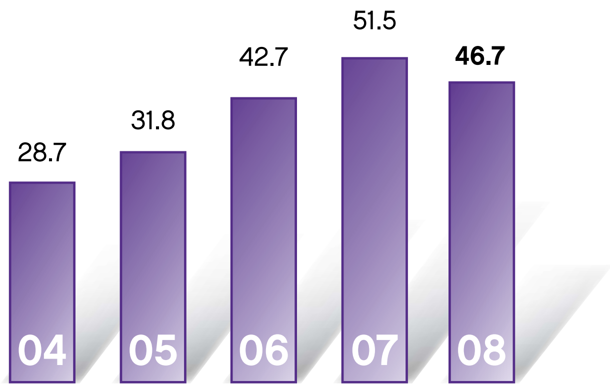
Mortgage servicing

A key element of our diversification strategy is the provision of mortgage services to other lenders. This takes the form of mortgage process outsourcing through HML, one of our first subsidiary companies, established in 1987.

Against the background of financial turmoil, HML's 2008 performance was creditable. For the first time in many years the portfolio of mortgage assets under administration reduced and the underlying activities that generate much of HML's revenue were significantly lower than in recent years which we have compensated for by broadening other revenue streams. Although total revenues have remained flat year-on-year, profit has reduced, as some pricing margin has been conceded and the company has invested heavily in a range of initiatives. Pre-tax profit of £8.3m (2007: £15.6m) was a satisfactory result under the circumstances and leaves the business well positioned to meet the further challenges that face the industry through 2009.

Despite the collapse in mortgage origination, existing lenders and new entrants to the market continue to seek opportunities. Outsourcing of mortgage processing continues to be a key component of many lenders' business models and there is genuine potential for the business to grow through 2009.

2008 saw further development in HML's operating model. The progressive introduction of lean operating techniques, complemented by separate initiatives to ensure quality of performance, has significantly enhanced operational efficiency and will ensure the business maintains its position as the leading third party mortgage administrator in the UK. The company has continued to make significant investment in technology. In addition to systems modification to ensure compliance with new CCA legislation there has been further development of credit management systems providing greater automation and flexibility in the management of arrears. This is supported by the establishment of a 'Special Servicing' capability designed to ensure that HML can provide the most comprehensive and effective credit management solution.



Assets under management (£bn)

Data provision

The data provision business line primarily consists of Callcredit Information Group (CIG). CIG supplies a wide range of credit referencing, marketing information and network planning services, and has extended the scope of these in 2008, following the acquisition of Broadsystem Limited at the end of 2007. Broadsystem creates, delivers and manages multi-channel customer communications, and has had a successful first year as part of CIG, its activities broadening the service offering to ensure CIG keeps pace with the challenging conditions in the marketing services sector.

CIG has continued to build on its success of 2007 in 2008. As the economy, particularly the consumer sector, enters uncertain times, the services Callcredit provides to lenders will become increasingly important and valuable.

It has been successful in responding to the requirement for counter-cyclical products centred on debt collection and customer management. Of particular note is its innovative Over-Indebtedness initiative, which monitors those customers most at risk of default due to high debt burdens.

In terms of financial results, after a long period of investing in the business infrastructure, Callcredit Information Group made an underlying profit of £4.7m, compared to £2.9m in 2007.

Financial services

The Group's financial services operations are conducted through a number of subsidiaries, each operating either in a different UK geographical region or using a different delivery channel, enabling us to maximise the potential from the services offered to customers.

The Skipton Group now comprises five IFA or Whole of Market businesses, with combined revenues of £40m, 30% of which is trail/renewal based. Joining the existing subsidiaries in 2008 were new acquisitions, Thomson Shepherd and Torquil Clark and the group also includes Skipton Financial Services, Pearson Jones and Parnell Fisher Child.

Thomson Shepherd, based in Scotland, specialises in investment advice and pensions, trust and estate planning; whilst Torquil Clark, based in Wolverhampton, offers financial planning, execution only investments, employee benefits, and life insurance services.

Equity markets were depressed throughout 2008 and falling asset values coupled with relatively attractive savings rates on offer from banks and building societies impacted the Group's financial services businesses during the period. This group of business incurred a pre-tax loss of £1.0m (2007: profit £0.9m) during the year.

However, the combined potential of these subsidiaries, together with a renewed focus on streamlining processes and improving efficiency, mean that they have a solid platform on which to build profitability once investor confidence returns. Whilst costs control remains paramount, the financial services subsidiaries continue to invest in a robust compliance regime, and are well placed to demonstrate its positive attitude to Treating Customers Fairly and the Retail Distribution Review.

Other businesses

The Group's other subsidiary businesses are lesser in size and therefore financial contribution. The largest of these businesses are Pink Homeloans, a mortgage packaging intermediary; Skipton Business Finance, a debt factoring and invoice discounting business; Sterling International Brokers, a money broker; and The Private Health Partnership, a medical insurance intermediary.

Principal risks and uncertainties

Risk management framework

The Group's objective is to appropriately manage all the risks that arise from its activities

Through its risk management framework, the Group has a formal structure for managing risks throughout the business. This framework is formulated within the parameters of the Board's overall objectives and appetite for risk. Essentially the framework is based upon the best practice 'three lines of defence' model, comprising:

- First line of defence, being the business which, through the implementation of the organisation's risk framework, identifies, assesses, mitigates and manages risk.
- Second line of defence comprising the Group risk functions (Operational, Credit, Market & Insurance) and related risk functions including Compliance, Systems Security, Finance and Legal. These functions challenge, monitor, guide and support the business in managing its risk exposure. The risk committee structure (ALCO, Group Retail Credit Committee and Operational Risk Committee) also sits within the second line, setting policy and framework and monitoring implementation by the business. Group risk functions are represented on each of the risk committees.
- Third line of defence, which covers the independent assurance aspects of the model and includes the Audit Services function, which performs a risk based programme of audits and reports on these and related risk and control matters to the Board Audit Committee.

The key risks and uncertainties faced by the Group, which are managed within the framework described above, are set out below.

Business conditions and the economic environment

As a financial services group, our businesses are affected by the external environment within which we operate and the profitability of the Group has been adversely affected by a downturn in the UK economy. Given the nature of our businesses, we are particularly exposed to a downturn in the UK housing market (either a significant decrease in house prices or transaction volumes), both in our core building society business, as well as in the major Group subsidiaries such as Connells and HML. A further worsening in the economic environment would impact on the demand for the Group's products and services, and could adversely impact the credit quality of the Group's assets.

However, through our annual planning process and active management, which includes detailed stress testing, we believe we are well placed to withstand a weakening of market conditions, should that arise.

Credit risk

Credit risk is the risk that a customer or counterparty is unable to honour its obligations to us as they fall due. The Group faces this risk in respect of individual customers (retail mortgages), businesses (commercial lending) and other financial institutions (wholesale lending).

Credit risk within our retail and commercial mortgage portfolios is driven by general UK economic pressures, including rising unemployment, deterioration in household finances due to inflation or other pressures, and further contraction in the UK housing market leading to falling property values. The extent of further economic slowdown and the extent of further falls in house prices will affect the level of impairment losses. In our residential mortgage business we monitor closely applicant quality, affordability and loan-to-value multiples. In addition to these factors, our commercial lending underwriting teams also assess business or tenant cash flows where relevant. The credit decision is always managed separately from the sales force. Retail mortgage and commercial lending credit risks are managed within credit policies and limits set by the Group Retail Credit Committee and loans which show signs of adverse performance are managed by specialist teams who manage the collections and recovery process.

Credit risk within our treasury portfolio assets arises from the investments held by the Group in order to meet our liquidity requirements and for general business purposes. The wholesale credit markets remain volatile and dislocated and a further deterioration could lead to further fair value adjustments in the Group's portfolio of AFS assets coupled with further impairment of our treasury investments portfolio. This element of credit risk is managed by the Group through regularly reviewed credit policies and limits set by ALCO.

Market risk

Market risk is the risk that the value of, or income from, the Group's assets and liabilities is impacted as a result of changes in market prices. The Group's market risk comprises three types of risk: interest rate risk, currency risk and equity risk.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

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 financial instruments.

The primary interest rate risk metrics employed by the Group to monitor interest rate risk are earnings-at-risk, market value and value-at-risk methodologies, which calculate interest rate risk exposure positions, based on 250 historical data observations. Monthly observation periods are used with equal weight being applied to all observations. All of these approaches employ 95% confidence intervals and are multi-currency. These advanced interest rate risk measurement exposures, which are compared to Board and Operational limits weekly and formally reported to ALCO and the Board monthly, are used to guide interest rate risk management decisions.

In addition, the Group also monitors interest rate risk exposure against limits by determining the effect on the Group's current net notional value of assets and liabilities for a shift in interest rates equivalent to 2% and 3% for all maturities.

The levels of Group interest rate risk exposures through the reporting period were as follows:

	As at 31.12.08 £m	Average 2008 £m	High 2008 £m	Low 2008 £m	As at 31.12.07 £m
Static Earnings-at-Risk	1.5	3.7	5.2	1.5	4.8
Historical Value-at-Risk	0.4	2.1	3.6	0.4	3.2
Stateside / Quanto Value-at-Risk	0.8	0.6	0.8	0.5	0.7
3% Parallel interest rate shift	n/a	14.7	25.4	1.2	21.8
2% Parallel interest rate shift	6.6	6.9	8.6	6.0	n/a

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) are also monitored closely and regularly reported to ALCO.

Currency risk

Currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Both at 31 December 2008 and during the year, the Group had no material direct exposure to foreign currency exchange fluctuations, with the exception of the Group's equity investments in Jade Software Corporation Limited and Northwest Investments NZ Limited which are denominated in New Zealand dollars.

Equity risk

As at 31 December 2008, the Group had a small amount of issued equity-linked savings products outstanding. Derivative contracts to eliminate this exposure are taken out by the Group which exactly match the terms of the savings products and the market risk on such contracts is therefore fully hedged.

Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due. These obligations include investors' deposits, both on demand and those with contractual maturity dates, as well as repayments of other borrowings and loan capital. The day-to-day management of liquidity is the responsibility of Treasury, which manages our portfolio of liquid assets and our contingency funding plans. Our liquidity risk policy is monitored by ALCO.

The wholesale markets remain extremely tight and opportunities for Skipton to raise longer-term unsecured funding in public debt markets remain closed. Whilst we have access to government schemes and to other sources of secured funding through repo agreements and Covered Bonds, these remain limited and expensive. Wholesale depositors are also tightening criteria in the wake of losses sustained during the year, particularly as a result of the Icelandic banking crisis. A worsening of these wholesale market conditions could put pressure on both the Society's liquidity profile and profitability.

However, around 70% of our funding comes from retail sources and we have been successful in increasing our balances over the past three years. As savers continue to demand a safe haven for their savings we will continue to offer good value products to attract further balances. In the medium term we would expect to fund any growth in lending balances entirely from net growth in retail balances.

The Group's liquidity policy is to maintain sufficient liquid resources to cover 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 as they fall due. This is achieved through maintaining a prudent level of liquid assets, maintaining an appropriate mix between savings and deposit funding balances and through rigorous management control of the growth of the business. We will continue to maintain a close watching brief on the money markets, but until such times as we believe the markets are returning to more normal conditions we will continue to hold a historically high level of liquidity.

The Board is responsible for setting limits over the level, composition and maturity of liquidity and deposit funding balances. Such limits are reviewed by the Board at least annually. Compliance against these limits is monitored daily by Finance personnel (i.e. independent of Treasury personnel). In addition a series of liquidity stress tests are performed weekly by Group Risk Services personnel, and formally reported to ALCO monthly, to ensure the Group maintains adequate liquidity for business purposes even under stressed conditions.

Operational risk

Operational risk is the risk of loss arising from inadequate or failed processes, people or systems, or from external events. For the purposes of managing operational risk, we divide it into a number of discrete areas which include fraud, information security and business continuity planning. Responsibility for managing operational risks lies with individual business areas that identify and assess risks in line with the processes described in the framework above. An independent operational risk function reports to the Operational Risk Committee and the Board on the key operational risks facing the business.

Given the nature of the regulated sectors in which we operate, one of our key operational risks is the potential failure to maintain ongoing compliance with relevant external regulation across the Group. Each of the regulated businesses has an established Compliance team which both monitors compliance with existing legislation and considers the impact of new requirements. Oversight is provided by a central Group Compliance function which ensures best practice is adhered to and shared across the Group as appropriate. We are confident that this framework will continue to effectively mitigate the risk of compliance and operational failures.

Additional information on risk is also provided in the Basel II Pillar 3 disclosure available on our website.

Outlook

The liquidity crisis that began in late 2007 has now evolved into a worldwide recession, with the UK expected to be particularly severely impacted. We expect these market conditions to continue throughout 2009 and well into next year, and are therefore already planning for a sustained period of lower house prices and lending growth. Additionally, the business is now faced with the prospect of interest rates at historically low levels, which inevitably will add to the pressure on maintaining interest margins.

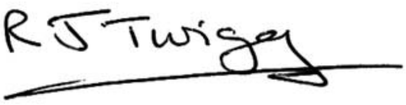
Consequently, in the light of the ongoing difficult funding markets, we will continue to take a cautious approach to lending volumes and continue to adopt a prudent approach to lending criteria in attracting only good quality borrowers. Whilst the housing and equity markets remain subdued, we believe the savings markets will remain strong, and trust that savers, even in these low interest rate times, will require a safe haven for their funds. Building societies, seen as a secure home for consumers' wealth, should be ideally placed to succeed in attracting retail funding, albeit this will continue to be relatively costly for a period. In these uncertain times, balance sheet growth is neither necessary nor desirable, and we will continue to concentrate on attracting retail savings to reduce our reliance on the wholesale funding markets.

Maintenance of sufficient liquidity, to ensure that all cash requirements can be met, remains key to all lenders and we will continue with our attempts to lengthen the duration and increase the sources of wholesale funding available to us, whilst maintaining liquidity in high quality short dated assets. To this end, we welcome the various UK Government initiatives to provide capital and funding to the banking system in order to restore stability, and we will consider accessing these schemes if economic to do so. However, whilst the cost of both retail and wholesale funding is expected to remain high, our detailed stress testing of projected liquidity balances gives us no cause for concern.

The last year has seen an increase in provisions against non-performing loans and against an Icelandic bank failure. Whilst we continue to have a good quality balance sheet, a further deterioration in the economic cycle resulting in higher levels of unemployment will undoubtedly put further pressure on mortgage provisions, which we will continue to manage to acceptable levels. Depending on how the costs being dealt with by the FSCS following bank failures are resolved, it is likely that further provisions for FSCS levies will need to be recognised in future years.

Clearly, the Group is not immune to the current downturn in the general economy, and the housing market in particular, but we believe that our 2008 results demonstrate our ongoing ability to withstand even this most severe of downturns. Our capital position remains strong, and we retain significant value in our subsidiary companies which is not translated into our regulatory capital ratios.

Whilst the immediate future is likely to see little in the way of further subsidiary acquisition, we are committed to our policy of diversification which we believe will bring real value to the Skipton Group. We are on schedule to complete the merger with Scarborough Building Society in the first quarter of 2009 and will seek to drive significant economic benefits at the earliest opportunity.



R J Twigg

Group Finance Director

24 February 2009

The Directors have pleasure in presenting their Annual Report and Accounts for the year ended 31 December 2008.

As set out more fully in the Statement of Accounting Policies, the Annual Report and Accounts are prepared in Accordance with International Financial Reporting Standards (IFRS). All financial information given in this Directors' Report is taken from the statutory accounts prepared on this basis. Further, unaudited, information which allows comparison between 2008 and 2007 is set out in the Business Review on pages 16 to 29.

Business objectives

The Society's long-term objectives remain to maximise the long-term value for an increasing number of retail savings and borrowing members, and to create safe and rewarding employment for its staff. The Directors believe that our status as a building society enables us to deliver attractive products to customers, whilst enjoying a pricing advantage over our plc competition. Our focus on profitably growing our core business of retail savings and mortgages remains, but investment in related businesses, where appropriate opportunities are identified, will continue. The profits generated by our investment in our subsidiary companies continue to deliver long-term benefit to our members.

The Skipton Group offers a range of financial services products and services to individual consumers, from mortgages and investments, financial advice, estate agency services, life and other insurance sales, through to personal credit record searches. Our diverse Group also provides a comprehensive range of mortgage, computer and credit related services to businesses, including outsourced mortgage servicing, mortgage broking, credit reference services and business finance through mortgages and debt factoring.

Business review and future developments

The Chairman's Statement, Chief Executive's Report and Business Review set out on pages 6 to 29 report on the performance of the business and its future objectives.

Profits and capital

Profit before tax was £22.5m (2007: £163.9m). The profit after tax transferred to the general reserve was £22.8m (2007: £125.5m).

Total Group reserves at 31 December 2008 were £703.6m (2007: £721.7m) after taking into account the available-for-sale reserve of £(13.2)m (2007: £(5.7)m) and the cash flow hedging reserve of £(21.2)m (2007: £(4.9)m).

Gross capital at 31 December 2008 was £917.5m (2007: £935.2m) including £183.7m (2007: £183.7m) of subordinated debt and £26.3m (2007: £26.3m) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings at 31 December 2008 was 7.50% (2007: 8.25%) and the free capital ratio was 4.95% (2007: 5.57%).

Mortgage arrears

Group mortgage balances at 31 December 2008 included 287 mortgage cases (2007: 80), either in possession or where payments were 12 months or more in arrears. The capital balances of these loans were £48.3m (2007: £11.9m). The total amount of arrears was £3.7m (2007: £1.0m).

Charitable donations

During the year the Group made charitable donations of £0.4m (2007: £0.6m). No contributions were made for political purposes.

Creditor payment policy

The Society's policy concerning the payment of suppliers is to negotiate and agree terms and conditions with all suppliers and upon complete provision of goods and services, unless there is an express provision for stage payments, undertake to pay suppliers within the agreed payment period. The number of trade creditor days as at 31 December 2008 was 5 days (2007: 5 days).

Risk management

As a result of its normal business activities, the Group is exposed to a variety of risks, the most significant of which are operational risk, credit risk and liquidity risk. The Group has established a number of committees and policies to manage these risks. These principal risks and uncertainties are set out in the Principal risks and uncertainties section of the Business Review on pages 26 to 28 and in note 37. In addition to these financial risks the Group is exposed to the effects of the economic cycle, particularly relating to the UK residential housing market, and the competitive nature of the UK personal financial services markets in which we operate.

The financial management objectives and policies of the Group are shown in the Business Review on pages 16 to 26 and in note 37 on pages 85 to 99.

Employees

The Group remains committed to its policy of treating all employees and job applicants equally at all times. Our policy is that no employee, or potential employee, is treated less favourably on the grounds of race, colour, religion, nationality, ethnic origin, sex, marital status or sexual orientation. We also give all applications from disabled people full consideration in relation to the vacancy concerned and their own aptitudes and abilities. In the event of an existing employee becoming disabled, we make every effort to maintain their present position or to employ them in alternative suitable work.

We also aim to provide high quality relevant training and development opportunities to all staff which enables them to achieve their full potential and helps the Group meet its corporate objectives. All employees have equal access to training and have the opportunity to acquire relevant professional qualifications for their respective roles.

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

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

Property, plant and equipment

The Directors consider that the overall market value of the Group's freehold and leasehold properties, excluding the Society's Principal Office, is in excess of the book value. In arriving at this view the Directors have taken account of internal valuations of the Group's property portfolio, excluding the Society's Principal Office. The Society's Principal Office is a special purpose facility and the Board considers that its value in use to the Society is greater than its book value.

Directors' responsibilities in respect of the preparation of the Annual Accounts

This statement, which should be read in conjunction with the Statement of the Auditors' Responsibilities on pages 40 to 41, is made by the Directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the Directors' emoluments disclosures within the Directors' Remuneration Report, the Directors' Report and the Annual Business Statement.

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

The Act states that references to 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 applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Annual Accounts; and
- prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

The Directors are also required by the Disclosure and Transparency Rules of the Financial Services Authority to include a management report containing a fair review of the business and a description of the principal risks and uncertainties facing the Group.

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

A copy of the Annual Accounts is placed on the Society's website.

Directors' responsibilities for accounting records and internal controls

The Directors are responsible for ensuring that the Group:

- keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society, in accordance with the Act;
- takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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

Directors' statement pursuant to the Disclosure and Transparency Rules

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware:

- the Annual Accounts, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Society; and
- the management report contained in the Business Review includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

Going concern

The Group's business activities together with its financial position, capital resources and the factors likely to affect its future development and performance are set out in the Business Review on pages 16 to 29. In addition note 37 to the Annual Accounts includes the Group's objectives, policies and processes for managing its liquidity risk, details of financial instruments and hedging activities, and its exposure to credit risk and liquidity risk.

In common with many financial institutions, the Group meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources, and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business. The Group's forecasts and objectives, taking into account a number of potential changes in trading performance and funding retention, show that the Group should be able to operate at adequate levels of both liquidity and capital, for the foreseeable future.

Consequently, after making enquiries, the Directors are satisfied that the Group should have sufficient resources to continue in business for the foreseeable future and have, therefore, continued to adopt the going concern basis in preparing the Annual Accounts.

Directors

The Directors of the Society during the year were as follows:

Mr J B Rawlings	(Chairman)
Mr A I Findlay	(Vice Chairman)
Mr D J Cutter*	
Mr J G Goodfellow*	(retired 31 December 2008)
Mr S W Haggerty*	(resigned 3 December 2008)
Mr P R Hales	
Ms P M Hay-Plumb	
Mr C N Hutton	
Mr W H Jack	
Ms A B E Kinney	
Mr R F Marriott	(retired 27 May 2008)
Mr R J Twigg*	

* Executive Directors

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

No Director at 31 December 2008 had any interest in the shares of any group undertaking at any time during the year.

Auditors

In accordance with Section 77 of the Building Societies Act 1986, a resolution for the re-appointment of KPMG Audit Plc as auditors is to be proposed at the forthcoming Annual General Meeting.

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Society's auditors are unaware; and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Society's auditors are aware of that information.

By Order of the Board

J B Rawlings

J B Rawlings

Chairman

24 February 2009

The Board is committed to best practice in corporate governance. This Report explains how the Board applies the principles of the Combined Code on Corporate Governance issued by the Financial Reporting Council in 2003 (as amended in 2006) (the Code). The Board considers that the Society applies all the Code principles, except where stated below.

Directors

The Board

The Society recognises that it must be headed by an effective Board, which is collectively responsible for the success of the Society.

The Board operates under terms of reference which clearly set out its responsibility for the overall stewardship of the Group. Its principal functions are to determine the long-term strategy and policies of the Group, to set out the guidelines within which the business is managed, to review business performance within its approved risk framework. The Board has a further duty to ensure that the Society operates within the terms of its Memorandum and Rules, that the Group meets all applicable legislative and regulatory requirements and that proper accounting records and effective systems of internal control are established, maintained, documented and audited.

The Board meets monthly (except August), and during 2008 also held its annual two-day strategy review meeting. The Non-Executive Directors also meet, without Executive Directors present, at least once a year.

All Directors have access to independent professional advice, if required, at the Society's expense.

The Board has a formal schedule of matters which are reserved to it, and has also delegated authority in other matters to a number of Board Committees, as described below. The Board has set clear terms of reference for each of these Committees, and has established an organisational structure with clearly defined and documented delegated authority to Executive management, together with reporting systems for financial results, risk exposure and control assessment.

Chairman and Chief Executive

The offices of the Chairman and Chief Executive are distinct and are held by different individuals. The role of each is set out in their terms of appointment or contract respectively. The Chairman is responsible for leading the Board and communicating with the Society's members on behalf of the Board. The Chairman is independent and has no conflicting relationships or circumstances that could affect his judgement.

The Chief Executive is responsible for managing the Group's business within the parameters set by the Board.

The Board elects its Chairman and Vice Chairman annually at the Board meeting immediately following the Annual General Meeting.

Board balance and independence

The Society's Rules detail the appointment process for Directors and require that the Board comprises not less than six nor more than 15 Directors.

The Board currently comprises seven Non-Executive Directors (including the Chairman) and two Executive Directors. The Board considers all the Non-Executive Directors to be independent in accordance with the criteria set out in the Code.

The Combined Code proposes that a Senior Independent Director be appointed, primarily to act as a separate point of contact for institutional shareholders. However, the Board has concluded that such an appointment is not appropriate for a building society given its mutual status and that all the Non-Executive Directors are independent and accessible to members.

Appointments to the Board

The Board has a Nominations Committee to lead the process for Board appointments and succession planning. The Committee, at least annually, reviews the structure, size and composition of the Board to ensure it contains the required balance of skills, knowledge and experience relevant to the activities of the Group.

Candidates for Non-Executive positions are identified in a number of ways, including the use of external search consultants. In addition, members of the Society have the right, under the Society's rules, to nominate candidates for election to the Board. All Directors must meet the FSA's fitness and propriety standards and be registered with the FSA as an Approved Person in order to fulfil their Controlled Function as a Director. A copy of the Non-Executive Director appointment letter can be obtained from the Secretary.

Information and professional development

On appointment, new directors receive appropriate induction; ongoing training and development needs are identified and addressed through an annual performance evaluation process.

Through the Secretary, the Chairman ensures that the Directors receive accurate, timely and clear information to facilitate effective contribution to Board discussions and decision making.

The Directors have access to the advice and services of the Secretary, whose appointment is a matter for the Board, and who is responsible for ensuring that Board procedures are followed and for advising the Chairman on matters relating to governance.

Performance evaluation

The Board reviews its performance and effectiveness annually. During 2008 the Board undertook an externally facilitated evaluation of the Directors' performance and an internally facilitated evaluation of the Board's effectiveness including the Board's interactions with its sub-committees and Society and Group management.

Individual Non-Executive Directors are evaluated on a one-to-one basis by the Chairman. Executive Directors are evaluated against agreed performance targets for their areas of responsibility and their own personal performance. The Chief Executive evaluates individual Executive Directors whilst the Chairman evaluates the Chief Executive's performance.

Re-election

The Society's Rules require that Directors stand for election at the AGM following their appointment and for re-election every three years thereafter. Non-Executive Directors are appointed for an initial period of three years and are not expected to serve more than three terms.

Remuneration

Details relating to Directors' remuneration and contracts are contained in the Directors' Remuneration Report set out on pages 37 to 39.

Accountability and audit

Financial reporting

The responsibilities of the Directors in relation to the preparation of the Society's Annual Accounts and a statement that the Society is a going concern are contained in the Statement of Directors' Responsibilities, set out on pages 31 to 32.

Internal control

The Board is responsible for determining the Society's strategy for managing risk and overseeing its systems of internal control. The Executive Directors and senior management are responsible for designing, operating and monitoring risk management and internal controls. Such systems are designed to manage rather than eliminate the risk of failure to achieve the Society's business objectives.

The Board reviews the effectiveness of systems of internal control through a combination of processes including:

- Regular reports and presentations to the Board by the Chairmen of the various Board Committees – see below;
- Presentations to the Board by Group Commercial Directors and subsidiary Managing Directors about the subsidiary companies, summarising both historic and future performance together with key business issues and strategies. Significant risk areas are highlighted, and appropriate control strategies and accountabilities are agreed;
- Regular reports to the Board, through the Board Audit Committee, from the internal audit function in respect of their independent audits of risk management processes and internal controls' effectiveness across the Society and its subsidiaries;
- Regular reports to the Board, through the Operational Risk Committee, on the principal operational risks facing the Society and its subsidiaries and the strength of the controls in place to mitigate such risks;
- Regular reports to the Board by the Compliance function on regulatory compliance.

Steps continue to be taken to embed internal control and risk management further into the operation of the Group and to deal with areas of improvement, which come to the attention of Executive management and the Board.

The Society has a comprehensive system for reporting financial results to the Board. The Society, and each of its subsidiary companies, prepare monthly results with comparisons against budget. The Board reviews these for the Group as a whole and determines appropriate action.

A number of the Group's key functions, including Finance, Treasury, Taxation, Compliance and Risk, are dealt with centrally. Each of these functions has a detailed procedures manual and is also subject both to self-assessment and to reviews by the internal audit function.

The internal audit function has a key role in supporting all areas of the business of the Society and its subsidiaries and in assisting in evaluation of major business risks. Through its programme of work, agreed by the Board Audit Committee, the internal audit function is able to provide assurance on control effectiveness. The General Manager, Audit Services, has direct access to the Chairman of the Board Audit Committee.

Board committees

In addition to the Audit Committee (see below), the following Board committees exist:

The Nominations Committee is responsible for succession planning and the appointment of new Directors. Mr Rawlings chairs the Committee which comprises three other Non-Executive Directors. Executive Director appointments, and the appointment of the Secretary, are confirmed by the full Board.

The Remuneration Committee is responsible for the Society's Executive remuneration policy. Further detail is set out in the Directors' Remuneration Report. Mr Hutton chairs the Committee which comprises three other Non-Executive Directors.

The Non-Executive Remuneration Committee is responsible for the review of the fees to be paid to the Vice Chairman and other Non-Executive Directors, in accordance with the Society rules. Mr Rawlings chairs the Committee which also comprises Messrs Cutter and Twigg.

Additionally, the Board has delegated responsibility to the following bodies:

The Operational Risk Committee meets bi-monthly and its primary responsibility is to develop and keep under review the Group's operational risk management framework. Mrs Davidson (Secretary) chairs the Committee which comprises the Executive Directors, and five senior Executives.

The Asset and Liability Committee's primary responsibility is to review and recommend to the Board changes to the Society's wholesale funding, liquidity and balance sheet risk management policies and oversee compliance with these policies. Mr Cutter chairs the Committee which comprises the Group Finance Director, Secretary and senior Executives from Treasury, Marketing, Risk and Finance.

The Group Retail Credit Committee is primarily responsible for reviewing and recommending to the Board changes to the Group's credit risk policies and overseeing compliance with these policies. Mr Twigg chairs the Committee which comprises the Chief Executive together with Senior Executives of the Society and its major lending subsidiaries.

The Group Senior Management Committee is responsible for ensuring that the Group meets its strategic and operational objectives as defined in the Corporate Plan. Mr Cutter chairs the Committee which comprises the Group Finance Director, Secretary and Chairman of the Society Operational Board.

The Society Operational Board is primarily responsible for overseeing the day-to-day management of the Society and its operations, corporate planning and changes to Society policy. Mr Aldous (General Manager - Customer Engagement) is acting Chairman of the Society Operational Board which comprises five General Managers and the Executive Directors.

Subsidiary Operational Boards are chaired by Group Senior Executives with the other members being a combination of Executive Directors, Society Executives, subsidiary Directors and Executive Managers. Their responsibilities are equivalent to those of the Society Operational Board.

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

Audit Committee and Auditors

The Audit Committee, which meets at least four times a year, comprises four Non-Executive directors, currently Mr Findlay (Chairman), Ms Hay-Plumb, Mr Hales and Ms Kinney. The Chief Executive, Group Finance Director, Director of Compliance and Risk, external audit representatives and the General Manager, Audit Services, may attend, by invitation. The Board is satisfied that the composition of the Audit Committee contains Directors with relevant, recent financial experience to provide appropriate challenge to management.

The Audit Committee monitors the integrity of the Group's financial statements and any formal announcements relating to the Group's financial performance.

The Audit Committee's primary responsibilities include:

- monitoring the effectiveness of the external audit process and making recommendations to the Board on the appointment, re-appointment and remuneration of the external auditors;
- ensuring that an appropriate relationship between the Group and the external auditors is maintained, including reviewing non-audit services which can be provided and fees;
- reviewing the effectiveness of the internal audit function. The Committee is responsible for approving, upon the recommendation of the Chief Executive, the appointment and removal of the General Manager, Audit Services.

The Audit Committee regularly monitors the Society's relationship with the external auditors and has adopted a framework for ensuring auditor independence, which defines unacceptable non-audit assignments, pre-approval of acceptable non-audit assignments and procedures for approval of other non-audit assignments across the Group. Details of the fees paid to the external auditors for audit and non-audit services are set out in note 7 to these Annual Accounts.

The Board has delegated responsibility for reviewing the Group's systems of internal control to the Audit Committee.

The minutes of the Audit Committee are distributed to the Board and the Committee Chairman reports verbally to the Board meeting following Committee meetings. In 2008, the Committee met on five occasions.

Board and Committee membership attendance record

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

	Board	Audit Committee	Nominations Committee	Remuneration Committee
Mr J B Rawlings (Chairman)	11/11	-	3/3	3/3
Mr A I Findlay (Vice Chairman)	11/11	5/5	3/3	-
Mr D J Cutter	11/11	-	-	-
Mr J G Goodfellow (retired 31 December 2008)	10/11	-	-	-
Mr S W Haggerty (resigned 3 December 2008)	10/10	-	-	-
Mr P R Hales	10/11	5/5	-	-
Ms P M Hay-Plumb	11/11	5/5	-	3/3
Mr C N Hutton	11/11	1/1	3/3	3/3
Mr W H Jack	10/11	-	1/3	3/3
Ms A B E Kinney	11/11	5/5	3/3	-
Mr R F Marriott (retired 27 May 2008)	4/4	-	-	-
Mr R J Twigg	11/11	-	-	-

Relations with members

As a mutual, the Society's membership comprises almost exclusively of individuals (rather than institutions), all of whom are our customers.

The Society encourages communication with its members and seeks to respond quickly to all enquiries received. Publications are sent to members regularly throughout the year inviting feedback. We also conduct customer service feedback surveys, market research and analyse customer feedback received through branches and at our head office.

Each year the Society gives all eligible members at least 21 days notice of the Annual General Meeting; all Directors attend this meeting (unless exceptionally their absence is unavoidable) and are available for questions both during a "question and answer" session within the meeting, and on an individual basis before and after the meeting.

All eligible members are encouraged to participate in the Annual General Meeting, either in person or by voting proxy. All proxy votes are returned to independent scrutineers.

In addition, the Summary Financial Statement is included as part of the Annual General Meeting magazine, the format of which is aimed at making its reading as accessible as possible. Copies of the full Annual Report & Accounts 2008 are also available on request in branches or by post.

J B Rawlings

Chairman

24 February 2009

The Board is committed to best practice in its remuneration policy for Directors and this report explains how the Society applies the principles in the Combined Code relating to remuneration. Additionally, a summary of this report will again be sent to all members entitled to vote at this year's Annual General Meeting, where members will have the opportunity to vote on the report.

Remuneration Committee

The Remuneration Committee, which comprises four Non-Executive Directors, is responsible for the Society's Executive remuneration policy. The Committee is also responsible for setting, reviewing and approving individual remuneration packages for Executive Directors and other senior Group Executives, and setting the Chairman's fees. The members of the Remuneration Committee are Messrs Hutton (Chairman), Rawlings, Jack and Ms Hay-Plumb. The Chief Executive may attend meetings by invitation, together with external advisers, where appropriate.

In discharging its duties, the Remuneration Committee also reviews and takes into account independently produced data and professional advice in similar financial services organisations. It also gives full consideration to the provisions set out in the Code of Best Practice of the Combined Code on Corporate Governance.

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

Directors' remuneration policy

Executive Directors' remuneration

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

The main components of Executive Directors' remuneration are as follows:

- Basic salary – which takes into account job content and responsibilities, individual performance (assessed annually) and salary levels of similar positions in comparable organisations.
- Annual bonus – which is calculated by reference to Group and Society performance measured together with individual performance against personal objectives, both of which are linked to the achievement of the Group's strategic objectives.
- Pensions – all Executive Directors are members of the Skipton Building Society Pension & Life Assurance Scheme, details of which are set out in the Notes to the Accounts.
- Other benefits include provision of a car, or car allowance, and private medical insurance.
- Policy on service contracts – the Executive Directors are employed on service contracts which expire at the age of 65, with a contractual notice period of 12 months.

Non-Executive Directors' remuneration

Non-Executive Directors' fees are based on comparable data from similar financial services organisations. Non-Executive Directors do not receive bonuses, are not eligible for pension benefits and do not have service contracts.

Executive Directors' contractual terms

The Executive Directors all have notice periods of 12 months under the policy on service contracts detailed above.

Directors' emoluments

Directors' emoluments are set out below:

Non-Executive Directors	2008 £000 Fees	2007 £000 Fees
Mr J B Rawlings (Chairman)	70	68
Mr A I Findlay (Vice Chairman)	50	39
Mr P Hales (appointed 29 May 2007)	40	23
Ms P M Hay-Plumb	40	39
Mr W J Henderson (retired 24 April 2007)	-	13
Mr C N Hutton	42	39
Mr W H Jack	44	46
Ms A B E Kinney	41	44
Mr R F Marriott (retired 27 May 2008)	13	39
Mr N Sherlock (retired 24 April 2007)	-	13
	340	363

Executive Directors 2008	Salary £000	Bonus £000	Benefits(†) £000	Sub total £000	Increase in accrued pension £000	Total £000
Mr J G Goodfellow (note 1)	363	37	56	456	7	463
Mr D J Cutter	246	26	41	313	7	320
Mr S W Haggerty (note 2)	210	-	34	244	12	256
Mr R J Twigg	238	24	39	301	6	307
Total	1,057	87	170	1,314	32	1,346

Executive Directors 2007	Salary £000	Bonus £000	Benefits(†) £000	Sub total £000	Increase in accrued pension £000	Total £000
Mr J G Goodfellow	325	238	54	617	25	642
Mr D J Cutter	223	115	42	380	9	389
Mr R J Twigg	220	127	40	387	10	397
Total	768	480	136	1,384	44	1,428

(†) Benefits comprise the provision of a car, or car allowance, the Society's contributions to the Skipton Building Society Pension & Life Assurance Scheme and private medical insurance contributions.

Notes

1. Mr Goodfellow retired as a Director on 31 December 2008 and will remain employed as a consultant to the Board until 31 December 2009. Under his settlement agreement, the Society will pay a total of £781,000 to Mr Goodfellow. This comprises salary and benefits of £385,000 in accordance with his service agreement and payments of £259,000 in respect of his early retirement and £137,000 in consideration of his entering into certain restrictive covenants. Additionally Mr Goodfellow will accrue pension benefits in the Skipton Building Society Pension & Life Assurance Scheme ('the Scheme') until 31 December 2009. As part of these arrangements the Society has also agreed to waive the early retirement discount factors applicable to his benefits in the Scheme with effect from 10 January 2010.

   In considering these arrangements, the Committee sought advice from external advisers to reach an agreement that was both fair and reasonable to both the Society and Mr Goodfellow. The Committee believes that the amounts agreed are fair and reasonable and adhere to good practice.

2. Mr Haggerty resigned as an Executive Director on 3 December 2008. In addition to the amounts shown above, Mr Haggerty will receive a compensation payment of £242,000 in line with his contractual arrangements.

Directors' pension benefits

The information below shows the value of Directors' pension benefits in the Skipton Building Society Pension & Life Assurance Scheme. The increase in accrued pension represents the change in the annual pension to which each Director is entitled as the result of changes in pensionable earnings (excluding inflation) and increases in pensionable service during the year. The transfer value equivalent represents the present capital value of the changes in Directors' accrued pension entitlements excluding members' contributions for the year. The amounts relating to Mr Goodfellow's pension include the arrangements agreed on his retirement, as described above.

	Increase in accrued pension in the year to 31 December 2008 £000	**Accrued pension entitlement as at 31 December 2008 £000**	**Transfer value of accrued rights at 31 December 2007 £000**	**Members' contribution for the year ended 31 December 2008 £000**	**Transfer value equivalent of increase in accrued pension for the year ended 31 December 2008 £000**	**Transfer value of accrued rights at 31 December 2008 £000**
Mr J G Goodfellow	**7**	**134**	**2,014**	**18**	**257**	**2,289**
Mr D J Cutter	**7**	**60**	**451**	**17**	**(47)**	**421**
Mr S W Haggerty	**12**	**60**	**566**	**15**	**36**	**617**
Mr R J Twigg	**6**	**57**	**378**	**17**	**(49)**	**346**

	Increase in accrued pension in the year to 31 December 2007 £000	Accrued pension entitlement as at 31 December 2007 £000	Transfer value of accrued rights at 31 December 2006 £000	Members' contribution for the year ended 31 December 2007 £000	Transfer value equivalent of increase in accrued pension for the year ended 31 December 2007 £000	Transfer value of accrued rights at 31 December 2007 £000
Mr J G Goodfellow	25	127	1,536	16	462	2,014
Mr D J Cutter	9	53	347	16	88	451
Mr R J Twigg	10	51	276	16	86	378

C N Hutton

Chairman of the Remuneration Committee

24 February 2009

Independent Auditors' Report to the Members of Skipton Building Society

We have audited the Group and Society Annual Accounts of Skipton Building Society for the year ended 31 December 2008 which comprise the Group and Society Income Statements, the Group and Society Balance Sheets, the Group and Society Statements of Recognised Income and Expense, the Group and Society Cash Flow Statements and the related notes. These Annual Accounts have been prepared under the accounting policies set out therein.

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

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

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report including the Directors' Report, the Annual Business Statement and the Annual Accounts in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on pages 31 to 32.

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

We report to you our opinion as to whether the Annual Accounts give a true and fair view and are properly prepared in accordance with the Building Societies Act 1986, regulations made under it and, as regards the Group Annual Accounts, Article 4 of the IAS Regulation. In addition, we report to you our opinion as to whether certain information in the Annual Business Statement gives a true representation of the matters in respect of which it is given, whether the information in the Directors' Report is consistent with the accounting records and the Annual Accounts and whether the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it. The information given in the Directors' Report includes that information presented in the Chairman's Statement, Chief Executive's Report and Business Review that is cross referred from the 'Business Review' section of the Directors' Report.

We also report to you if, in our opinion, the Annual Accounts are not in agreement with the accounting records or if we have not received all the information and explanations that we require for our audit.

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

Basis of audit opinion

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

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

Opinion

In our opinion:

a) the Annual Accounts give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of affairs of the Group and of the Society as at 31 December 2008 and of the income and expenditure of the Group and of the Society for the year then ended;

b) the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given;

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

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

KPMG Audit Plc

Chartered Accountants

Registered Auditor

Leeds

24 February 2009

Income Statements

For the year ended 31 December 2008

	Notes	**Group 2008 £m**	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
Interest receivable and similar income	2	**770.0**	683.2	**746.8**	650.6
Interest payable and similar charges	3	**(684.0)**	(573.5)	**(677.0)**	(568.6)
Net interest receivable		**86.0**	109.7	**69.8**	82.0
Fees and commissions receivable	4	**420.9**	496.0	**13.5**	15.6
Fees and commissions payable	5	**(27.0)**	(46.5)	**(2.0)**	(1.7)
Fair value losses on financial instruments		**(3.3)**	(3.9)	**(2.9)**	(3.9)
Income from shares in subsidiary undertakings		**-**	-	**22.6**	103.4
Profit on disposal of subsidiaries	17 b)	**9.1**	-	**-**	-
Share of profits from joint ventures and associates	17 c)	**3.9**	3.7	**-**	-
Profit on disposal of associate	17 c)	**22.3**	36.0	**-**	-
Other operating income	6	**10.5**	16.1	**2.7**	2.8
Total income		**522.4**	611.1	**103.7**	198.2
Administrative expenses	7	**(433.0)**	(441.0)	**(61.4)**	(54.0)
Impairment losses on loans and advances	16	**(34.6)**	(5.4)	**(4.2)**	(1.2)
Impairment losses on debt securities	13	**(11.5)**	-	**(11.5)**	-
Provisions for liabilities	27	**(20.8)**	(0.8)	**(15.3)**	0.8
Provisions against loans to subsidiary undertakings		**-**	-	**-**	(7.0)
Profit before tax		**22.5**	163.9	**11.3**	136.8
Tax income/(expense)	11	**1.3**	(37.3)	**2.4**	(13.4)
Profit for the financial year		**23.8**	126.6	**13.7**	123.4
Attributable to:					
Members of Skipton Building Society	31	**22.8**	125.5	**13.7**	123.4
Minority interests	35	**1.0**	1.1	**-**	-
		23.8	126.6	**13.7**	123.4

Segmental performance of the Group is shown in note 38. The profit for the financial year was derived wholly from continuing operations.

The notes on pages 47 to 107 form part of these Accounts.

	Notes	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
					As at 31 December 2008
Assets					
Cash in hand and balances with the Bank of England		**359.4**	136.0	**359.4**	135.0
Loans and advances to credit institutions	12	**1,084.3**	409.3	**1,041.5**	380.2
Debt securities	13	**1,734.6**	2,124.8	**1,734.6**	2,124.8
Derivative financial instruments	14	**429.9**	122.3	**500.4**	121.0
Loans and advances to customers	15	**9,567.7**	9,291.9	**7,740.6**	7,372.3
Corporation tax asset		**12.5**	-	**7.2**	-
Deferred tax asset	28	**28.1**	18.7	**14.7**	5.1
Investments in group undertakings	17	**1.5**	6.1	**2,658.7**	1,791.8
Intangible assets	18	**242.5**	230.4	**2.8**	2.0
Property, plant and equipment	19	**74.3**	79.6	**17.2**	16.9
Investment property	20	**9.1**	5.1	**16.7**	12.7
Other assets	21	**103.1**	106.3	**7.3**	5.1
Total assets		**13,647.0**	12,530.5	**14,101.1**	11,966.9
Liabilities					
Shares	22	**8,158.2**	7,191.1	**8,158.2**	7,191.1
Amounts owed to credit institutions	23	**690.0**	402.8	**822.4**	598.5
Amounts owed to other customers	24	**2,012.8**	2,207.8	**2,622.6**	1,738.4
Debt securities in issue	25	**1,375.0**	1,533.5	**1,375.0**	1,533.2
Derivative financial instruments	14	**280.3**	50.4	**247.3**	42.6
Corporation tax liability		**-**	9.1	**-**	0.7
Other liabilities	26	**97.8**	116.8	**7.9**	5.9
Accruals and deferred income		**46.4**	51.1	**5.7**	1.5
Deferred tax liability	28	**7.1**	6.9	**3.3**	3.2
Provisions for liabilities	27	**24.0**	3.5	**16.7**	1.6
Retirement benefit obligations	39	**37.9**	22.3	**18.1**	7.8
Subordinated liabilities	29	**183.7**	183.7	**183.7**	183.7
Subscribed capital	30	**26.3**	26.3	**26.3**	26.3
Total liabilities		**12,939.5**	11,805.3	**13,487.2**	11,334.5
Capital and reserves attributable to members of Skipton Building Society					
General reserve	31	**737.0**	731.4	**648.3**	643.0
Available-for-sale reserve	32	**(13.2)**	(5.7)	**(13.2)**	(5.7)
Cash flow hedging reserve	33	**(21.2)**	(4.9)	**(21.2)**	(4.9)
Translation reserve	34	**1.0**	0.9	**-**	-
		703.6	721.7	**613.9**	632.4
Minority interests	35	**3.9**	3.5	**-**	-
Total liabilities and reserves		**13,647.0**	12,530.5	**14,101.1**	11,966.9

These Accounts were approved by the Board of Directors on 24 February 2009 and were signed on its behalf by:

J B Rawlings — Chairman
D J Cutter — Chief Executive and Director
R J Twigg — Group Finance Director

The notes on pages 47 to 107 form part of these Accounts.

Statements of Recognised Income and Expense

For the year ended 31 December 2008

	Notes	**Group 2008 £m**	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
Available-for-sale investments: valuation losses taken to equity	32	**(10.5)**	(7.2)	**(10.5)**	(7.2)
Cash flow hedges: losses taken to equity	33	**(22.6)**	(10.5)	**(22.6)**	(10.5)
Exchange differences on translation of foreign operations	34	**0.1**	0.3	**-**	-
Actuarial (losses) / gains on retirement benefit obligations	39	**(24.1)**	8.7	**(11.7)**	1.2
Tax on items taken directly to or transferred from equity		**16.2**	4.3	**12.6**	5.8
Net expense not recognised directly in the Income Statements		**(40.9)**	(4.4)	**(32.2)**	(10.7)
Profit for the financial year		**23.8**	126.6	**13.7**	123.4
Total recognised income and expense for the financial year		**(17.1)**	122.2	**(18.5)**	112.7
Total Income and Expense for the period attributable to:					
Members of Skipton Building Society		**(18.1)**	121.1	**(18.5)**	112.7
Minority Interests		**1.0**	1.1	**-**	-
		(17.1)	122.2	**(18.5)**	112.7

The notes on pages 47 to 107 form part of these Accounts.

	Notes	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
		For the year ended 31 December 2008			
Cash flows from operating activities					
Profit before taxation		**22.5**	163.9	**11.3**	136.8
Movement in prepayments and accrued income		**4.6**	(7.0)	**6.7**	7.9
Movement in accruals and deferred income		**10.9**	105.1	**19.8**	101.6
Impairment losses on loans and advances	16	**34.6**	5.4	**4.2**	1.2
Impairment losses on debt securities	13	**11.5**	-	**11.5**	-
Loans and advances written off, net of recoveries		**(6.5)**	(5.5)	**(0.9)**	(5.0)
Goodwill impairment	18	**5.9**	0.9	**-**	-
Depreciation and amortisation	18, 19, 20	**22.8**	21.0	**3.1**	3.1
Dividends received		**-**	-	**(22.6)**	(103.4)
Interest on capital and subordinated liabilities		**14.2**	14.0	**14.2**	14.0
Loss / (profit) on sale of property, plant and equipment and investment property		**0.3**	(0.4)	**-**	0.1
Movement in provisions for liabilities	27	**20.5**	(1.1)	**15.1**	(1.0)
Share of profits from joint ventures and associates	17 c)	**(3.9)**	(3.7)	**-**	-
Profit on disposal of subsidiaries	17 b)	**(9.1)**	-	**-**	-
Profit on sale of associate	17 c)	**(22.3)**	(36.0)	**-**	-
Other non-cash movements		**(145.2)**	(14.6)	**(215.6)**	(47.2)
Net cash inflow from trading activities		**(39.2)**	242.0	**(153.2)**	108.1
Movement in loans and advances to customers		**(680.0)**	(1,824.7)	**(651.6)**	(1,310.9)
Movement in shares		**1,340.8**	1,334.6	**1,340.8**	1,334.6
Interest received from loans and advances to customers		**564.0**	502.0	**433.0**	405.0
Interest paid on shares		**(404.9)**	(361.1)	**(404.9)**	(361.1)
Net movement in amounts owed to credit institutions and other customers		**71.6**	868.6	**1,087.4**	794.3
Net movement in debt securities in issue		**(277.0)**	(99.1)	**(276.9)**	(99.0)
Net movement in loans and advances to credit institutions		**(657.9)**	(102.9)	**(657.3)**	(107.7)
Purchase of mortgage portfolios		**(8.1)**	(412.6)	**-**	-
Sale of mortgage portfolios		**-**	427.1	**-**	-
Net movement in other assets		**(4.5)**	(5.4)	**9.6**	1.0
Net movement in other liabilities		**3.5**	8.7	**2.0**	(17.3)
Income taxes paid		**(20.6)**	(40.5)	**(5.6)**	(14.2)
Net cash flows from operating activities		**(112.3)**	536.7	**723.3**	732.8

	Notes	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Net cash flows from operating activities		**(112.3)**	536.7	**723.3**	732.8
Cash flows from investing activities					
Purchase of debt securities	13	**(6,648.4)**	(3,545.7)	**(6,648.4)**	(3,545.7)
Proceeds from disposal of debt securities	13	**7,016.6**	3,208.7	**7,016.6**	3,208.7
Purchase of intangible assets	18	**(12.5)**	(10.4)	**(1.8)**	(1.0)
Purchase of property, plant and equipment and investment property	19,20	**(15.9)**	(17.5)	**(7.5)**	(3.8)
Proceeds from disposal of property, plant and equipment and investment property		**4.0**	2.2	**1.1**	0.1
Dividends received		**-**	-	**22.6**	103.4
Dividends paid to minority interests		**(0.5)**	(2.1)	**-**	-
Purchase of subsidiary undertakings in the year	17 a)	**(16.5)**	(31.0)	**-**	-
Net cash acquired with subsidiaries		**1.3**	3.2	**-**	-
Further investment in subsidiaries	17 a)	**(13.0)**	(67.3)	**(1.2)**	-
Purchases of other business units		**-**	(1.0)	**-**	-
Net cash acquired with other business units		**-**	0.3	**-**	-
Cash received from sale of subsidiaries	17 b)	**13.4**	-	**-**	-
Cash received from sale of associate and joint venture		**35.0**	38.0	**-**	-
Net cash flows from investing activities		**363.5**	(422.6)	**381.4**	(238.3)
Cash flows from financing activities					
Proceeds from issue of subordinated liabilities		**75.0**	-	**75.0**	-
Redemption of subordinated liabilities		**(75.0)**	-	**(75.0)**	-
Increase in loans to subsidiary undertakings		**-**	-	**(865.7)**	(387.7)
Interest paid on subordinated liabilities		**(10.9)**	(8.2)	**(10.9)**	(8.2)
Interest paid on permanent interest bearing shares		**(3.2)**	(3.2)	**(3.2)**	(3.2)
Net cash flows from financing activities		**(14.1)**	(11.4)	**(879.8)**	(399.1)
Net increase in cash and cash equivalents		**237.1**	102.7	**224.9**	95.4
Cash and cash equivalents at 1 January		**154.3**	51.6	**126.2**	30.8
Cash and cash equivalents at 31 December		**391.4**	154.3	**351.1**	126.2

Analysis of the cash balances as shown in the Balance Sheet:

Group	Notes	Group 2008 £m	Cash flows £m	Group 2007 £m
Cash in hand and balances with the Bank of England		**359.4**	**223.4**	136.0
Mandatory reserve deposit with the Bank of England		**(8.3)**	**0.5**	(8.8)
		351.1	**223.9**	127.2
Loans and advances to credit institutions repayable on demand	12	**40.3**	**13.2**	27.1
Included in cash and cash equivalents as at 31 December		**391.4**	**237.1**	154.3

Society	Society 2008 £m	Cash flows £m	Society 2007 £m
Cash in hand and balances with the Bank of England	**359.4**	**224.4**	135.0
Mandatory reserve deposit with the Bank of England	**(8.3)**	**0.5**	(8.8)
Included in cash and cash equivalents as at 31 December	**351.1**	**224.9**	126.2

The notes on pages 47 to 107 form part of these Accounts.

1. Accounting policies

The principal accounting policies applied consistently in the preparation of these consolidated Accounts are set out below.

a) Basis of preparation

The Annual Accounts of the Group and the Society have been prepared in accordance with International Financial Reporting Standards (IFRS) and its interpretations as adopted by the EU and effective at 31 December 2008; and with those parts of the Building Societies (Accounts and Related Provisions) Regulations, 1998, and the Building Societies Act 1986 applicable to societies reporting under IFRS.

The Annual Accounts have been prepared under the historical cost convention as modified by the revaluation of available-for-sale assets, derivatives and other financial assets at fair value through the Income Statement.

The Directors have adopted IFRIC 14 - IAS 19, *The Limit on a Defined Benefit Asset Minimum Funding Requirements and their Interaction* and IAS 39, *Financial Instruments: Recognition and Measurement,* and IFRS 7, *Financial Instruments: Disclosures – Amendments* (see note 40).

The Directors have not adopted IAS 1, *Presentation of Financial Statements (2007)*, IFRS 8, *Operating Segments*, IAS 23, *Borrowing Costs (Revised)* which although endorsed by the EU, are currently not effective (see note 40).

In 2007 the Directors adopted IAS 1, *Presentation of Financial Statements – Capital Disclosure*. The capital disclosures for the 2008 Annual Accounts are set out in the Business Review and form part of the audited Annual Accounts.

Note 40 to the Accounts sets out details of forthcoming standards and interpretations and summarises their impact as at 31 December 2008.

b) Basis of consolidation

Subsidiaries

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

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

As part of the Group's acquisition strategy, within a number of subsidiaries which have less than 100% ownership, there is an option for minority shareholders to sell their shares to the Group at some point in the future. In accordance with IAS 32, *Financial Instruments: Disclosure and Presentation*, the Group recognises the present value of minorities' options as a financial obligation, along with recognition of further goodwill on the purchase of remaining minority interests. Under this accounting policy the Group consolidates 100% of the results of affected subsidiaries to reflect the 100% ownership implicit in the recording of the future purchase of minorities' remaining shareholdings (ie put option liability).

Minority interests in the net assets of non-100% consolidated subsidiaries are identified separately from the Group's equity therein. Minority interests comprise the amount of those interests at the date of the original business combination and the minority's changes in equity since that date. Losses applicable to the minority in excess of the minority's interests in the subsidiary's equity are allocated against the interests of the Group except to the extent the minority has a binding obligation and is able to make an additional investment to cover the losses.

1. Accounting policies (continued)

Joint ventures and associates

A joint venture is an undertaking in which the Group has joint control, established by contractual agreement.

An associate is a company over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is neither control nor joint control over those policies.

The results and assets and liabilities of joint ventures and associates are accounted for in these consolidated financial statements using the equity method of accounting. Investments in joint ventures and associates are carried in the Balance Sheet at cost, as adjusted by post-acquisition changes in the Group's share of the net assets of the joint venture or associate, less any impairment in the value of individual investments.

c) Intangible assets

Goodwill

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

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash generating units expected to benefit from the synergies of combination. The impairment test compares the carrying value of goodwill to its associated value in use. The value in use calculations are carried out by discounting the future cash flows of the cash generating unit, usually a subsidiary undertaking. Future cash flows are based upon approved profit budgets for the next three years (adjusted for non-cash items) and assumed growth thereafter for the next 12 years in line with the Bank of England's long term target for inflation. The Group estimates the discount rate based on current costs of capital adjusted for the risks inherent in each cash generating unit. A 15 year time horizon has been used to reflect that cash generating units are held for the long term.

On the sale of a subsidiary, the profit or loss on sale is calculated after charging or crediting the net book value of any related goodwill.

Goodwill arising on acquisitions before the transition to IFRS on 1 January 2005 has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to that date has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

Negative goodwill arising on an acquisition would be recognised directly in the Income Statement.

Computer software, databases and customer contracts

In accordance with IAS 38, *Intangible Assets*, computer software development costs, databases and customer contracts (including internally generated costs) are recognised as an intangible asset only if all of the following tests are met:

- An asset is created that can be identified (such as software and new processes);
- It is probable that the asset created will generate future economic benefits; and
- The development cost of the asset can be measured reliably.

Expenditure incurred to maintain existing levels of performance is recognised as an expense.

Computer software licences, databases and customer contracts recognised as intangible assets are initially recognised at cost and subsequently amortised from the date they are available for use using the straight line method over their estimated useful economic lives, which range from three to ten years.

Intangible assets are tested for impairment at each balance sheet date or when there is an indication of impairment. The Group identifies impairment by comparing the future economic benefit against the carrying value of the asset.

1. Accounting policies (continued)

d) Financial assets

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

At fair value through profit or loss

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

Derivative financial instruments (both assets and liabilities) are held at fair value in the Balance Sheet with changes in their fair value going through the Income Statement. However, by applying the hedge accounting rules set out in IAS 39 the changes in fair value of derivatives used to hedge particular risks can either be offset in the Income Statement or deferred to equity.

There are two types of hedge accounting strategies that the Group undertakes and these are summarised below:

- Fair value hedges – Where a derivative financial instrument hedges the changes in fair value of a recognised asset or liability or an unrecognised firm commitment, any gain or loss on the hedging instrument is recognised in the Income Statement. To the extent that there is an effective hedge relationship, the associated hedged items (e.g. mortgage assets) are stated at fair value in respect of the hedged risk, with any gain or loss also recognised in the Income Statement. As a result the hedging instrument and hedged items offset each other and reduce profit volatility. Any residual fair value hedge ineffectiveness is recognised in the Income Statement.
- Cash flow hedges – Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately. If the forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss recognised in equity is then recognised immediately in the Income Statement.

Derivatives that do not qualify for hedge accounting are held at fair value with changes in fair value recognised in the Income Statement with no offset within the Income Statement or deferral to equity.

Certain derivatives are embedded within other non-derivative host financial instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and 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 accounting policy.

Fair values are obtained from quoted market prices in active markets, recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. Income and expense on derivative financial instruments is recognised in interest in the Income Statement. Gains and losses on all derivatives, hedged items, and on the sale of available-for-sale assets are recognised in the Income Statement, 'Fair value gains and losses on financial instruments' caption.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group's loans and advances to customers together with certain investment securities are classified as loans and receivables, which are measured at amortised cost using the effective interest method. The effective interest method implies an interest rate which exactly discounts the forecast cash flows of an asset over its expected life back to its carrying value.

In accordance with the effective interest method, upfront costs and fees such as cashbacks, mortgage premia paid on acquisition of mortgage books, mortgage indemnity guarantee insurance paid by customers, procuration fees and completion fees are deferred and recognised over the expected life of mortgage assets. Mortgage discounts are also recognised over the expected life of the mortgage assets. Historical and forecast mortgage redemption data and management judgement are used to estimate the expected lives of mortgage assets.

1. Accounting policies (continued)

Available-for-sale

Available-for-sale assets are non-derivative financial assets that are not classified into either of the two categories above. Available-for-sale assets are initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in their fair value recognised in equity, except for impairment losses which are recognised in the Income Statement. Interest income is recognised in the Income Statement on an effective yield basis.

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

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

Change in accounting policy

In October 2008 the IASB issued *Reclassification of Financial Assets (Amendments to* IAS 39*, Financial Instruments: Recognition and Measurement* and IFRS 7*, Financial Instruments: Disclosures).* The amendment to IAS 39 permits an entity to transfer from the available-for-sale category to the loans and receivable category a non-derivative financial asset that would otherwise have met the definition of loans and receivables if the entity has the intention and ability to hold that financial asset for the foreseeable future or until maturity.

The amendment to IFRS 7 introduces additional disclosure requirements if an entity has reclassified financial assets in accordance with the amendment to IAS 39. The amendments are retrospective from 1 July 2008.

Consequently, the Group has reclassified certain non-derivative financial assets, within debt securities, from available-for-sale to loans and advances. Details of the impact of this reclassification are shown in note 13, but there was no impact on the Group profit for the year.

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

Purchases and sales of financial assets are accounted for at trade date.

e) Financial liabilities

All financial liabilities including shares, deposits, debt securities in issue and subordinated liabilities held by the Group are recognised initially at fair value, being the issue proceeds, net of premia, discounts and transaction costs incurred. Financial liabilities are subsequently measured at amortised cost using the effective interest method, except for those financial liabilities, for example derivative liabilities, which are measured at fair value through profit and loss.

Permanent Interest Bearing Shares with no fixed maturity are classified as financial liabilities and are carried at amortised cost.

f) Impairment of financial assets

Impairment of mortgage loans and advances

Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or are in possession or where fraud or negligence has been identified. Objective evidence of impairment may include indications that the borrower or group of borrowers are experiencing significant financial difficulty, default or delinquency in interest or principal payments or the debt being renegotiated to reduce the burden on the borrower. Based upon these assessments an individual impairment reduction of these assets is made.

Loans are classed as renegotiated when their terms have changed during the year and would have been past due or impaired if their terms had not been renegotiated.

1. Accounting policies (continued)

In addition, 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. The impairment value is calculated by applying various economic factors to our mortgage portfolio exposures. These factors take into account the Group's experience of default rates, loss emergence periods, the effect of regional movements in house prices based on a recognised index and adjustments to allow for ultimate forced sales values and realisation costs.

Impairment provisions are recognised in the Income Statement and reflected as a deduction against the carrying value of the asset. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment losses to decrease, the decrease in impairment loss is recognised through the Income Statement.

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

Impairment of other loans and advances

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

Impairment of financial assets

At each balance sheet date the Group assesses, on an individual security basis, whether there is objective evidence that financial assets held by the Group are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that financial assets are impaired may include default or delinquency by a counterparty, the disappearance of an active market for a security, indications that a counterparty will enter bankruptcy or a significant and prolonged decline in the fair value of a security.

Impairment losses on financial assets carried at amortised cost are measured as the difference between the carrying value of the asset and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in the Income Statement and reflected as a deduction against the carrying value of the asset. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment losses to decrease, the decrease in impairment loss is recognised through the Income Statement.

Impairment losses on available-for-sale assets are recognised by transferring the cumulative loss, that has been recognised directly in equity, to the Income Statement. The cumulative loss that is removed from equity and recognised in the Income Statement is measured as the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss on that asset previously recognised in the Income Statement.

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

1. Accounting policies (continued)

g) Derecognition of financial assets and liabilities

Financial assets are derecognised when the rights to receive cash flows have expired or where substantially all the risks and rewards of ownership have been transferred. Financial liabilities are derecognised only when the obligation is discharged, cancelled or has expired.

h) Foreign currency transactions

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

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

The Income Statements of subsidiaries with non-Sterling functional currencies are translated into Sterling at the monthly average rates for the period, and assets and liabilities are translated at the closing rate of exchange. Any exchange differences arising on the translation of net assets of overseas subsidiaries are taken to reserves as a separate component of equity and disclosed in the Statement of Recognised Income and Expense.

i) Taxation

The income tax expense on the profits for the year comprises current tax and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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

Deferred tax is provided using the balance sheet liability method, which recognises temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor income and expenditure, and differences relating to investments in subsidiaries to the extent that it is probable they will not reverse in the foreseeable future. Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which temporary differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

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

j) Leases

Where the Group enters into a lease, which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. The asset is recorded in the Balance Sheet as an item of property, plant and equipment and is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease less accumulated depreciation and impairment losses. Future instalments under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the Income Statement at a constant annual rate, and the amount which reduces the outstanding obligation for future instalments.

All other leases are accounted for as operating leases and the rental charges are charged to the Income Statement on a straight-line basis.

Assets held by the Group on which operating leases are granted are included as items of property, plant and equipment. Rents receivable under operating leases are recognised in the Income Statement on a straight-line basis over the term of the lease.

Where leasehold premises cease to be occupied by the Society or its subsidiaries and current market conditions are expected to preclude sub-letting for a rental sufficient to cover the rental costs, a provision is made to cover the expected deficit.

1. Accounting policies (continued)

k) Employee benefits

Defined contribution pension arrangements

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

Defined benefit schemes

The Group operates four funded defined benefit pension schemes administered by trustees, the funds of which are separate from those of the Group.

Included in the Balance Sheet are the Group's net obligations in respect of the defined benefit pension schemes. The obligation of each scheme is calculated separately by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods.

That benefit is discounted to determine its present value, and the fair value of any scheme assets is deducted. The discount rate is based on the average yield available from long-dated AA-rated corporate bonds. The calculation is performed by a qualified actuary using the projected unit credit method.

Past and current service costs are recognised immediately in the Income Statement. Actuarial gains and losses arise from the differences between previous actuarial assumptions and what has actually occurred. These gains and losses are recognised in the Statement of Recognised Income and Expense.

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

l) Fees and commissions income

Fees and commissions are generally recognised, net of VAT (where applicable), when all contractual obligations have been fulfilled. Commissions earned on the sales of properties are recognised as earned on the date contracts are exchanged if thereafter the contract is, or is expected to be, completed.

Commission receivable from the sale of third party Regulated Financial Services products is recognised upon fulfilment of contractual obligations, that is when policies go on risk or, on completion of a mortgage, with a provision for future clawbacks for repayment in the event of early termination by the customer.

Commission income received monthly over the life of a policy is recognised on a cash received basis as this approximates to recognition of income over the period of the service.

m) Government grants

Grants relating to expenditure on property, plant and equipment are treated as deferred income and are credited to the Income Statement over the useful economic lives of qualifying assets. Grants relating to revenue expenditure are matched with the expenditure to which they relate.

1. Accounting policies (continued)

n) Property, plant and equipment

Property, plant and equipment are measured at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of those items.

Depreciation is calculated to write down the cost of items of property, plant and equipment less estimated residual values over their estimated useful lives as set out below on a straight-line basis unless stated otherwise.

Freehold and long-leasehold buildings	50 to 100 years
Special purpose head office facility	40 years
Refurbishment of freehold and long-leasehold buildings	5 to 10 years
Short-leasehold buildings	Period of lease
Equipment, fixtures and fittings	2 to 10 years
Motor vehicles	25% of net book value

Land is not depreciated. Major items of property, plant and equipment purchased are depreciated on a monthly basis from the date the asset is available for utilisation. In accordance with IAS 36, *Impairment of Assets*, all items of property, plant and equipment are regularly reviewed for indications of impairment. Any impairment identified is charged to the Income Statement.

o) Segmental reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

p) Cash and cash equivalents

For the purposes of the Cash Flow Statements, cash comprises cash in hand and loans and advances to credit institutions repayable on demand, and cash equivalents comprise highly-liquid investments that are readily convertible into cash with an insignificant risk of changes in value with original maturities of less than 3 months.

The Cash Flow Statements have been prepared using the indirect method.

q) Investment properties

Properties held by the Group either being surplus to Group requirements or to earn rentals or for capital appreciation are recognised as investment properties at cost less depreciation. The market value of investment properties is disclosed within the notes to the accounts, and a valuation is carried out internally on an annual basis.

The depreciation policy for investment properties is consistent with the policy for property, plant and equipment. In accordance with IAS 36, *Impairment of Assets*, investment properties are regularly reviewed for indications of impairment. Any impairment identified would be charged to the Income Statement.

1. Accounting policies (continued)

r) Financial guarantee contracts

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

s) Sale and repurchase agreements

Investment 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 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 agreements.

t) Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year.

The Group also has to make judgements in applying its accounting policies which affect the amounts recognised in the financial statements.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The key estimates, assumptions and judgements are set out below:

Effective interest rate

The valuation of assets or liabilities measured at amortised cost is calculated using the effective interest method. The effective interest method implies an interest rate which discounts the future forecast cash flows of an asset over its expected life back to its carrying value. The most critical factor in calculating the amortised cost of assets and liabilities held by the Group is the expected lives of these assets and liabilities which are determined on the basis of historical data and management judgement.

The impact of a one month increase in the anticipated life of the financial instruments would result in an increase in interest income of Group £2.6m and Society £1.7m.

Impairment of mortgage loans and advances

The Group regularly reviews its loan portfolios to assess the level of impairment. In determining whether an impairment loss should be recorded in the Income Statement, management makes judgements as to whether there is any objective data indicating that there is a measurable impairment loss. Specifically, management regularly assesses key assumptions such as the probability of an account going into possession, the time period over which an account will exhibit objective evidence of impairment loss (the 'emergence period') and the eventual loss incurred in the event of forced sale or write-off.

Based upon the Group's impairment modelling a 15% increase in the forecast unemployment rate over a two year period, above the current view, coupled with a fall in house prices of approximately 4%, above the current view, would increase the impairment by circa £10m.

Impairment of treasury investments

Treasury investments are regularly reviewed for objective evidence of impairment. In determining whether objective evidence exists, the Group considers, amongst other factors, current market conditions, fair value volatility, appropriateness of valuation techniques and the financial stability of the counterparty.

1. Accounting policies (continued)

Put option obligation

Where the Group acquires a majority shareholding in a subsidiary, but grants the minority shareholders an option to sell their shares to the Group at some future date, on acquisition the Group estimates the fair value of the total consideration payable in calculating the goodwill arising.

The fair value of both the put option obligation and the associated goodwill recognised are dependent on the following assumptions: an estimate of when the put option will be exercised by the minority shareholders, the market value growth of the obligation and the discount rate used at the balance sheet date. These assumptions are reviewed on a regular basis by senior management.

Extending the estimated exercise date of all put options by one year would result in the reduction of the aggregate put option obligation by £0.7m (2007: £1.4m). A 10% increase in the aggregate market value of these businesses would increase the put option liability by £3.2m (2007: £4.4m).

Fair value of derivatives and financial assets

The most reliable fair values of derivative financial instruments and available-for-sale assets are quoted market prices in an actively traded market. Where there is no active market, valuation techniques are used. Techniques adopted include valuation models used to calculate the present value of expected future cash flows, and options pricing models, if market values are not available. These techniques make use of observable market data and hence fair value estimates can be considered to be reliable. Where inputs are not observable they may be based on historic data. Changes in assumptions used in the models could affect the reported fair value of derivatives and available-for-sale assets.

Where previously active markets no longer provide prices, other market sources are monitored, such as real-time market information, custodian and independent financial institution valuations, and management judgement is exercised in determining fair values for these or similar instruments.

Basis risk derivatives are valued using discounted cash flow models, using observable market data and will be sensitive to benchmark interest rate curves.

Taxation

Significant estimates are required in determining the provision for corporation tax. There are a number of transactions for which the final tax determination is uncertain at the balance sheet date.

Retirement benefit obligations

In conjunction with its actuaries the Group makes key financial assumptions which are used in the actuarial valuation of the defined pension benefit obligation and, therefore, changes to these assumptions have an impact on the defined pension obligation, service cost and expected return on plan assets. These assumptions include the inflation and discount rates, the expected return on plan assets and the rate of increase of pensions in payment; see note 39 for further details on these assumptions.

One key assumption is the discount rate used to discount future plan liabilities where currently a 0.25% increase in the discount rate would reduce the pension obligation by £7.8m and vice versa. Another key assumption surrounds mortality rates where a one year increase in expected lives would increase the pension obligation by £3.2m and vice versa.

Provisions for liabilities

The ultimate liability and accounting treatment, for levies payable to the Financial Services Compensation Scheme (FSCS), to safeguard protected deposits from those banks which collapsed in 2008 remains uncertain. The Directors have considered the amount to be recognised in these Annual Accounts and have recognised the estimated liability for FSCS management expense levies for the three years following the first claim on the Scheme. These liabilities can be reasonably estimated, the Society was a member of the Scheme on 31 December 2008, at which date the obligating event triggering liabilities for the Scheme years 2008/09 and 2009/10 had occurred and the FSA has indicated that exit levies would be payable by any firm wishing to cease membership of the Scheme within the first three years. The amount provided is based on the Directors estimate of the Group's share of qualifying deposits, noting that the authorities have capped the annual management expenses levy to the Industry at £1.0bn for the next three years.

The ultimate liability for levies payable to the FSCS in future years is uncertain, and dependent on a number of factors outside our control. These factors include the extent to which the FSCS can recover its loans to fund the transfer of qualifying deposits, future interest rates and future failures of deposit takers coupled with the FSCS view as to how exit levies should be applied to those leaving the scheme.

2. Interest receivable and similar income

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
On loans fully secured on residential property	**524.4**	473.3	**402.8**	375.5
On other loans:				
To subsidiary undertakings	**-**	-	**100.6**	85.0
Other	**39.7**	46.8	**34.6**	29.5
On debt securities	**106.8**	96.4	**106.5**	96.1
On other liquid assets	**75.2**	22.9	**73.1**	20.7
Net income on derivative financial instruments	**23.9**	43.8	**29.2**	43.8
	770.0	683.2	**746.8**	650.6

Included within Group and Society interest and other similar income on debt securities is income from fixed income securities of £5.9m (2007: £3.7m).

Included within interest receivable and similar income is interest accrued on impaired financial assets: Group £10.1m (2007: £3.1m), Society £2.2m (2007: £1.1m).

3. Interest payable and similar charges

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
On shares held by individuals	**404.8**	360.9	**404.8**	360.9
On other shares	**0.1**	0.2	**0.1**	0.2
On subscribed capital	**3.2**	3.2	**3.2**	3.2
On deposits and other borrowings:				
Subordinated liabilities	**10.9**	10.7	**10.9**	10.7
Subsidiary undertakings	**-**	-	**17.9**	16.7
Wholesale and other funding	**239.9**	180.3	**210.6**	152.6
Net expense on derivative financial instruments	**23.1**	18.0	**29.5**	24.3
Other	**2.0**	0.2	**-**	-
	684.0	573.5	**677.0**	568.6

4. Fees and commissions receivable

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Mortgage related fees	**138.9**	144.8	**4.6**	5.2
General insurance fees	**25.1**	34.9	**5.2**	5.7
Commissions earned on property sales	**97.5**	151.1	**-**	-
Other fees and commissions	**159.4**	165.2	**3.7**	4.7
	420.9	496.0	**13.5**	15.6

5. Fees and commissions payable

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Mortgage related fees	**20.7**	40.2	**0.2**	0.3
Other fees and commissions	**6.3**	6.3	**1.8**	1.4
	27.0	46.5	**2.0**	1.7

6. Other operating income

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Investment property income	**0.4**	0.4	**1.4**	1.5
Expected return on pension scheme assets (note 39)	**9.9**	8.9	**4.4**	3.9
Interest on pension scheme liabilities (note 39)	**(9.7)**	(8.6)	**(4.3)**	(3.6)
Government grants	**0.1**	0.5	**-**	-
Other	**9.8**	14.9	**1.2**	1.0
	10.5	16.1	**2.7**	2.8

7. Administrative expenses

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Employee costs:				
- Wages and salaries	**231.8**	233.1	**30.5**	26.4
- Social security costs	**21.0**	21.6	**2.8**	2.4
Pension costs:				
- Defined contribution arrangements (note 39)	**6.8**	5.6	**1.7**	1.4
- Defined benefit schemes service costs (note 39)	**2.3**	2.8	**1.2**	1.3
- Defined benefit schemes curtailments (note 39)	**(6.3)**	-	**-**	-
	255.6	263.1	**36.2**	31.5
Other administrative expenses	**177.4**	177.9	**25.2**	22.5
	433.0	441.0	**61.4**	54.0
Other administrative expenses include:				
Amortisation of intangible assets (note 18)	**9.8**	8.4	**1.0**	1.1
Depreciation of property, plant and equipment (note 19) and investment properties (note 20)	**13.0**	12.6	**2.1**	2.0
Impairment of goodwill (note 18)	**5.9**	0.9	**-**	-
Auditors' and their associates' remuneration:				
- Audit of the Society and Group accounts	**0.1**	0.1	**0.1**	0.1
- Audit of the Group's subsidiaries	**0.6**	0.6	**-**	-
- Other services pursuant to legislation	**0.1**	0.1	**-**	-
- Other services relating to taxation	**0.1**	0.1	**-**	-
- All other services	**0.2**	0.3	**0.2**	0.1
Amounts payable under operating leases:				
- Plant and machinery	**5.9**	3.7	**3.6**	3.5
- Other	**19.6**	19.1	**4.9**	5.1

8. Employee numbers

	Group 2008	Group 2007	**Society 2008**	Society 2007
The average number of persons employed (including Executive Directors and part-time staff) during the year was as follows:				
- Principal office and administration centres	**726**	666	**726**	666
- Society branch offices	**511**	463	**511**	463
- Subsidiaries	**7,900**	8,848	**-**	-
	9,137	9,977	**1,237**	1,129

9. Directors' emoluments

Directors' emoluments are set out within the Directors' Remuneration Report in accordance with Schedule 10A, paragraphs 1 to 9 of the Building Societies Act 1986.

Total Directors' emoluments amounted to £2.8m (2007: £1.8m), including £1.0m of compensation payments for loss of office.

10. Related party transactions

A number of transactions are entered into with related parties in the normal course of business; these are detailed below:

Key management personnel

Key management personnel comprise the Executive Directors and Non-Executive Directors, who are responsible for ensuring that the Society and its subsidiaries meet their strategic and operational objectives.

The table below summarises the benefits paid to key management personnel in the year.

	2008 £m	2007 £m
Short-term employee benefits such as wages and bonuses	**2.7**	1.7
Employer pension contributions	**0.1**	0.1
	2.8	1.8

The table below sets out the outstanding balances in relation to related party transactions with key management personnel and persons who are connected with key management personnel.

	2008 £m	2007 £m
Mortgage loans outstanding at 31 December	**0.2**	0.2

	2008 £m	2007 £m
Savings balances at 31 December	**1.4**	1.0

Interest receivable and payable on the above accounts:	**2008 £m**	2007 £m
Interest receivable	**-**	-
Interest payable	**0.1**	0.1

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

10. Related party transactions (continued)

Directors' loans and transactions

At 31 December 2008 there were outstanding mortgage loans granted in the ordinary course of business amounting in aggregate to £0.2m (2007: £0.2m) to 3 (2007: 3) Directors and persons who are connected with Directors.

A register is maintained at the Principal Office of the Society, which shows details of all loans, transactions and arrangements with Directors and connected persons. A statement, for the current financial year, of the appropriate details contained in the register will be available for inspection at the Principal Office for a period of 15 days up to and including the Annual General Meeting.

Contributions to pension schemes

During the year, the Group and Society paid contributions of £11.0m (2007: £20.6m) and £4.2m (2007: £15.0m) respectively to defined benefit pension schemes, which are classified as related parties.

Related party transactions

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

	2008 £m	2007 £m
Rendering and receiving of services	**2.6**	5.1
Recharges of central costs	**11.5**	10.9
Interest received	**100.7**	85.0
Interest paid	**(17.9)**	(16.7)
Other income	**1.1**	1.3
Collateral transferred for covered bond programme	**968.9**	-

All above transactions were entered into on an arm's-length basis. For details of the relationship between the Society and its principal subsidiaries see note 17.

At 31 December 2008 the Society owed subsidiary undertakings £1,210.5m (2007: £214.9m) and was owed £2,580.7m (2007: £1,722.0m) by subsidiary undertakings and associated companies. Interest on Group borrowings is charged at the appropriate market rate.

During the year the Group purchased a 75% shareholding in Thomson Shepherd Limited, a business in which Mr W H Jack had a 10.8% shareholding in and was Chairman of its board. Mr Jack withdrew from all the Board's deliberations on the acquisition and, on acquisition, sold his shareholding to the Group for £0.2m and resigned from the board of Thomson Shepherd Limited.

During the year, the Group had the following related party transactions with joint ventures and associates.

	2008 £m	2007 £m
Services provided to the Group	**1.1**	0.8
Services provided by the Group	**1.2**	1.4

11. Taxation (income) / expense

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Current tax	**(4.5)**	35.7	**(2.0)**	13.2
Deferred tax (note 28)	**3.2**	1.6	**(0.4)**	0.2
	(1.3)	37.3	**(2.4)**	13.4

A reconciliation of the tax (income) / expense on profit before tax at the standard UK corporation tax rate to the actual tax expense is as follows:

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Profit before tax	**22.5**	163.9	**11.3**	136.8
Less share of profits of joint venture and associate	**(3.9)**	(3.7)	**-**	-
	18.6	160.2	**11.3**	136.8
Tax calculated at UK standard rate of 28.5% (2007: 30%)	**5.3**	48.1	**3.2**	41.0
Effects of:				
Expenses not deductible for tax purposes	**2.8**	3.1	**0.4**	2.2
Adjustment to tax expense in respect of prior periods	**(0.8)**	1.0	**0.2**	1.0
Utilisation of tax losses	**-**	(3.1)	**-**	-
Tax on dividends receivable	**(0.7)**	-	**(6.3)**	(30.7)
Profit on disposals not taxable	**(8.8)**	(11.2)	**-**	-
Other	**0.9**	(0.6)	**0.1**	(0.1)
Tax (income) / expense	**(1.3)**	37.3	**(2.4)**	13.4

The tax charge for the year includes a reduction in the corporation tax rate from 30% to 28% which was effective from 1 April 2008. The effective tax rate for the year ended 31 December 2008 is negative 5.8% (2007: positive 22.8%) and is lower than the standard rate of corporation tax due to the impact of non-taxable gains on disposal of subsidiaries and associates.

12. Loans and advances to credit institutions

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Loans and advances to credit institutions have remaining maturities as follows:				
Repayable on demand	**40.3**	27.1	**-**	-
Other loans and advances by residual maturity repayable:				
In not more than three months	**1,044.0**	376.1	**1,041.5**	374.1
In more than three months but not more than one year	**-**	6.1	**-**	6.1
	1,084.3	409.3	**1,041.5**	380.2

13. Debt securities

Group and Society	**2008 £m**	2007 £m
Issued by public bodies	**116.0**	76.0
Issued by other borrowers	**1,618.6**	2,048.8
	1,734.6	2,124.8
Debt securities have remaining maturities as follows:		
In not more than one year	**1,209.5**	1,394.5
In more than one year	**525.1**	730.3
	1,734.6	2,124.8
Transferable debt securities comprise:		
Listed on a recognised investment exchange	**777.6**	891.6
Unlisted	**957.0**	1,233.2
	1,734.6	2,124.8
Market value of listed transferable debt securities	**777.6**	891.6

The Directors consider that the primary purpose of holding debt securities is prudential. The debt securities are held as liquid assets with the intention of use on a continuing basis in the Group's activities.

At 31 December 2008, £590.5m (2007: £230.5m) of investment securities were pledged as collateral under sale and repurchase agreements. All sale and repurchase transactions are conducted in line with market standard terms and conditions as defined in ISMA PSA Global Master Repurchase Agreements.

Movements in debt securities during the year may be summarised as follows:

Group and Society	**2008 £m**	2007 £m
At 1 January	**2,124.8**	1,795.0
Additions	**6,648.4**	3,545.7
Disposals	**(7,016.6)**	(3,208.7)
Impairment losses	**(11.5)**	-
Changes in fair value	**(13.2)**	(7.2)
Amortisation of fair value adjustment	**2.7**	-
At 31 December	**1,734.6**	2,124.8

Pursuant to the amendments to IAS 39, *Financial Instruments: Recognition and Measurement*, and IFRS 7, *Financial Instruments: Disclosures* (described in note 1 (d)), the Group reclassified certain available-for-sale investment securities to the loans and receivable category. The Group identified financial assets that would have met the definition of loans and receivables (if they had not been designated as available-for-sale) for which at 1 July 2008 it had the intention and the ability to hold them for the foreseeable future or until maturity. The average effective interest rate of those investment securities that have transferred is 5.10%.

Under IAS 39, *Financial Instruments: Recognition and Measurement* as amended, the reclassifications were made with effect from 1 July 2008 at fair value at that date. The table below sets out the financial assets reclassified and their carrying and fair values:

Group and Society	**1 July 2008 £m**	**31 December 2008 £m**
Carrying value of reclassified assets	**339.4**	**303.4**
Fair value of reclassified assets	**339.4**	**288.9**

14. Derivative financial instruments

	Group		Society	
	Positive market value 2008 £m	**Negative market value 2008 £m**	**Positive market value 2008 £m**	**Negative market value 2008 £m**
Derivatives designated as fair value hedges:				
Interest rate swaps	101.8	187.0	101.8	154.2
Currency swaps	255.3	-	255.3	-
	357.1	**187.0**	**357.1**	**154.2**
Derivatives designated as cash flow hedges:				
Interest rate swaps	5.5	33.6	5.5	33.6
	5.5	**33.6**	**5.5**	**33.6**
Other derivatives held at fair value:				
Quanto swaps	0.6	0.1	0.6	0.1
Mortgage products - embedded derivatives	0.2	1.2	0.2	1.2
Equity swaps	-	8.0	-	8.0
Investment products - embedded derivatives	7.5	0.1	7.5	0.1
Interest rate swaps	57.2	50.3	127.7	50.1
Options	1.8	-	1.8	-
	67.3	**59.7**	**137.8**	**59.5**
	429.9	**280.3**	**500.4**	**247.3**

	Group		Society	
	Positive market value 2007 £m	Negative market value 2007 £m	Positive market value 2007 £m	Negative market value 2007 £m
Derivatives designated as fair value hedges:				
Interest rate swaps	48.2	20.6	47.1	14.0
Currency swaps	39.7	-	39.7	-
	87.9	20.6	86.8	14.0
Derivatives designated as cash flow hedges:				
Interest rate swaps	2.9	7.6	2.9	7.6
	2.9	7.6	2.9	7.6
Other derivatives held at fair value:				
Quanto swaps	0.7	-	0.7	-
Mortgage products – embedded derivatives	-	0.4	-	0.4
Equity swaps	2.6	4.9	2.6	4.9
Investment products – embedded derivatives	4.8	5.9	4.8	5.9
Interest rate swaps	21.4	11.0	21.2	9.8
Options	2.0	-	2.0	-
	31.5	22.2	31.3	21.0
	122.3	50.4	121.0	42.6

All derivatives held are held for economic hedging purposes.

15. Loans and advances to customers

	Group 2008 £m	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
Loans fully secured on residential property	**8,774.8**	8,685.0	**7,031.8**	6,880.5
Other loans:				
Loans fully secured on land	**526.3**	464.0	**526.3**	464.0
Other loans	**79.3**	134.4	**27.2**	25.5
Fair value adjustment for hedged risk	**187.3**	8.5	**155.3**	2.3
	9,567.7	9,291.9	**7,740.6**	7,372.3
Maturity analysis				
The remaining maturity of loans and advances to customers from the date of the balance sheet is as follows:				
On call and at short notice	**42.6**	33.5	**5.8**	1.0
In not more than three months	**3.5**	11.4	**2.8**	4.9
In more than three months but not more than one year	**20.8**	88.5	**18.1**	28.1
In more than one year but not more than five years	**262.2**	213.0	**241.3**	190.9
In more than five years	**9,282.7**	8,962.5	**7,481.5**	7,153.0
	9,611.8	9,308.9	**7,749.5**	7,377.9
Less: Impairment (note 16)	**(44.1)**	(17.0)	**(8.9)**	(5.6)
	9,567.7	9,291.9	**7,740.6**	7,372.3

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

Covered bonds

Loans and advances to customers include £968.9m (2007: £Nil) for both the Group and Society which have been transferred from the Society to Skipton Covered Bonds LLP, a Limited Liability Partnership which is consolidated into the Group Accounts. The loans secure £750.0m (2007: £Nil) of covered bonds issued by the Society. The loans are retained on the Society's balance sheet as the Society substantially retains the risks and rewards relating to the loans.

16. Impairment losses on loans and advances

	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans £m	Total £m
Group				
At 1 January 2008				
Individual impairment	3.1	0.5	2.5	6.1
Collective impairment	10.1	0.8	-	10.9
	13.2	**1.3**	**2.5**	**17.0**
Amounts written off during the year				
Individual impairment	(5.5)	(0.4)	(0.6)	(6.5)
	(5.5)	**(0.4)**	**(0.6)**	**(6.5)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	30.5	0.6	0.8	31.9
Collective impairment	3.1	-	-	3.1
	33.6	**0.6**	**0.8**	**35.0**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.4)	-	-	(0.4)
Charge for the year	**33.2**	**0.6**	**0.8**	**34.6**
Disposal of subsidiaries	**-**	**-**	**(1.0)**	**(1.0)**
At 31 December 2008				
Individual impairment	**27.7**	**0.7**	**1.7**	**30.1**
Collective impairment	**13.2**	**0.8**	**-**	**14.0**
	40.9	**1.5**	**1.7**	**44.1**
Group				
At 1 January 2007				
Individual impairment	2.5	0.2	5.0	7.7
Collective impairment	7.2	0.5	1.7	9.4
	9.7	0.7	6.7	17.1
Amounts written off during the year				
Individual impairment	(1.2)	-	(4.2)	(5.4)
Collective impairment	1.6	-	(1.7)	(0.1)
	0.4	-	(5.9)	(5.5)
Income Statement				
Impairment losses on loans and advances				
Individual impairment	2.6	0.3	1.7	4.6
Collective impairment	1.3	0.3	-	1.6
	3.9	0.6	1.7	6.2
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.8)	-	-	(0.8)
Charge for the year	3.1	0.6	1.7	5.4
At 31 December 2007				
Individual impairment	3.1	0.5	2.5	6.1
Collective impairment	10.1	0.8	-	10.9
	13.2	1.3	2.5	17.0

16. Impairment losses on loans and advances (continued)

	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans £m	Total £m
Society				
At 1 January 2008				
Individual impairment	0.1	0.5	0.9	1.5
Collective impairment	3.3	0.8	-	4.1
	3.4	**1.3**	**0.9**	**5.6**
Amounts written off during the year				
Individual impairment	(0.4)	(0.4)	(0.1)	(0.9)
	(0.4)	**(0.4)**	**(0.1)**	**(0.9)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	3.4	0.6	0.6	4.6
	3.4	**0.6**	**0.6**	**4.6**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.4)	-	-	(0.4)
Charge for the year	**3.0**	**0.6**	**0.6**	**4.2**
At 31 December 2008				
Individual impairment	**2.7**	**0.7**	**1.4**	**4.8**
Collective impairment	**3.3**	**0.8**	**-**	**4.1**
	6.0	**1.5**	**1.4**	**8.9**
Society				
At 1 January 2007				
Individual impairment	-	0.2	5.3	5.5
Collective impairment	3.3	0.5	0.1	3.9
	3.3	0.7	5.4	9.4
Amounts written off during the year				
Individual impairment	0.4	-	(5.3)	(4.9)
Collective impairment	-	-	(0.1)	(0.1)
	0.4	-	(5.4)	(5.0)
Income Statement				
Impairment losses on loans and advances				
Individual impairment	0.2	0.3	0.9	1.4
Collective impairment	-	0.3	-	0.3
	0.2	0.6	0.9	1.7
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.5)	-	-	(0.5)
Charge / (credit) for the year	(0.3)	0.6	0.9	1.2
At 31 December 2007				
Individual impairment	0.1	0.5	0.9	1.5
Collective impairment	3.3	0.8	-	4.1
	3.4	1.3	0.9	5.6

Included within the charge to the Income Statement is the impact of the change in impairment charge due to the time value of money. For the Group this amounted to £1.1m (2007: £0.1m); for the Society it amounted to £0.2m (2007: £Nil).

17. Investments in group undertakings

a) Subsidiaries

Investments in subsidiary undertakings are recorded at cost, which includes an estimate of the remaining liability to purchase the minority shareholdings at a future date (where applicable), which is the fair value of the consideration paid, less impairment and dividends paid out of pre-acquisition reserves.

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

	Shares in subsidiary undertakings		Loans to subsidiary undertakings		Total	
	2008 £m	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
Society						
Cost						
At 1 January	**76.8**	76.8	**1,722.0**	1,327.3	**1,798.8**	1,404.1
Additions	**1.2**	-	**1,023.3**	428.2	**1,024.5**	428.2
Disposals	**-**	-	**(164.6)**	(33.5)	**(164.6)**	(33.5)
At 31 December	**78.0**	76.8	**2,580.7**	1,722.0	**2,658.7**	1,798.8
Provisions						
At 1 January	**-**	-	**7.0**	-	**7.0**	-
Provided in the year	**-**	-	**-**	7.0	**-**	7.0
Utilised in the year	**-**	-	**(7.0)**	-	**(7.0)**	-
At 31 December	**-**	-	**-**	7.0	**-**	7.0
Net book value						
At 31 December	**78.0**	76.8	**2,580.7**	1,715.0	**2,658.7**	1,791.8

17. Investments in group undertakings (continued)

At 31 December 2008, the Group held a controlling interest in the following principal trading subsidiary undertakings:

Name of subsidiary undertaking	Principal business activity	Percentage of ownership interest 2008	2007
Advance Mortgage Funding Limited T/A Pink Home Loans *	Provider of mortgage packaging services	**97.5**	97.5
Amber Homeloans Limited	Lending body	**100.0**	100.0
Amber Select Limited	Provider of short term credit facilities	**-**	100.0
Bailey Computer Services Limited	Provider of IT services	**100.0**	100.0
Baseline Capital Limited *	Provider of data analysis solutions	**92.5**	92.5
Callcredit Information Group Limited and subsidiaries *	Credit reference agency, database specialist and related businesses	**94.4**	89.3
Connells Limited and subsidiaries *	Estate agency and related businesses	**96.7**	96.7
Direct Life and Pension Services Limited	Life insurance intermediary	**-**	75.0
Homeloan Management Limited	Provider of mortgage services	**100.0**	100.0
Jade Software Corporation Limited and subsidiaries	Provider of software development services	**53.9**	52.8
Mutual One Limited *	Provider of support services	**82.5**	80.0
Northwest Investments NZ Limited	Provider of software development services	**100.0**	100.0
Parnell Fisher Child & Co. Limited *	Independent financial adviser	**79.0**	75.0
Pearson Jones plc *	Independent financial adviser	**96.5**	80.2
Skipton Business Finance Limited	Provider of debt factoring services	**100.0**	100.0
Skipton Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	**(See below)**	-
Skipton Financial Services Limited	Financial adviser	**100.0**	100.0
Skipton Group Holdings Limited ("SGHL")	Intermediate holding company	**100.0**	100.0
Skipton Guernsey Limited	Offshore deposit taker and lender	**100.0**	100.0
Skipton Trustees Limited	Provider of will writing services	**100.0**	100.0
Skipton Premises Limited	Property developer	**100.0**	100.0
Sterling International Brokers Limited *	Money broker	**92.0**	90.0
The Private Health Partnership Limited *	Medical insurance broker	**88.7**	88.7
Thomson Shepherd Limited *	Financial adviser	**85.7**	-
Torquil Clark Holdings Limited *	Financial adviser	**75.0**	-

* Indicates where an option to purchase minority interests in future exists

The Group holds a majority stake in these subsidiaries, and the minority shareholders have options to require SGHL to purchase the remaining shareholding at some future date. Under IAS 32, *Financial instruments: presentation* and IAS 39, *Financial Instruments: Recognition and Measurement*, these options are designated as '*financial instruments*'. As such, the net present value of the estimated future payments under such put options are shown as a financial liability, with a corresponding entry to goodwill. In subsequent periods, any adjustment to the Group's estimation of the present value of the liability will result in a restatement in goodwill. The estimate of liability is principally dependent on the forecast performance of the businesses and the estimated timing of the exercise of the option. The change in fair value of the financial liability due to the accretion of the discount on the liability is expensed in the Income Statement.

At 31 December 2008 this financial liability was £28.7m (2007: £40.6m).

17. Investments in group undertakings (continued)

The remaining subsidiaries are 100% owned except for Jade Software Corporation Limited where the Group holds a 53.9% (2007: 52.8%) where no put options exist.

The Society's interests in Skipton Covered Bonds Limited Liability Partnership is, in substance, no different than if it was a 100% held subsidiary undertaking and consequently it is consolidated in the Group accounts.

All the above bodies are incorporated and registered in England and operate in the United Kingdom except for Skipton Guernsey Limited, which is incorporated in, registered in, and operates in Guernsey and Jade Software Corporation Limited and Northwest Investments NZ Limited, which are both incorporated in, registered in, and operate in New Zealand.

All the above subsidiary undertakings have prepared accounts to 31 December 2008 and their audited results have been included in the Group Accounts.

During the year, the Group acquired shareholdings in subsidiaries as follows:

Name of subsidiary undertaking	Principal business activity	Date of acquisition	Percentage of ownership interest	Cost £m	Goodwill arising £m
BDS Mortgage Group Limited	Provider of mortgage packaging services	8 February 2008	90.0	5.0	4.0
Torquil Clark Holding Limited	Financial adviser	25 March 2008	85.7	11.5	13.4
Thomson Shepherd Limited	Financial adviser	4 April 2008	75.0	5.5	5.7
Medical Care Direct Limited	Medical procedure service sourcer	18 April 2008	80.0	0.7	0.7
H E Grant (Holdings) Limited	Independent financial adviser	18 July 2008	100.0	1.7	0.9
				24.4	**24.7**

17. Investments in group undertakings (continued)

The net assets of subsidiaries acquired during the year have been incorporated into the Group Accounts at their values as outlined below:

	Book value of assets acquired £m	Fair value adjustments £m	Total £m
Cash consideration			16.5
Deferred cash consideration			5.0
Fair value of put option to purchase minority shareholdings			2.9
Total consideration			**24.4**
Property, plant and equipment	0.4	-	0.4
Intangible assets	0.5	0.7	1.2
Debtors	1.2	0.5	1.7
Cash	1.3	-	1.3
Liabilities	(4.3)	(0.6)	(4.9)
Net assets	**(0.9)**	**0.6**	**(0.3)**
Goodwill			**24.7**

The acquisitions individually are not considered to be material to the Group and therefore the above analysis has not been set out for each subsidiary; instead the aggregate position is provided.

The results of all subsidiaries have been consolidated using the acquisition method of accounting, and the net assets of subsidiaries acquired have been incorporated into the Group Accounts at fair value.

The majority of the above acquisitions relate to companies within the financial services and related sectors and the consideration paid for these businesses often exceeds the fair value of the net assets acquired. This premium arises as a result of the expected future economic benefit arising from the staff within those businesses. Where intangible assets can be separately identified, in accordance with IAS 38, these are recognised within the fair values of the assets acquired. The residual excess of the consideration over the net assets acquired is recognised as goodwill in the financial statements.

From the dates of their acquisition to 31 December 2008 the aggregate amount that the acquisitions contributed to income was £13.0m and loss before tax was £1.1m.

If we had purchased these subsidiaries at the start of the year, the aggregate amount that the acquisitions would have contributed to income would have been £16.6m and their loss before tax would have been £1.2m.

The accounting for acquisitions during the year has been determined on a provisional basis at 31 December 2008 because the fair values assigned to the acquirees' identifiable assets and liabilities have not been determined finally. Any adjustments to these provisional values as a result of completing the work on the fair values of the assets and liabilities acquired will be recognised within a year of the acquisition date and will be recognised as if they had occurred at the date of acquisition.

A review of acquisitions made in 2007 identified further fair value adjustments, arising on those acquisitions. Consequently £0.3m was transferred out of goodwill and reclassified as intangible assets.

17. Investments in group undertakings (continued)

In addition to these acquisitions, during the year the Group increased its shareholdings in a number of existing subsidiaries at a total cost of £13.0m (2007: £67.3m). Together with the reassessment of the expected future payments under the put options, this resulted in a further £(0.7)m (2007: £9.7m) of goodwill being recognised.

b) Disposals

During the year the Group disposed of its entire holding in the following subsidiaries:

Name of subsidiary undertaking	Principal business activity	Date of disposal	Cash received £m	Profit / (loss) on disposal £m
Direct Life & Pension Services Limited	Life insurance intermediary	18 March 2008	11.2	10.3
Amber Select Limited	Provider of short-term credit facilities	25 March 2008	2.1	(1.2)
			13.3	**9.1**

In June 2008, Callcredit Information Group Limited reduced its shareholding in Broadsystem Limited from 100.0% to 97.7% for a consideration of £0.1m.

As a result of these disposals and part disposal of subsidiaries, goodwill of £6.3m was eliminated.

During the period of ownership Direct Life & Pension Services Limited contributed £0.4m (2007: £1.3m) and Amber Select Limited contributed £Nil (2007: £(2.1)m) to the Group's profits before taxation.

c) Joint ventures and associates

The Group's interests relate to a joint venture where Connells Limited owns 33.3% (2007: 33.3%) of TMG Holdings Limited, a property search provider, and at 31 December 2007 an associate where Connells Limited holds an interest of 16.4% of Rightmove PLC, an internet property portal, which was disposed of during the year, resulting in a profit of £22.3m and a reduction in goodwill of £4.1m.

	Group 2008 £m	Group 2007 £m
Share of joint ventures and associates		
Gross assets	**2.3**	10.3
Gross liabilities	**(0.8)**	(4.2)
At 31 December	**1.5**	6.1
Share of joint ventures and associates		
Income	**23.2**	21.9
Expense	**(17.8)**	(16.6)
Taxation	**(1.5)**	(1.6)
Share of joint ventures' profit after tax	**3.9**	3.7

Joint ventures and associates are recognised within the Group's financial statements using the equity accounting method. The joint ventures and associates are incorporated in England and Wales.

The aggregate market value of the Group's interests in listed investments included within joint ventures, associates and equity investments above was £Nil (2007: £98.6m).

18. Intangible assets

	Group 2008 £m	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
Software, databases and customer contracts	**31.6**	28.1	**2.8**	2.0
Goodwill	**210.9**	202.3	**-**	-
	242.5	230.4	**2.8**	2.0

Software, databases and customer contracts	**Group 2008 £m**	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
Cost				
At 1 January	**68.4**	53.4	**6.6**	5.8
Acquisitions	**1.2**	5.6	**-**	-
Additions	**12.5**	10.4	**1.8**	1.0
Disposals	**(0.5)**	(1.0)	**(0.4)**	(0.2)
Disposals of subsidiaries	**(6.4)**	-	**-**	-
At 31 December	**75.2**	68.4	**8.0**	6.6
Amortisation and impairment				
At 1 January	**40.3**	32.9	**4.6**	3.7
Charge for the year	**9.8**	8.4	**1.0**	1.1
Disposals	**(0.5)**	(1.0)	**(0.4)**	(0.2)
Disposal of subsidiaries	**(6.0)**	-	**-**	-
At 31 December	**43.6**	40.3	**5.2**	4.6
Net book value				
At 1 January	**28.1**	20.5	**2.0**	2.1
Net book value				
At 31 December	**31.6**	28.1	**2.8**	2.0

Goodwill	**Group 2008 £m**	Group 2007 £m
Cost less amortisation to 1 January 2004		
At 1 January	**208.8**	169.4
Acquisitions of subsidiaries and business units	**24.0**	40.6
Disposals	**(10.4)**	(1.2)
At 31 December	**222.4**	208.8
Impairment losses		
At 1 January	**6.5**	5.6
Provisions for impairment loss in the year	**5.9**	0.9
Disposals	**(0.9)**	-
At 31 December	**11.5**	6.5
Net book value		
At 1 January	**202.3**	163.8
Net book value		
At 31 December	**210.9**	202.3

18. Intangible assets (continued)

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating units (CGUs) that are expected to benefit from that business combination. Before recognition of impairment losses, the cost of goodwill before impairment had been allocated as follows:

Cash generating units	Group 2008 £m	Group 2007 £m
Mortgage services	**2.4**	2.4
Estate agency	**99.9**	114.7
Financial services	**39.2**	25.1
Data provision	**43.7**	33.0
Other related activities	**37.2**	33.6
	222.4	208.8

The recoverable amounts of the CGUs are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the cash flows, discount rates and growth rates.

The Group prepares cash flow forecasts on the assumption that the subsidiaries are held for long-term investment. The cash flows are derived from the most recent financial budgets for the next three years, which take into account the risks inherent in the businesses, and extrapolates cash flows for subsequent years (up to an additional 12 years) based on a long-term growth rate of 2.0% (2007 2.0%).

The Group estimates discount rates based on the current cost of capital adjusted for the risks inherent in each cash generating unit which fall within a range (post-tax) of between 10% and 12% (2007: single rate of 7.9%). A reduction in the availability of credit lines led to a general increase in the cost of capital.

At 31 December 2008, impairment of £11.5m (2007: £6.5m) was allocated to CGUs as follows to reduce the goodwill to its estimated recoverable amount, based upon current revised forecasts:

Cash generating units	Group 2008 £m	Group 2007 £m
Financial services	**0.2**	0.2
Estate agency	**3.3**	0.5
Data provision	**2.3**	2.2
Other related activities	**5.7**	3.6
	11.5	6.5

At 31 December 2008, before impairment testing, goodwill of £7.7m was allocated to the Pink Homeloans CGU within the 'Other related activities' segment. Pink Homeloans operates within the mortgage broking sector where business volumes have fallen substantially and the Group has revised its future cash flow forecasts for this CGU. As a result, an impairment loss of £3.0m has been recognised.

At 31 December 2008, before impairment testing, goodwill of £67.5m was allocated to a number of subsidiaries within the estate agency CGU. Due to the downturn in the housing market the Group has revised its cash flows for some of these subsidiaries. As a result, an impairment of £2.8m has been recognised.

At 1 January 2008 the fair value of goodwill was substantially in excess of its book value. Due to current market conditions, at 31 December 2008 the fair value is substantially closer to book value and consequently the likelihood of future impairment losses has increased.

19. Property, plant and equipment

	Land and buildings £m	Equipment, fixtures and fittings £m	Total £m
Group			
Cost			
At 1 January 2008	67.2	114.4	181.6
Acquisitions	0.1	0.3	0.4
Additions	3.8	7.8	11.6
Disposals	(2.3)	(7.9)	(10.2)
Disposal of subsidiaries	-	(3.1)	(3.1)
At 31 December 2008	**68.8**	**111.5**	**180.3**
Depreciation			
At 1 January 2008	17.0	85.0	102.0
Charge for the year	2.2	10.5	12.7
Disposals	(1.7)	(4.3)	(6.0)
Disposal of subsidiaries	-	(2.7)	(2.7)
At 31 December 2008	**17.5**	**88.5**	**106.0**
Net book value			
At 1 January 2008	50.2	29.4	79.6
Net book value			
At 31 December 2008	**51.3**	**23.0**	**74.3**
Group			
Cost			
At 1 January 2007	69.7	110.3	180.0
Acquisitions	0.1	2.6	2.7
Additions	3.8	13.1	16.9
Disposals	(6.4)	(11.6)	(18.0)
At 31 December 2007	67.2	114.4	181.6
Depreciation			
At 1 January 2007	21.5	83.3	104.8
Acquisitions	-	1.8	1.8
Charge for the year	2.2	10.3	12.5
Disposals	(6.7)	(10.4)	(17.1)
At 31 December 2007	17.0	85.0	102.0
Net book value			
At 1 January 2007	48.2	27.0	75.2
Net book value			
At 31 December 2007	50.2	29.4	79.6

19. Property, plant and equipment (continued)

	Land and buildings £m	Equipment, fixtures and fittings £m	Total £m
Society			
Cost			
At 1 January 2008	23.7	29.5	53.2
Additions	1.9	1.3	3.2
Disposals	(1.6)	(1.9)	(3.5)
At 31 December 2008	**24.0**	**28.9**	**52.9**
Depreciation			
At 1 January 2008	9.9	26.4	36.3
Charge for the year	0.8	1.0	1.8
Disposals	(1.3)	(1.1)	(2.4)
At 31 December 2008	**9.4**	**26.3**	**35.7**
Net book value			
At 1 January 2008	13.8	3.1	16.9
Net book value			
At 31 December 2008	**14.6**	**2.6**	**17.2**

	Land and buildings £m	Equipment, fixtures and fittings £m	Total £m
Society			
Cost			
At 1 January 2007	22.5	28.6	51.1
Additions	1.6	1.5	3.1
Disposals	(0.4)	(0.6)	(1.0)
At 31 December 2007	23.7	29.5	53.2
Depreciation			
At 1 January 2007	9.6	25.7	35.3
Charge for the year	1.0	1.0	2.0
Disposals	(0.7)	(0.3)	(1.0)
At 31 December 2007	9.9	26.4	36.3
Net book value			
At 1 January 2007	12.9	2.9	15.8
Net book value			
At 31 December 2007	13.8	3.1	16.9

19. Property, plant and equipment (continued)

The net book value of land and buildings comprises:

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Freehold	**45.5**	44.4	**11.2**	10.9
Long leasehold	**2.1**	1.3	**2.1**	1.2
Short leasehold	**3.7**	4.5	**1.3**	1.7
	51.3	50.2	**14.6**	13.8

20. Investment property

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Cost				
At 1 January	**7.7**	8.3	**16.0**	15.9
Additions	**4.3**	0.6	**4.3**	0.7
Disposals	**-**	(1.2)	**-**	(0.6)
At 31 December	**12.0**	7.7	**20.3**	16.0
Depreciation				
At 1 January	**2.6**	2.8	**3.3**	3.5
Charge for the year	**0.3**	0.1	**0.3**	-
Disposals	**-**	(0.3)	**-**	(0.2)
At 31 December	**2.9**	2.6	**3.6**	3.3
Net book value				
At 1 January	**5.1**	5.5	**12.7**	12.4
Net book value				
At 31 December	**9.1**	5.1	**16.7**	12.7

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

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Market value of investment property	**10.0**	11.8	**21.9**	23.3

The additions for the Society and the Group in 2008, include properties under construction with a net book value of £3.1m.

The estimated market value of the investment properties were determined by an appropriately qualified internal valuer in accordance with RICS Appraisal and Valuation Standards.

21. Other assets

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Prepayments and accrued income	**28.3**	25.0	**5.9**	4.8
Trade debtors	**65.0**	57.2	**-**	-
Other	**9.8**	24.1	**1.4**	0.3
	103.1	106.3	**7.3**	5.1

The ageing of the Group's trade debtors at the reporting date was:

	2008		2007	
	Gross £m	Impairment £m	Gross £m	Impairment £m
Not past due	**42.5**	**-**	33.1	-
Past due 0-30 days	**12.3**	**(0.3)**	12.9	-
Past due 31-120 days	**9.5**	**(1.2)**	9.4	(0.2)
Past due 120 days plus	**6.1**	**(3.9)**	3.8	(1.8)
	70.4	**(5.4)**	59.2	(2.0)

The movement in the allowance for impairment in respect of the Group's trade debtors during the year was as follows:

	2008 £m	2007 £m
At 1 January	**(2.0)**	(1.4)
Provisions made during the year	**(4.2)**	(1.4)
Debtors written off during the year	**0.4**	0.7
Provisions no longer required	**0.4**	0.1
At 31 December	**(5.4)**	(2.0)

22. Shares

	2008 £m	2007 £m
Group and Society		
Held by individuals	**8,117.2**	7,184.5
Other shares	**2.7**	5.0
Fair value adjustment for hedged risk	**38.3**	1.6
	8,158.2	7,191.1
Shares are repayable from the date of the balance sheet in the ordinary course of business as follows:		
On demand	**2,257.1**	1,966.7
Other shares by residual maturity repayable:		
In not more than three months	**3,472.7**	3,555.2
In more than three months but not more than one year	**1,568.2**	996.1
In more than one year but not more than five years	**719.4**	548.8
In more than five years	**140.8**	124.3
	8,158.2	7,191.1

23. Amounts owed to credit institutions

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Amounts owed to subsidiary undertakings	-	-	132.4	195.7
Other	690.0	402.8	690.0	402.8
	690.0	402.8	822.4	598.5
Amounts owed to credit institutions are repayable from the date of the balance sheet in the ordinary course of business as follows:				
Repayable on demand	28.3	19.7	153.5	215.4
Other amounts owed to credit institutions by residual maturity repayable:				
In not more than three months	252.1	377.0	259.3	377.0
In more than three months but not more than one year	159.0	6.1	159.0	6.1
In more than one year but not more than five years	250.6	-	250.6	-
	690.0	402.8	822.4	598.5

Included in amounts owed to credit institutions is £487.1m (2007: £220.7m) relating to securities sold under agreements to repurchase, the carrying and market value of the related securities is £590.5m (2007: £230.5m) and £477.5m (2007: £223.3m) respectively.

All sale and repurchase transactions are conducted in line with market standard terms and conditions as defined in ISMA PSA global master repurchase agreements.

24. Amounts owed to other customers

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Amounts owed to subsidiary undertakings	-	-	1,078.1	19.2
Other	2,012.8	2,207.8	1,544.5	1,719.2
	2,012.8	2,207.8	2,622.6	1,738.4
Amounts owed to other customers are repayable from the date of the balance sheet in the ordinary course of business as follows:				
Repayable on demand	232.4	264.4	1,078.1	19.8
Other amounts owed to other customers by residual maturity repayable:				
In not more than three months	1,282.4	1,581.2	1,046.5	1,383.5
In more than three months but not more than one year	426.7	292.2	426.7	268.6
In more than one year but not more than five years	71.3	70.0	71.3	66.5
	2,012.8	2,207.8	2,622.6	1,738.4

25. Debt securities in issue

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Certificates of deposit	**341.1**	696.3	**341.1**	696.3
Other debt securities	**895.5**	817.2	**895.5**	816.9
Fair value adjustment for hedged risk	**138.4**	20.0	**138.4**	20.0
	1,375.0	1,533.5	**1,375.0**	1,533.2
Debt securities in issue are repayable from the date of the balance sheet in the ordinary course of business as follows:				
In not more than one year	**818.8**	759.6	**818.8**	759.6
In more than one year	**556.2**	773.9	**556.2**	773.6
	1,375.0	1,533.5	**1,375.0**	1,533.2

Included in Group and Society other debt securities are 33 (2007: 46) floating rate notes issued to the capital markets totalling £732.4m (2007: £755.5m).

26. Other liabilities

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Tax deducted at source from interest paid	**4.5**	2.5	**4.0**	2.0
Trade creditors	**7.4**	11.8	**0.4**	0.3
Fair value of put option obligation	**28.7**	40.6	**-**	-
Other creditors	**57.2**	61.9	**3.5**	3.6
	97.8	116.8	**7.9**	5.9

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

	Group 2008 £m	Group 2007 £m
At 1 January	**40.6**	72.0
Unwind of the discount factor	**1.9**	0.3
Exercise of put options by minority shareholders	**(2.2)**	(34.1)
Revaluation of market value and future exercise dates	**(11.3)**	0.8
Acquisition of subsidiaries during the year	**2.9**	3.7
Disposal of subsidiaries during the year	**(2.7)**	-
Dividends paid to minority shareholders	**(0.5)**	(2.1)
At 31 December	**28.7**	40.6

27. Provisions for liabilities

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Provision for the costs of closed branches	5.3	0.9	-	-
Financial Services Compensation Scheme	16.3	-	16.3	-
Regulatory and other provisions	2.4	2.6	0.4	1.6
	24.0	3.5	16.7	1.6

Movements in provisions during the year:

	Provision for the costs of closed branches Group 2008 £m	Financial Services Compensation Scheme Group 2008 £m	Regulatory and other Group 2008 £m	Total Group 2008 £m	Financial Services Compensation Scheme Society 2008 £m	Regulatory and other Society 2008 £m	Total Society 2008 £m
At 1 January	0.9	-	2.6	3.5	-	1.6	1.6
(Release) / charge for the year	4.5	16.3	-	20.8	16.3	(1.0)	15.3
Utilised during the year	(0.1)	-	(0.2)	(0.3)	-	(0.2)	(0.2)
At 31 December	5.3	16.3	2.4	24.0	16.3	0.4	16.7

	Provision for the costs of closed branches Group 2007 £m	Financial Services Compensation Scheme Group 2007 £m	Regulatory and other Group 2007 £m	Total Group 2007 £m	Financial Services Compensation Scheme Society 2007 £m	Regulatory and other Society 2007 £m	Total Society 2007 £m
At 1 January	1.0	-	2.6	3.6	-	2.6	2.6
(Release) / charge for the year	0.6	-	0.2	0.8	-	(0.8)	(0.8)
Utilised during the year	(0.7)	-	(0.2)	(0.9)	-	(0.2)	(0.2)
At 31 December	0.9	-	2.6	3.5	-	1.6	1.6

The provision for the costs of closed branches is expected to reverse over the remaining life of the leases, or period to anticipated date of disposal, if sooner.

For further details on the Financial Services Compensation Scheme see note 36.

28. Deferred tax

Deferred taxes are calculated on timing differences under the liability method using an effective tax rate of 28% (2007: 30%).

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

	Group 2008 £m	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
At 1 January	**11.8**	16.9	**1.9**	3.3
Income Statement (note 11)	**(3.2)**	(1.6)	**0.4**	(0.2)
Items taken directly to reserves	**11.9**	(3.3)	**9.1**	(1.2)
Acquisitions/disposals	**0.5**	(0.2)	**-**	-
At 31 December	**21.0**	11.8	**11.4**	1.9

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

Deferred tax assets	**Group 2008 £m**	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
Fixed asset temporary differences	**3.4**	3.0	**-**	-
Pension benefits	**11.5**	8.0	**5.4**	2.8
Provisions for loan impairment	**0.3**	2.7	**0.1**	0.4
Corporation tax losses	**2.4**	1.2	**1.0**	-
Derivatives and loans	**8.2**	1.9	**8.2**	1.9
Other	**2.3**	1.9	**-**	-
	28.1	18.7	**14.7**	5.1

Deferred tax liabilities	**Group 2008 £m**	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
Fixed asset temporary differences	**4.7**	5.1	**1.7**	1.4
Derivatives and loans	**1.6**	1.8	**1.6**	1.8
Other	**0.8**	-	**-**	-
	7.1	6.9	**3.3**	3.2
Net deferred tax asset	**21.0**	11.8	**11.4**	1.9

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

	Group 2008 £m	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
Fixed asset temporary differences	**(0.5)**	0.5	**-**	(0.2)
Provisions	**2.2**	-	**-**	-
Other	**1.5**	1.1	**(0.4)**	0.4
	3.2	1.6	**(0.4)**	0.2

There is no unrecognised deferred tax relating to trading losses brought forward at 31 December 2008 (2007: £Nil).

29. Subordinated liabilities

Group and Society	2008 £m	2007 £m
Subordinated fixed rate notes 2013	-	75.2
Subordinated fixed rate notes 2014	15.3	15.3
Subordinated fixed rate notes 2018	128.1	52.7
Subordinated fixed rate notes 2019	10.2	10.2
Subordinated fixed rate notes 2022	31.2	31.2
	184.8	184.6
Unamortised discount on issue	(1.1)	(0.9)
	183.7	183.7

All the notes are denominated in Sterling. Coupons are paid on a fixed basis annually except for the notes repayable in 2014, £75.0m (2007: £Nil) of the notes repayable in 2018 and the notes repayable in 2019 where coupons are paid on a fixed basis semi-annually.

All the notes are repayable at maturity, or earlier at the option of the Society. In each case the option for early repayment may only be exercised with the prior consent of the Financial Services Authority. The note holders' rights are subordinate to those of the depositors and other creditors and also to those of the shareholders in respect of share principal and accrued interest.

30. Subscribed capital

Group and Society	2008 £m	2007 £m
12.875% sterling Permanent Interest Bearing Shares	26.3	26.3

All Permanent Interest Bearing Shares are unsecured and rank pari passu with each other. They are deferred shares of the Society and rank behind the claims against the Society of all subordinated note holders, depositors, creditors and investing members of the Society. These shares are measured at amortised cost.

31. General reserve

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
At 1 January	731.4	598.1	643.0	517.7
Profit for the financial year	22.8	125.5	13.7	123.4
Actuarial (loss) / gain on retirement benefit obligations	(17.2)	5.7	(8.4)	0.8
Taxation	-	2.1	-	1.0
Other	-	-	-	0.1
At 31 December	737.0	731.4	648.3	643.0

32. Available-for-sale reserve

The changes in fair value of available-for-sale (AFS) assets are recognised in the AFS reserve. On the sale of AFS assets the associated gains and losses which were recognised in the AFS reserve are transferred to the Income Statement.

Group and Society	2008 £m	2007 £m
At 1 January	(5.7)	(0.6)
Net losses from changes in fair value	(13.2)	(7.2)
Unwind of fair value recognised on assets transferred to loans and receivables	2.7	-
Taxation	3.0	2.1
At 31 December	(13.2)	(5.7)

Further details regarding the reclassification of some debt securities from being categorised as available-for-sale to loans and receivables is shown in note 13.

33. Cash flow hedging reserve

Cash flow hedging is used primarily for interest rate swaps taken out to pre-hedge fixed mortgage completions and pre-hedge fixed savings products prior to receipt of funds. The weighted average maturity of interest rate swaps being cash flow hedged at 31 December 2008 was approximately 3.3 years (2007: 2.6 years); the amounts held in the cash flow hedging reserve will be recognised in the Income Statement over this period.

Group and Society	2008 £m	2007 £m
At 1 January	(4.9)	2.5
Net losses from changes in fair value	(22.6)	(10.5)
Taxation	6.3	3.1
At 31 December	(21.2)	(4.9)

34. Translation reserve

The translation reserve sets out any exchange differences arising on the translation of net assets of overseas subsidiaries.

Group	2008 £m	2007 £m
At 1 January	0.9	0.6
Exchange differences on translation of foreign operations	0.1	0.3
At 31 December	1.0	0.9

35. Minority interest reserve

Group	2008 £m	2007 £m
At 1 January	3.5	5.1
Subsidiary share restructure	(0.6)	(2.7)
Profit attributable to minority interests	1.0	1.1
At 31 December	3.9	3.5

36. Other financial commitments

a) The Society is obliged under Section 22 of the Building Societies Act 1986 to discharge the liabilities of its subsidiary undertakings incurred prior to 11 June 1996 when this section was repealed. Additionally, the Society has given a legal undertaking agreeing to discharge the liabilities of Skipton Guernsey Limited in so far as it is unable to discharge them out of its own assets whilst it remains a subsidiary of Skipton Building Society. Furthermore, the Society has confirmed it will provide continuing support to those subsidiaries that have net liabilities at 31 December 2008.

b) In common with all regulated UK deposit takers, the Society pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it. The FSCS levy consists of two parts – a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to 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. 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, in turn, acquired the rights to the realisation of the assets of these failed banks.

We understand that the FSCS will meet these claims by way of loans now received from HM Treasury. The terms of these loans are interest only for the first three years, and the FSCS will seek to recover the interest cost, together with ongoing management expenses, by way of annual management expenses levies on member firms over this period. Subsequently, should there be insufficient funds from the realisation of the failed banks' assets to fully extinguish the FSCS' loans from HM Treasury, this may result in the FSCS raising a compensation levy on member firms.

The Society has recognised, in this year's results, a provision for management expense levies of £16.3m, covering the next three years. This amount has been calculated on the basis of the Society's current share of protected deposits taking into account the FSA's estimate of the total management expense levies for the scheme years 2008/09 and 2009/10 and assuming that levies for subsequent years are at similar levels. The amounts provided do not take any account of any future compensation levies which may be payable should the FSCS fail to recover sufficient funds to repay its loans, as any such amounts are unable to be reliably estimated.

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

	Group 2008 £m	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
Contracted but not provided for	**15.1**	0.9	**15.0**	0.8

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

	Land and buildings 2008 £m	**Other 2008 £m**	Land and buildings 2007 £m	Other 2007 £m
Group				
Amounts falling due:				
Within one year	**18.6**	**3.9**	6.2	3.6
Within two to five years inclusive	**60.7**	**3.3**	30.2	4.0
Over five years	**43.1**	**-**	80.0	-
	122.4	**7.2**	116.4	7.6
Society				
Amounts falling due:				
Within one year	**5.3**	**2.8**	3.9	3.5
Within two to five years inclusive	**19.8**	**1.5**	14.2	3.6
Over five years	**21.1**	**-**	19.3	-
	46.2	**4.3**	37.4	7.1

37. Financial instruments

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity of another entity. The Society is a retailer of financial instruments, mainly in the form of mortgages and savings.

The Group uses wholesale financial instruments to invest liquid asset balances and raise wholesale funding, and to manage the risks arising from its operations. The Group does not run a trading book.

Instruments used for risk management purposes include derivative financial instruments ("derivatives"). Derivatives are instruments whose value is derived from one or more underlying price, rate or index (such as interest rates, exchange rates or stock market indices) but tend to have a smaller or no initial net investment relative to financial assets/liabilities offering the same risk/return as cash flows are generally settled at a future date.

The Board has authorised the use of derivatives by the Group to reduce the risk of loss arising from changes in market risks in accordance with Section 9A (4) of the Building Societies Act 1986 and are used by the Group for economic hedging reasons only.

Types of derivatives

The principal derivatives used by the Group are interest rate swaps, interest rate options, forward rate agreements and foreign exchange contracts that are used to hedge Group balance sheet exposures.

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

Activity	Risk	Type of hedge
Fixed rate savings products	Sensitivity to falls in interest rates	Receive fixed interest rate swaps (fair value hedge)
Variable rate funding	Sensitivity to increases in interest rates	Pay fixed interest rate swaps (cash flow hedge)
Fixed rate mortgage lending	Sensitivity to increases in interest rates	Pay fixed interest rate swaps (fair value hedge)
Variable rate liquidity	Sensitivity to falls in interest rates	Receive fixed interest rate swaps (cash flow 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)
Mortgage and savings products with embedded options	Sensitivity to changes in interest rates	Interest rate swaps, caps and floors and other options
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)

Derivative products, which are combinations of more basic derivatives, are used only in circumstances where the underlying position being hedged contains similar risk features.

In such cases the derivative used will be designed to minimise the risks of the underlying asset or liability.

37. Financial instruments (continued)

Controls over financial instruments

The Group has a formal structure of managing risk, including established risk limits, reporting requirements, mandates and other control procedures. This structure is reviewed regularly by the Asset and Liability Committee (ALCO), which is charged with the responsibility for managing and controlling the balance sheet exposures of the Group.

Credit exposures arising on derivative contracts with certain counterparties are collaterised with cash deposits, to mitigate credit exposures. All derivative activity is contracted with OECD financial institutions.

The accounting policies for derivatives are described in note 1 to the Accounts.

Hedge accounting

A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. For each main class of fair value hedge documentation is produced in accordance with requirements of IAS 39.

A cash flow hedge is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss. For each main class of cash flow hedge documentation is produced in accordance with requirements of IAS 39.

Financial risks

The principal financial risks to which the Group is exposed are liquidity risk, market risk and credit risk. Each of these is considered below. An overview of how the Group manages the risks it faces is also disclosed in the 'Principal risks and uncertainties' section of the Business Review.

Liquidity risk

Liquidity risk is the risk that the Group is not able to meet its financial obligations as they fall due or can do so only at excessive cost.

The Group's liquidity policy is to maintain sufficient liquid resources to cover 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 as they fall due. This is achieved through maintaining a prudent level of liquid assets, maintaining an appropriate mix between savings and deposit funding balances and through rigorous management control of the growth of the business. In practice this is achieved by ensuring the prudential liquidity ratio (prudential liquidity as a percentage of share and deposit liabilities) is held within a certain range at all times, by ensuring reliance on deposit funding is not excessive and through the planning, implementation and management control and review of business flows.

The Board is responsible for setting limits over the level, composition and maturity of liquidity and deposit funding balances. Such limits are reviewed by the Board at least annually. Compliance against these limits is monitored daily by Finance personnel (i.e. independent of Treasury staff). In addition a series of liquidity stress tests are performed weekly by Group Risk Services personnel, and formally reported to ALCO monthly, to ensure the Group maintains adequate liquidity for business purposes even under stressed conditions.

37. Financial instruments (continued)

The significant development of liquidity stress testing and forecast models carried out in 2007 has continued in 2008 due to economic and market conditions. A wide range of scenarios are considered incorporating mild and severe stresses and a total closure of the wholesale market. An analysis of the liquidity portfolio is set out in the table below:

Group	**2008**		2007	
	£m	**%**	£m	%
Cash in hand and balances with the Bank of England	**359.4**	**11.3**	136.0	5.1
Cash with banks and building societies	**1,064.4**	**33.5**	370.2	13.9
Gilts	**111.0**	**3.5**	75.0	2.8
Certificates of deposit	**946.5**	**29.8**	1,213.9	45.5
Local authority investments	**3.7**	**0.1**	56.7	2.1
Fixed rate bonds	**1.7**	**0.1**	25.0	0.9
Floating rate notes	**390.0**	**12.3**	400.7	15.0
Residential mortgage backed securities	**243.0**	**7.6**	328.9	12.3
Commercial mortgage backed securities	**58.6**	**1.8**	63.7	2.4
Total	**3,178.3**	**100.0**	2,670.1	100.0

During the year the liquidity balances have increased from £2,670.1m at 31 December 2007 to £3,178.3m at 31 December 2008, expressed as a proportion of our combined shares and deposit liabilities this represents an increase from 23.56% to 28.84%.

The following table is an analysis of gross cash flows payable under financial liabilities:

2008 Group	**0-3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Liabilities					
Shares	5,736.3	1,633.2	793.4	140.8	**8,303.7**
Amounts owed to credit institutions, customers and debt securities	1,585.2	1,005.3	886.2	51.6	**3,528.3**
Derivative financial instruments	45.2	129.1	175.2	23.3	**372.8**
Subordinated liabilities	3.7	10.4	56.4	254.2	**324.7**
Subscribed capital	1.6	1.6	12.9	22.5	**38.6**
Total liabilities	**7,372.0**	**2,779.6**	**1,924.1**	**492.4**	**12,568.1**

2007 Group	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Liabilities					
Shares	5,577.6	1,051.9	605.0	129.8	7,364.3
Amounts owed to credit institutions, customers and debt securities	2,776.0	471.3	965.4	59.0	4,271.7
Derivative financial instruments	22.3	41.6	40.2	3.0	107.1
Subordinated liabilities	3.7	7.0	42.9	227.5	281.1
Subscribed capital	1.6	1.6	12.9	22.5	38.6
Total liabilities	8,381.2	1,573.4	1,666.4	441.8	12,062.8

For each material class of financial liability a maturity analysis is provided in notes 22 to 25.

37. Financial instruments (continued)

2008 Society	**0-3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Liabilities					
Shares	5,736.3	1,633.2	793.4	140.8	**8,303.7**
Amounts owed to credit institutions, customers and debt securities	1,758.7	1,005.3	886.2	51.6	**3,701.8**
Derivative financial instruments	45.8	129.2	175.3	23.4	**373.7**
Subordinated liabilities	3.7	10.4	56.4	254.2	**324.7**
Subscribed capital	1.6	1.6	12.9	22.5	**38.6**
Total liabilities	**7,546.1**	**2,779.7**	**1,924.2**	**492.5**	**12,742.5**

2007 Society	0-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Liabilities					
Shares	5,577.6	1,051.9	605.0	129.8	7,364.3
Amounts owed to credit institutions, customers and debt securities	2,531.0	446.5	961.7	59.0	3,998.2
Derivative financial instruments	24.2	45.1	43.4	4.1	116.8
Subordinated liabilities	3.7	7.0	42.9	227.5	281.1
Subscribed capital	1.6	1.6	12.9	22.5	38.6
Total liabilities	8,138.1	1,552.1	1,665.9	442.9	11,799.0

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk and other price risk. These risks are measured and managed at a Group level.

Interest rate risk

The main market risk faced by the Group is interest rate risk. Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

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 financial instruments.

The Group uses a number of different metrics to monitor interest rate risk and details of these are set out below.

37. Financial instruments (continued)

The primary interest rate risk metrics employed by the Group incorporate earnings-at-risk, market value and value-at-risk methodologies, which calculate interest rate risk exposure positions based on 250 historical data observations going back over approximately the last seven years. Monthly observation periods are used (3 observations per month, 10th to 10th; 20th to 20th and month end to month end), with equal weight being applied to all observations. All of these approaches employ 95% confidence intervals and are multi-currency. These advanced interest rate risk measurement exposures, which are compared to Board and Operational limits weekly and formally reported to ALCO and the Board monthly, are used to guide interest rate risk management decisions.

Although these measures provide valuable insights to the market risk to which the Group is exposed, they need to be viewed in the context of the following limitations:

- historical data is not necessarily a good guide to future events
- the use of 95% confidence levels, by definition, does not take account of changes that may occur beyond this level of confidence and therefore may not fully take into account extreme events
- exposures are calculated on static balance sheet positions and therefore future changes in the structure of the balance sheet are ignored.

In addition, the Group also monitors interest rate risk exposure against limits by determining the effect on the Group's current net notional value of assets and liabilities for a shift in interest rates equivalent to 2% and 3% for all maturities.

The levels of Group interest rate risk exposures through the reporting period were as follows:

	As at 31 December 2008 £m	**Average 2008 £m**	**High 2008 £m**	**Low 2008 £m**	As at 31 December 2007 £m
Static Earnings-at-Risk	1.5	3.7	5.2	1.5	4.8
Historical Value-at-Risk	0.4	2.1	3.6	0.4	3.2
Stateside \ Quanto Value-at-Risk	0.8	0.6	0.8	0.5	0.7
3% Parallel interest rate shift	n/a	14.7	25.4	1.2	21.8
2% Parallel interest rate shift	6.6	6.9	8.6	6.0	n/a

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) are also monitored closely and regularly reported to ALCO.

37. Financial instruments (continued)

Effective interest rate

The table below summarises the average effective interest rate over the year for monetary financial instruments not carried at fair value through profit and loss.

	Group effective interest rate		Society effective interest rate	
	2008	2007	**2008**	2007
Assets				
Cash and balances with the Bank of England	**3.92%**	4.29%	**3.92%**	4.29%
Loans and advances to credit institutions	**5.38%**	5.56%	**5.38%**	5.56%
Loans fully secured on residential property and other loans	**6.01%**	5.97%	**5.85%**	5.84%
Liabilities				
Shares	**5.46%**	5.59%	**5.46%**	5.59%
Amounts owed to credit institutions, other customers and debt securities in issue	**5.82%**	5.91%	**5.81%**	5.84%
Subordinated liabilities	**6.06%**	5.96%	**6.06%**	5.96%
Subscribed capital	**12.88%**	12.88%	**12.88%**	12.88%

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Both at the year end and during the year, the Group had no material direct exposure to foreign currency exchange fluctuations, with the exception of the Group's equity investments in Jade Software Corporation Limited and Northwest Investments NZ Limited which are denominated in New Zealand dollars. The Group has a small exposure to foreign currency interest rates at the year end arising from a hedging mismatch on a sterling mortgage product whose rate is linked to US Dollar interest rates. In addition, the Group has Euro debt issuances, however due to the effect of cross currency swaps the net exposure is immaterial.

Other price risk

As at 31 December 2008, the Group had a small amount of issued equity savings products outstanding. Derivative contracts to eliminate this exposure are taken out by the Group which exactly match the terms of the savings products and the market risk on such contracts is therefore fully hedged.

37. Financial instruments (continued)

Credit risk

The most significant credit risk which the Group is exposed to is in relation to Loans and advances to customers (note 15), Debt securities (note 13), Loans and advances to credit institutions (note 12) and Derivative financial instruments (note 14). The maximum exposure to credit risk is represented by the carrying amount of each financial asset, except for loans and advances to customers where a fair value adjustment for hedged risk of £187.3m (2007: £8.5m) is included.

Credit risk - Loans and advances to customers

The table below shows the mix of the Group's loans and advances to customers.

Loans and advances to customers	2008		2007	
	£m	%	£m	%
Total residential mortgages	8,815.7	93.6	8,698.2	93.5
Commercial loans	527.8	5.6	465.3	5.0
Other lending:				
Debt factoring loans	30.8	0.3	34.4	0.4
Premium finance loans	-	-	63.4	0.7
Other loans	50.2	0.5	39.1	0.4
Gross balances	9,424.5	100.0	9,300.4	100.0
Impairment provisions	(44.1)		(17.0)	
Fair value adjustment	187.3		8.5	
	9,567.7		9,291.9	

a) Residential mortgages

The majority of loans and advances to customers are secured on UK residential properties with no particular geographic concentrations. By their nature, our residential lending books are comprised of a large number of smaller loans, and historically had a low volatility of credit risk outcomes.

The Group's portfolio of loans fully secured on residential property includes the specialist mortgage lender Amber Homeloans. Amber Homeloans balances outstanding at the year-end were £1,442.0m (2007: £1,511.6m) of which £161.0m (2007: £185.0m) were in respect of buy-to-let.

Loan-to-value information on the Group's residential loan portfolio is set out as follows:

Indexed loan-to-value analysis	Group		Society	
	2008	2007	2008	2007
	%	%	%	%
Total book:				
<70%	49.2	63.2	55.8	72.4
70% - 80%	14.3	15.7	15.1	14.9
80% - 90 %	14.3	13.4	14.1	8.5
>90%	22.2	7.7	15.0	4.2
Average indexed loan-to-value	50.6	44.5	47.2	41.6

The indexed loan-to-value is updated on a quarterly basis to reflect changes in the house price index.

37. Financial instruments (continued)

The table below provides further information on residential loans and advances by payment due status:

	Group				Society			
	2008		2007		**2008**		2007	
	£m	**%**	£m	%	**£m**	**%**	£m	%
Neither past due nor individually impaired	**8,342.5**	**94.6**	8,442.8	97.1	**6,909.5**	**98.2**	6,801.6	98.9
Past due but not individually impaired:								
Up to 3 months	**156.8**	**1.8**	104.7	1.2	**93.4**	**1.3**	67.3	1.0
3 to 6 months	**22.1**	**0.3**	15.7	0.2	**19.1**	**0.3**	10.0	0.1
6 to 9 months	**8.9**	**0.1**	2.6	-	**6.7**	**0.1**	1.4	-
9 to 12 months	**2.4**	**-**	1.6	-	**1.8**	**-**	1.4	-
Over 12 months	**2.2**	**-**	1.5	-	**1.9**	**-**	1.2	-
Total	**8,534.9**	**96.8**	8,568.9	98.5	**7,032.4**	**99.9**	6,882.9	100.0
Individually impaired	**242.7**	**2.8**	120.3	1.4	**0.1**	**-**	-	-
Possessions	**38.1**	**0.4**	9.0	0.1	**5.3**	**0.1**	1.0	-
Total	**8,815.7**	**100.0**	8,698.2	100.0	**7,037.8**	**100.0**	6,883.9	100.0

Loans in the analysis above which are less than one month past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears. For details refer to note 16.

Fair value of collateral held:	Group		Society	
	2008	2007	**2008**	2007
	£m	£m	**£m**	£m
Not individually impaired	**17,133.4**	19,377.3	**14,889.0**	16,553.7
Impaired	**256.8**	147.1	**0.1**	-
Possessions	**39.9**	11.0	**6.8**	1.3
Total	**17,430.1**	19,535.4	**14,895.9**	16,555.0

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

Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In subsequent periods, the fair value is updated by reference to market price or indexes of similar assets.

37. Financial instruments (continued)

b) Commercial loans

Loans secured on commercial property are well diversified by industry type and an analysis is provided below:

Group and Society	2008		2007	
	£m	%	£m	%
Leisure and hotel	**53.5**	**10.1**	49.5	10.6
Retail	**19.8**	**3.7**	20.5	4.4
Nursing/residential homes	**42.3**	**8.0**	38.1	8.2
Offices	**17.4**	**3.3**	19.9	4.3
Commercial investment and industrial units	**313.4**	**59.5**	308.9	66.4
Residential investment	**58.6**	**11.1**	9.2	2.0
Miscellaneous	**22.8**	**4.3**	19.2	4.1
Total	**527.8**	**100.0**	465.3	100.0

The table below provides further information on commercial loans and advances by payment due status:

Group and Society	2008		2007	
	£m	%	£m	%
Neither past due nor individually impaired	**511.5**	**96.9**	457.1	98.2
Past due but not individually impaired:				
Up to 3 months	**10.6**	**2.0**	4.1	0.9
3 to 6 months	**1.8**	**0.4**	0.6	0.1
6 to 9 months	**0.1**	**-**	0.8	0.2
9 to 12 months	**0.1**	**-**	0.7	0.2
Over 12 months	**-**	**-**	-	-
Total	**524.1**	**99.3**	463.3	99.6
Individually impaired	**3.7**	**0.7**	2.0	0.4
Total	**527.8**	**100.0**	465.3	100.0

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

Fair value of collateral held:

Group and Society	2008	2007
	£m	£m
Not individually impaired	**883.5**	801.9
Individually Impaired	**4.1**	2.1
Total	**887.6**	804.0

The collateral held consists of properties held within the above categories. The use of such collateral is in line with terms that are usual and customary to standard stock borrowing and lending activities.

37. Financial instruments (continued)

c) Other lending

These loans predominately relate to factored debts secured by way of a floating charge over book debts and other commercial loans.

	Group				Society			
	2008		2007		**2008**		2007	
	Gross £m	**Impairment £m**	Gross £m	Impairment £m	**Gross £m**	**Impairment £m**	Gross	Impairment
Short-term premium finance	**-**	**-**	63.4	(1.0)	**-**	**-**	-	-
Factored debts and invoice discounting	**30.8**	**(0.4)**	34.4	(0.4)	**-**	**-**	-	-
Other loans	**50.2**	**(1.3)**	39.1	(1.1)	**28.6**	**(1.4)**	26.4	(0.9)
	81.0	**(1.7)**	136.9	(2.5)	**28.6**	**(1.4)**	26.4	(0.9)

The majority of these loans have an original maturity of less than one year.

The Group's short-term premium finance lending was held in Amber Select Limited which was sold on 25 March 2008 (for further details refer to note 17b).

Credit risk - debt securities, loans and advances to credit institutions and derivative financial instruments

The Group holds treasury investments in order to meet the liquidity requirements and for general business purposes. The credit risk arising from these investments is closely monitored and managed by the Group.

As at 31 December 2008 £14.7m (2007: £Nil) 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. The Group determines that treasury assets are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Group evaluates among other factors, the normal volatility in valuation, evidence of deterioration in the financial health of the investee, industry and sector performance and operational and financing cash flows.

As at 31 December 2008, 97% of the Group's treasury investment assets were rated single A or better. The Group continues to have no exposure to emerging markets and only limited exposure to non investment grade debt.

The table below provides further details of the ratings of the Group's treasury investment portfolio.

Rating	**2008**		2007	
	£m	**%**	£m	%
Aaa	**843.8**	**26.5**	653.2	24.5
Aa1	**766.3**	**24.1**	442.3	16.6
Aa2	**461.0**	**14.5**	488.7	18.3
Aa3	**453.3**	**14.3**	520.5	19.5
A1	**180.0**	**5.7**	105.5	3.9
A2	**270.0**	**8.5**	266.1	10.0
A3	**102.7**	**3.2**	64.0	2.4
Baa1	**19.0**	**0.6**	-	-
Baa2	**25.5**	**0.8**	-	-
Unrated:				
Building societies	**53.0**	**1.7**	73.1	2.7
Local authorities	**3.7**	**0.1**	56.7	2.1
Total	**3,178.3**	**100.0**	2,670.1	100.0

37. Financial Instruments (continued)

The Group also monitors exposure concentrations against a variety of criteria including industry sector/asset class and country of risk.

Industry sector / asset class	2008		2007	
	£m	%	£m	%
Cash in hand and balances with the Bank of England	**359.4**	**11.3**	136.0	5.1
Cash with banks and building societies	**1,064.4**	**33.5**	370.2	13.9
Gilts	**111.0**	**3.5**	75.0	2.8
Certificates of deposit	**946.5**	**29.8**	1,213.9	45.5
Local authority investments	**3.7**	**0.1**	56.7	2.1
Fixed rate bonds	**1.7**	**0.1**	25.0	0.9
Floating rate notes	**390.0**	**12.3**	400.7	15.0
Residential mortgage backed securities	**243.0**	**7.6**	328.9	12.3
Commercial mortgage backed securities	**58.6**	**1.8**	63.7	2.4
Total	**3,178.3**	**100.0**	2,670.1	100.0

The Group does not hold any mortgage backed securities with US institutions as collateral.

Geographical exposure	2008		2007	
	£m	%	£m	%
UK	**1,724.5**	**54.3**	1,243.5	46.6
Rest of Europe	**1,043.4**	**32.8**	1,351.5	50.6
North America	**106.3**	**3.3**	5.1	0.2
Australasia	**214.1**	**6.7**	70.0	2.6
Far East	**90.0**	**2.9**	-	-
Total	**3,178.3**	**100.0**	2,670.1	100.0

Collateral held for treasury assets is determined by the nature of the instrument. Loans and debt securities are generally unsecured with the exception of asset backed securities which are secured by pools of financial assets. The International Swaps and Derivatives Association (ISDA) Master Agreement is the Group's preferred agreement for documenting derivative activity. In addition a Credit Support Annex (CSA) has been executed with certain counterparties in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between parties to mitigate the market contingent counterparty risk inherent in outstanding derivative positions. The posting of collateral is also used to reduce the credit exposure arising on sale and repurchase transactions and guaranteed equity bonds.

Netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. The Group's legal documentation for derivative transactions does grant legal rights of set-off for those transactions. Accordingly the credit risk associated with such contracts is reduced to the extent that negative mark to market valuations on derivatives will offset positive mark to market values on derivatives, subject to an absolute exposure of zero.

Fair values of financial instruments

The tables overleaf are a comparison of the book and fair values of the Group and Society's financial instruments by category as at the balance sheet date. Where available, market values have been used to determine fair values. Where market values are not available, fair values have been calculated for options by using option-pricing models and for other financial instruments by discounting cash flows at prevailing interest rates.

37. Financial Instruments (continued)

2008 Group	**Positive book value £m**	**Positive fair value £m**	**Negative book value £m**	**Negative fair value £m**	**Notional value/ principal £m**
Cash and cash equivalents	359.4	359.4	-	-	359.4
Debt securities	1,734.6	1,721.4	-	-	1,757.7
Loans and advances to customers	9,567.7	9,509.5	-	-	9,361.7
Loans and advances to credit institutions	1,084.3	1,084.3	-	-	1,079.4
Trade debtors	65.0	65.0	-	-	65.0
Shares	-	-	(8,158.2)	(8,119.9)	7,925.5
Amounts owed to credit institutions	-	-	(690.0)	(690.0)	686.9
Amounts owed to other customers	-	-	(2,012.8)	(1,916.7)	1,994.5
Debt securities in issue	-	-	(1,375.0)	(1,227.5)	1,224.7
Subordinated liabilities and subscribed capital	-	-	(210.0)	(209.9)	205.0
Trade creditors	-	-	(7.4)	(7.4)	7.4
Derivatives designated as fair value hedges	357.1	357.1	(187.0)	(187.0)	4,583.5
Derivatives designated as cash flow hedges	5.5	5.5	(33.6)	(33.6)	717.8
Other derivatives and embedded derivatives	67.3	67.3	(59.7)	(59.7)	5,011.4
Total	**13,240.9**	**13,169.5**	**(12,733.7)**	**(12,451.7)**	

2007 Group	Positive book value £m	Positive fair value £m	Negative book value £m	Negative fair value £m	Notional value/ principal £m
Cash and cash equivalents	136.0	136.0	-	-	136.0
Debt securities	2,124.8	2,119.1	-	-	2,109.7
Loans and advances to customers	9,291.9	9,332.7	-	-	9,198.1
Loans and advances to credit institutions	409.3	409.3	-	-	408.2
Trade debtors	57.2	57.2	-	-	57.2
Shares	-	-	(7,191.1)	(7,185.8)	6,953.0
Amounts owed to credit institutions	-	-	(402.8)	(402.8)	401.8
Amounts owed to other customers	-	-	(2,207.8)	(2,207.8)	2,191.9
Debt securities in issue	-	-	(1,533.5)	(1,512.3)	1,501.1
Subordinated liabilities and subscribed capital	-	-	(210.0)	(209.9)	205.0
Trade creditors	-	-	(11.8)	(11.8)	11.8
Derivatives designated as fair value hedges	87.9	87.9	(20.6)	(20.6)	3,768.3
Derivatives designated as cash flow hedges	2.9	2.9	(7.6)	(7.6)	948.4
Other derivatives and embedded derivatives	31.5	31.5	(22.2)	(22.2)	4,723.8
Total	12,141.5	12,176.6	(11,607.4)	(11,580.8)	

37. Financial instruments (continued)

2008 Society	**Positive book value £m**	**Positive fair value £m**	**Negative book value £m**	**Negative fair value £m**	**Notional value/ principal £m**
Cash and cash equivalents	359.4	359.4	-	-	359.4
Debt securities	1,734.6	1,721.4	-	-	1,757.7
Loans and advances to customers	7,740.6	7,712.5	-	-	7,590.5
Loans and advances to credit institutions	1,041.5	1,041.5	-	-	1,036.6
Shares	-	-	(8,158.2)	(8,119.9)	7,963.8
Amounts owed to credit institutions	-	-	(822.4)	(822.4)	817.4
Amounts owed to other customers	-	-	(2,622.6)	(2,522.9)	2,589.1
Debt securities in issue	-	-	(1,375.0)	(1,227.5)	1,224.7
Subordinated liabilities and subscribed capital	-	-	(210.0)	(209.9)	205.0
Trade creditors	-	-	(0.4)	(0.4)	0.4
Derivatives designated as fair value hedges	357.1	357.1	(154.2)	(154.2)	5,542.3
Derivatives designated as cash flow hedges	5.5	5.5	(33.6)	(33.6)	717.8
Other derivatives and embedded derivatives	137.8	137.8	(59.5)	(59.5)	5,961.1
Total	**11,376.5**	**11,335.2**	**(13,435.9)**	**(13,150.3)**	

2007 Society	Positive book value £m	Positive fair value £m	Negative book value £m	Negative fair value £m	Notional value/ principal £m
Cash and cash equivalents	135.0	135.0	-	-	135.0
Debt securities	2,124.8	2,119.1	-	-	2,109.7
Loans and advances to customers	7,372.3	7,396.0	-	-	7,372.8
Loans and advances to credit institutions	380.2	380.2	-	-	379.1
Shares	-		(7,191.1)	(7,185.8)	6,953.0
Amounts owed to credit institutions	-	-	(598.5)	(598.5)	596.4
Amounts owed to other customers	-	-	(1,738.4)	(1,738.4)	1,722.5
Debt securities in issue	-	-	(1,533.2)	(1,512.1)	1,500.9
Subordinated liabilities and subscribed capital	-	-	(210.0)	(209.9)	205.0
Trade creditors	-	-	(0.3)	(0.3)	0.3
Derivatives designated as fair value hedges	86.7	86.7	(14.0)	(14.0)	4,644.0
Derivatives designated as cash flow hedges	2.9	2.9	(7.6)	(7.6)	948.4
Other derivatives and embedded derivatives	31.4	31.4	(21.0)	(21.0)	4,877.4
Total	10,133.3	10,151.3	(11,314.1)	(11,287.6)	

The fair value of mortgages has been determined at a unit of account level of the individual mortgage and is based on the present value of future cash flows. These cash flows represent the best estimate of future interest flows adjusted for credit risk. However, were the Society to dispose of portfolio mortgages, it is likely that the fair value would be lower than that shown above, as there is currently no market for the sale of mortgage books.

37. Financial Instruments (continued)

The table below summarises the Group's main financial instruments by financial asset type.

2008	**Amortised cost £m**	**Held at fair value as available-for-sale assets £m**	**Fair value through profit or loss £m**	**Total £m**
Cash and cash equivalents	359.4	-	-	**359.4**
Trade debtors	65.0	-	-	**65.0**
Loans and advances to credit institutions	1,084.3	-	-	**1,084.3**
Loans and advances to customers	9,567.7	-	-	**9,567.7**
Debt securities	303.4	1,431.2		**1,734.6**
Derivative financial instruments	-	-	429.9	**429.9**
Shares	(8,158.2)	-	-	**(8,158.2)**
Amounts owed to credit institutions and other customers	(2,702.8)	-	-	**(2,702.8)**
Trade creditors	(7.4)	-	-	**(7.4)**
Debt securities in issue	(1,375.0)	-	-	**(1,375.0)**
Subordinated liabilities	(183.7)	-	-	**(183.7)**
Derivative financial instruments	-	-	(280.3)	**(280.3)**
	(1,047.3)	**1,431.2**	**149.6**	

2007	Amortised cost £m	Held at fair value as available-for-sale assets £m	Fair value through profit or loss £m	Total £m
Cash and cash equivalents	136.0	-	-	136.0
Trade debtors	57.2	-	-	57.2
Loans and advances to credit institutions	409.3	-	-	409.3
Loans and advances to customers	9,291.9	-	-	9,291.9
Debt securities	-	2,124.8	-	2,124.8
Derivative financial instruments	-	-	122.3	122.3
Shares	(7,191.1)	-	-	(7,191.1)
Amounts owed to credit institutions and other customers	(2,610.6)	-	-	(2,610.6)
Trade creditors	(11.8)	-	-	(11.8)
Debt securities in issue	(1,533.5)		-	(1,533.5)
Subordinated liabilities	(183.7)	-	-	(183.7)
Derivative financial instruments	-	-	(50.4)	(50.4)
	(1,636.3)	2,124.8	71.9	

37. Financial instruments (continued)

The table below summarises the Society's main financial instruments by financial asset type.

2008	**Amortised cost £m**	**Held at fair value as available-for-sale assets £m**	**Fair value through profit or loss £m**	**Total £m**
Cash and cash equivalents	359.4	-	-	**359.4**
Trade debtors	-	-	-	**-**
Loans and advances to credit institutions	1,041.5	-	-	**1,041.5**
Loans and advances to customers	7,740.6	-	-	**7,740.6**
Debt securities	303.4	1,431.2	-	**1,734.6**
Derivative financial instruments	-	-	500.4	**500.4**
Shares	(8,158.2)	-	-	**(8,158.2)**
Amounts owed to credit institutions and other customers	(2,476.1)	-	(968.9)	**(3,445.0)**
Trade creditors	(0.4)	-	-	**(0.4)**
Debt securities in issue	(1,375.0)	-	-	**(1,375.0)**
Subordinated liabilities	(183.7)	-	-	**(183.7)**
Derivative financial instruments	-	-	(247.3)	**(247.3)**
	(2,748.5)	**1,431.2**	**(715.8)**	

2007	Amortised cost £m	Held at fair value as available-for-sale assets £m	Fair value through profit or loss £m	Total £m
Cash and cash equivalents	135.0	-	-	135.0
Trade debtors	-	-	-	-
Loans and advances to credit institutions	380.2	-	-	380.2
Loans and advances to customers	7,372.3	-	-	7,372.3
Debt securities	-	2,124.8	-	2,124.8
Derivative financial instruments	-	-	121.0	121.0
Shares	(7,191.1)	-	-	(7,191.1)
Amounts owed to credit institutions and other customers	(2,336.9)	-	-	(2,336.9)
Trade creditors	(0.3)	-	-	(0.3)
Debt securities in issue	(1,533.2)		-	(1,533.2)
Subordinated liabilities	(183.7)	-	-	(183.7)
Derivative financial instruments	-	-	(42.6)	(42.6)
	(3,357.7)	2,124.8	78.4	

38. Group segmental reporting

2008	Mortgages and savings £m	Mortgage servicing £m	Estate agency £m	Financial services £m	Data provision £m	Other £m	Inter-company adjustments £m	Total £m
Income								
Interest receivable and similar income	887.9	0.3	1.9	0.9	-	6.9	(131.2)	766.7
Interest payable and similar charges	(801.9)	(0.2)	(1.3)	(0.5)	(1.5)	(10.3)	131.7	(684.0)
Fees and commissions receivable	14.6	85.9	178.0	40.4	49.3	59.0	(6.3)	420.9
Fees and commissions payable	(2.1)	-	(1.6)	(5.3)	-	(21.1)	3.1	(27.0)
Profit on disposal of subsidiaries	-	-	-	-	-	9.1		9.1
Share of profits from joint ventures	-	-	3.9	-	-	-	-	3.9
Profit on disposal of associate	-	-	22.3	-	-	-	-	22.3
Other income	3.3	2.8	1.7	-	0.1	11.9	(9.3)	10.5
Total income	101.8	88.8	204.9	35.5	47.9	55.5	(12.0)	522.4
Employee and pension costs	38.3	47.3	96.4	25.0	21.4	27.2	-	255.6
Depreciation and amortisation	3.2	5.3	5.0	1.9	3.9	3.6	(0.1)	22.8
Impairment losses / provisions for liabilities	61.0	-	5.5	-	-	0.4	-	66.9
Other admin expenses	27.5	27.9	61.8	9.6	18.0	19.6	(9.8)	154.6
Total expenses	130.0	80.5	168.7	36.5	43.3	50.8	(9.9)	499.9
Profit before tax	(28.2)	8.3	36.2	(1.0)	4.6	4.7	(2.1)	22.5
Total assets	15,913.7	30.4	154.7	25.9	62.5	299.9	(2,840.1)	13,647.0
Total liabilities	15,264.7	5.4	71.1	1.9	34.6	211.4	(2,649.6)	12,939.5
Capital expenditure	9.4	5.1	3.4	1.9	5.4	3.2	-	28.4

38. Group segmental reporting (continued)

2007	Mortgages and savings £m	Mortgage servicing £m	Estate agency £m	Financial services £m	Data provision £m	Other £m	Inter-company adjustments £m	Total £m
Income								
Interest receivable and similar income	764.0	0.5	3.8	0.9	-	19.2	(109.1)	679.3
Interest payable and similar charges	(669.9)	(0.2)	(0.2)	(0.4)	(1.0)	(10.8)	109.0	(573.5)
Fees and commissions receivable	19.3	86.8	253.5	34.9	28.6	84.4	(11.5)	496.0
Fees and commissions payable	(1.4)	-	-	(5.4)	-	(38.8)	(0.9)	(46.5)
Share of profits from joint ventures	-	-	3.7	-	-	-	-	3.7
Profit on part disposal of associate	-	-	36.0	-	-	-	-	36.0
Other income	(4.2)	2.8	0.9	0.6	-	10.3	5.7	16.1
Total income	107.8	89.9	297.7	30.6	27.6	64.3	(6.8)	611.1
Employee and pension costs	34.3	38.2	130.2	21.1	13.1	26.2	-	263.1
Depreciation and amortisation	3.2	5.0	4.4	0.8	2.3	5.3	-	21.0
Impairment losses / provisions for liabilities	3.9	-	1.6	-	-	0.7	-	6.2
Other admin expenses	28.5	31.1	65.8	7.8	9.3	22.3	(7.9)	156.9
Total expenses	69.9	74.3	202.0	29.7	24.7	54.5	(7.9)	447.2
Profit before tax	37.9	15.6	95.7	0.9	2.9	9.8	1.1	163.9
Total assets	13,804.2	32.6	146.2	14.2	62.8	329.7	(1,859.2)	12,530.5
Total liabilities	13,123.3	9.9	78.6	(2.8)	38.1	251.5	(1,693.3)	11,805.3
Capital expenditure	4.8	6.5	7.0	1.4	4.8	3.4	-	27.9

There is no requirement for the Group to report using a secondary reporting secondment, as the Group's risks and returns are not materially affected by geographical segmentation.

39. Pensions

Defined contribution schemes

The amount charged to the Income Statement in respect of contributions to the Group's defined contribution and stakeholder pension arrangements is the contribution payable in the year. The total pension cost charged to the Income Statement amounted to Group: £6.8m (2007: £5.6m) and Society: £1.7m (2007: £1.4m).

Defined benefit schemes

The Group has four funded defined benefit arrangements, all of which are now closed to new members:

- The Skipton Building Society Pension & Life Assurance Scheme ("the Skipton Scheme")
- The Connells Limited Pension & Life Assurance Scheme ("the Connells Scheme")
- The Sequence (UK) Limited (1997) Pension & Life Assurance Scheme ("the Sequence 1997 Scheme")
- The Sequence (UK) Limited (South) Staff Pension Scheme ("the Sequence Staff Scheme")

The Schemes provide benefits based on final salary for employees (although for benefits accruing after 1 January 2003 for the Skipton Scheme, 30 April 2006 for the Connells Scheme and 1 September 2006 for the Sequence 1997 Scheme, Career Average Revalued Earnings applies). The Connells Scheme, Sequence 1997 Scheme and Sequence Staff Scheme all closed to future accrual of benefits on 1 January 2009 at which point all active members left pensionable service and became entitled to deferred benefits. The assets of the Schemes are held in separate trustee-administered funds.

Contributions to the Schemes are assessed in accordance with the advice of an independent qualified actuary using the projected unit method.

The Group's policy for recognising actuarial gains and losses is to recognise them immediately on the Balance Sheet through the Statement of Recognised Income and Expense.

The aggregate costs of the four schemes are recognised in accordance with IAS 19 (Amended). The Skipton Scheme is operated by a number of Group companies. Each of the participating entities, except for the Society, accounts on the basis of contributions paid by that company. The Society accounts for the difference between the aggregate IAS 19 (Amended) costs of the scheme and the aggregate contributions paid by the other entities.

A qualified independent actuary carried out the last full actuarial valuations of the schemes as at the following dates:

- 1 April 2008 for the Skipton Scheme
- 30 April 2005 for the Connells Scheme
- 5 April 2005 for the Sequence 1997 Scheme
- 1 April 2007 for the Sequence Staff Scheme

In addition the Connells Scheme and the Sequence 1997 Scheme have valuations in the process of being finalised at 30 April 2008 and 5 April 2008. The preliminary results of these valuations have been used in the production of these disclosures.

39. Pensions (continued)

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

Group and Society	2008 %	2007 %
Inflation rate	**3.00**	3.40
Discount rate	**6.20**	6.00
Expected return on assets	**6.90-7.37**	6.80-7.69
Rate of increase in pay	**5.00**	4.90-5.40
Rate of increase of pensions in payment		
- increasing in line with LPI (Limited Price Inflation)	**2.90**	3.30
- increasing in line with LPI, subject to a minimum of 3% pa	**3.60**	3.80
- increasing in line with LPI, subject to a maximum of 2.5% pa	**2.30**	2.40
Rate of increase deferred pensions	**3.00**	3.40

The most significant non-financial assumption is the assumed rate of longevity. For the year ending 31 December 2008, this has been based on the PMA92 tables for males (or PFA92 tables for females) with an allowance for projected improvements in mortality in line with medium cohort improvements. This represents an increase in the assumed life expectancy assumption compared to 31 December 2007 which assumed short cohort improvements. The tables adopted assume that, when a member who is fifteen years from retirement reaches age 65, the life expectancy from age 65 is as follows:

Non-retired members	2008	2007
Males	**24.0**	22.8
Females	**26.2**	25.6

The table below shows the net pension liability which is recognised in the Balance Sheet:

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
Fair value of plan assets	**115.7**	140.2	**54.2**	63.7
Present value of defined benefit obligations	**(153.6)**	(161.0)	**(72.3)**	(71.5)
Total amount of surplus not recoverable	**-**	(1.5)	**-**	-
Net pension liability	**(37.9)**	(22.3)	**(18.1)**	(7.8)

As all actuarial gains and assets are recognised, the deficits shown above are those recognised in the Balance Sheet.

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

	Group 2008 £m	Group 2007 £m	Society 2008 £m	Society 2007 £m
At 1 January	**140.2**	120.4	**63.7**	48.1
Expected return on assets	**9.9**	8.9	**4.4**	3.9
Actuarial losses	**(37.5)**	(1.3)	**(16.0)**	(0.6)
Contributions by employer	**4.2**	15.0	**2.5**	13.3
Contributions by employees	**1.4**	1.5	**0.4**	0.4
Benefits paid	**(2.5)**	(4.3)	**(0.8)**	(1.4)
At 31 December	**115.7**	140.2	**54.2**	63.7

39. Pensions (continued)

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

	Group 2008 £m	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
At 1 January	**161.0**	163.8	**71.5**	69.4
Current service cost	**2.1**	2.8	**1.0**	1.3
Past service costs	**0.2**	-	**0.2**	-
Curtailments	**(6.3)**	-	**-**	-
Interest cost	**9.7**	8.6	**4.3**	3.6
Contributions by employees	**1.4**	1.5	**0.4**	0.4
Actuarial gains	**(12.0)**	(11.4)	**(4.3)**	(1.8)
Actual benefit payments	**(2.5)**	(4.3)	**(0.8)**	(1.4)
At 31 December	**153.6**	161.0	**72.3**	71.5

The difference between the expected return and the actual return on scheme assets is recognised in the Statement of Recognised Income and Expense and is reconciled below:

	Group 2008 £m	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
Actual return on assets	**(27.6)**	7.6	**(11.6)**	3.3
Expected return on assets	**(9.9)**	(8.9)	**(4.4)**	(3.9)
Actuarial loss on assets	**(37.5)**	(1.3)	**(16.0)**	(0.6)

The expected return on assets has been derived as the weighted average of the expected returns from each of the main asset classes. The expected return for each asset class, which is provided in the next table, reflects a combination of historical performance analysis, the forward looking views of the financial markets (as suggested by the yields available), and the views of investment organisations. The table also sets out the fair value of the scheme assets by each major category.

Group	**2008 £m**	**2008 % pa**	2007 £m	2007 % pa
Equities	**70.2**	**8.50**	84.2	8.10
Property	**6.2**	**6.80**	9.2	6.40
Corporate bonds	**15.0**	**6.20**	18.1	6.00
Government bonds	**22.8**	**3.70**	27.0	4.60
Cash	**1.5**	**2.00**	1.7	5.50
Total	**115.7**	**7.08**	140.2	7.01

The actual return on the scheme assets over the year ended 31 December 2008 was estimated as (19.4)%.

Society	**2008 £m**	**2008 % pa**	2007 £m	2007 % pa
Equities	**29.7**	**8.50**	33.6	8.10
Property	**3.3**	**6.80**	4.8	6.40
Corporate bonds	**8.4**	**6.20**	9.8	6.00
Government bonds	**12.5**	**3.70**	15.2	4.60
Cash	**0.3**	**2.00**	0.3	5.50
Total	**54.2**	**6.90**	63.7	6.80

The actual return on the scheme assets over the year ended 31 December 2008 was (18.0)%.

39. Pensions (continued)

The service costs and curtailments for the year are recognised in 'Administrative expenses', whilst the interest cost and expected return on assets are recognised within 'Other income'. An analysis of the charge is set out below:

	Group 2008 £m	Group 2007 £m	**Society 2008 £m**	Society 2007 £m
Current service cost	**2.1**	2.8	**1.0**	1.3
Past service cost	**0.2**	-	**0.2**	-
Curtailments	**(6.3)**	-	**-**	-
Interest on liabilities	**9.7**	8.6	**4.3**	3.6
Expected return on assets	**(9.9)**	(8.9)	**(4.4)**	(3.9)
Total pension expense	**(4.2)**	2.5	**1.1**	1.0

The tables below set out the actuarial gains and losses which have been recognised within the Statement of Recognised Income and Expense (SORIE).

Group	**2008 £m**	2007 £m	2006 £m	2005 £m	2004 £m
Experience (losses) / gains on scheme assets	**(37.5)**	(1.3)	2.7	10.5	1.8
Experience (losses) / gains on defined benefit obligation	**(1.6)**	(4.4)	5.3	(2.1)	-
Gains / (losses) from change in assumptions	**13.5**	15.9	6.0	(25.2)	(4.1)
Total amount of surplus not recoverable	**1.5**	(1.5)	-	-	
Total (losses) / gains recognised in SORIE during the year	**(24.1)**	8.7	14.0	(16.8)	(2.3)
Cumulative actuarial (losses) / gains recognised at end of year	**(20.5)**	3.6	(5.1)	(19.1)	(2.3)

Society	**2008 £m**	2007 £m	2006 £m	2005 £m	2004 £m
Experience (losses) / gains on scheme assets	**(16.0)**	(0.6)	1.3	4.1	1.2
Experience (losses) / gains on defined benefit obligation	**(1.5)**	(3.6)	5.1	(0.6)	(0.2)
Gains / (losses) from change in assumptions	**5.8**	5.4	2.7	(11.8)	(1.4)
Total (losses) / gains recognised in SORIE during the year	**(11.7)**	1.2	9.1	(8.3)	(0.4)
Cumulative actuarial (losses) / gains recognised at end of year	**(10.1)**	1.6	0.4	(8.7)	(0.4)

The present value of the defined benefit obligation and the fair value of the scheme assets are as follows:

Group	**2008 £m**	2007 £m	2006 £m	2005 £m	2004 £m
Fair value of plan assets	**115.7**	140.2	120.4	96.0	76.1
Present value of defined benefit obligations	**(153.6)**	(161.0)	(163.8)	(164.8)	(126.2)
Total amount of surplus not recoverable	**-**	(1.5)	-	-	-
Net pension liability	**(37.9)**	(22.3)	(43.4)	(68.8)	(50.1)

39. Pensions (continued)

Society	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Fair value of plan assets	**54.2**	63.7	48.1	38.4	30.4
Present value of defined benefit obligations	**(72.3)**	(71.5)	(69.4)	(73.1)	(56.2)
Net pension liability	**(18.1)**	(7.8)	(21.3)	(34.7)	25.8

The table below sets out our best estimate, of the aggregate contributions expected to be paid to the schemes during the year ending 31 December 2009.

	Group 2009 £m	Society 2009 £m
Estimated employer contributions	**3.3**	2.3
Estimated employee contributions	**0.5**	0.5
Estimated total contributions	**3.8**	2.8

40. Adoption of new and revised International Financial Reporting Standards

Disclosed below are new standards and interpretations which have been adopted during the year.

- IFRIC 14 - *IAS 19 - The Limit on a Defined Benefit Asset Minimum Funding Requirements and their Interaction*. This interpretation sets out when refunds or reductions in future contributions should be regarded as available, how a minimum funding requirement might affect the availability of reductions in future contributions and when a minimum funding requirement might give rise to a liability. The adoption of this interpretation had no impact on the Annual Accounts.
- IAS 39, *Financial Instruments: Recognition and Measurement* and IFRS 7, *Financial Instruments: Disclosures – Amendments*. These revised standards permit an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances. The amendment also permits an entity to transfer from the available-for-sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available-for-sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future. The adoption of this amendment increased the Group's reserves by £2.7m but had no impact on the Group's profit for the year.

Disclosed below are the new IFRS, interpretations and amendments which as at 31 December 2008 have been EU endorsed but do not yet apply to the Group:

- IFRS 8, *Operating Segments*. This new standard was issued on 30 November 2006 and replaces IAS 14, *Segment Reporting* and is effective from 1 January 2009. In summary, this standard requires entities to report segmental information on the same basis it is reported internally.
- IAS 1, *Presentation of Financial Statements (2007)*. This standard replaces the current IAS 1, *Presentation of Financial Statements* and is effective from 1 January 2009. In summary, IAS 1 sets overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. It is likely that this standard will have a significant impact on the presentation of the financial performance of the Group, in line with other financial institutions. However, it is not anticipated that it will change the recognition, measurement or disclosure of specific transactions and other events required by other IFRSs.
- IAS 23, *Borrowing Costs (Revised)*. This revised standard relates to interest costs on assets that take a substantial time to get ready for intended use or sale and is effective from 1 January 2009. The option to recognise all borrowing costs immediately as an expense is eliminated, such costs must be capitalised. All other borrowing costs should be expensed as incurred.

41. Subsequent events

There have been no material subsequent events between 31 December 2008 and the approval of this Report and Accounts by the Board.

1. Statutory percentages

	As at 31 December 2008 %	Statutory Limit %
Lending limit	**13.59**	25.00
Funding limit	**31.02**	50.00

These percentages form part of the audited accounts.

Explanation

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

The lending limit measures the proportion of business assets not in the form of loans fully secured on residential property. Business assets are defined as the total assets of the Group plus provisions for impairment losses on loans and receivables less liquid assets, intangible assets, property, plant and equipment and investment properties as shown in the Group Balance Sheet.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals. We have taken advantage of the relief set out in SI 2007/No 860, effective from April 2007, to exclude retail offshore deposits from the total of wholesale funds.

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

2. Other percentages

	At 31 December	
	2008 %	2007 %
As a percentage of shares and borrowings:		
(i) Gross capital	**7.50**	8.25
(ii) Free capital	**4.95**	5.57
(iii) Liquid assets	**28.84**	23.56
As a percentage of mean total assets:		
(i) Group profit after taxation	**0.18**	1.09
(ii) Group management expenses	**3.31**	3.81
(iii) Society management expenses	**0.47**	0.49

These percentages form part of the audited accounts.

Explanation

The above percentages have been calculated from the Group and Society Balance Sheets.

Shares and borrowings represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest and the fair value adjustment for hedged risk.

Gross capital represents the general reserve together with the available-for-sale reserve, cash flow reserve, translation reserve, subordinated liabilities, subscribed capital and minority interests, as shown in the Group Balance Sheet.

Free capital represents gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment, investment properties and intangible assets as shown in the Group Balance Sheet.

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

Mean total assets are the average of the 2008 and 2007 total assets.

Management expenses represent the aggregate of administrative expenses, depreciation and amortisation.

3. Information relating to Directors and other officers at 31 December 2008

The Board of Directors at 31 December 2008, their dates of birth and dates of appointment as Director were:

	Date of Birth	Date of Appointment
D J Cutter	1 January 1962	1 January 2000
A I Findlay	1 April 1952	12 June 2006
J G Goodfellow (*)	10 January 1947	22 July 1991
P R Hales	21 October 1946	29 May 2007
P M Hay-Plumb	18 March 1960	12 June 2006
C N Hutton	4 November 1949	28 June 2004
W H Jack	4 December 1944	19 February 2001
A B E Kinney	30 May 1958	15 July 2003
J B Rawlings	10 February 1947	1 June 1995
R J Twigg	12 February 1965	1 March 2002

(*) J G Goodfellow retired as a Director on 31 December 2008.

Documents may be served on any of the above named Directors at the following address: Addleshaw Goddard, Sovereign House, Sovereign Street, Leeds, LS1 1HQ.

The Society's officers at 31 December 2008 and their business occupations were:

S E Aldous	General Manager, Customer Engagement
S P Barker	Head of Group Tax
E A Blythe	General Manager, Audit Services
P M Craddock	Group Commercial Director
G M Davidson	Secretary and General Manager
J J Gibson	Director of Compliance and Risk
E N Law	Group Commercial Director
B Ndawula	Head of Group Finance
A C Robinson	Group Commercial Director

The Directors' business occupations and other Directorships at 31 December 2008 were:

D J Cutter	Building Society Deputy Chief Executive	Advance Mortgage Funding Limited
		Amber Homeloans Limited
		B2A Solutions Limited
		Baseline Capital Data Limited
		Baseline Capital Limited
		BDS Mortgage Group Limited
		Clark Thomson Financial Planning Limited
		Commercial Mortgage Systems Limited
		Connells Limited
		Enable Mortgage & Insurance Adviser Network Limited
		EuroDirect Database Marketing Limited
		GMAP Limited
		Homeloan Management Limited
		Incresco Limited
		Jade Software Corporation Limited
		KB Analytics Limited
		Leeds Share Shop Limited
		Life Policies Direct Limited
		Malsis School Trust

D J Cutter (continued)		MBO 1994 Limited M.L.P. Private Health Care Limited Mortgage Systems Limited North East Trustees Limited Pace Financial Solutions Limited Pace Mortgage Solutions Limited Parnell Fisher Child & Co. Limited Pearson Jones Plc PS Employee Benefits Limited RED ARC Assured Ltd Savings Management Limited Sequence (UK) Limited Skipton Business Finance Limited Skipton Covered Bonds LLP Skipton Financial Services Limited Skipton Group Holdings Limited Skipton Group Limited Skipton Guernsey Limited Skipton Limited Skipton Premier Mortgages Limited Skipton Share Dealing Services Limited Skipton Trustees Limited Sterling International Brokers Limited Symington Glass (1) Limited Symington Glass (2) Limited The Independent Mortgage Shop Limited The Private Health Partnership Limited Thomson Shepherd Limited Torquil Clark Holdings Limited Torquil Clark Limited Torquil Clark Pension Trustees Limited Torquil Clark Professional Connections Limited TQ Management Services Limited Wooljon Limited Yorkshire Factors Limited
A I Findlay	Company Director	Amec Executive Pensions Trustee Limited Amec Staff Pensions Trustee Limited Countess of Chester Hospital NHS Foundation Trust Skipton Group Holdings Limited
J G Goodfellow	Building Society Chief Executive	Advance Mortgage Funding Limited Amber Credit Limited Amber Homeloans Limited B2A Solutions Limited Bailey Computer Services Limited Baseline Capital Data Limited Baseline Capital Limited Building Societies Trust Limited Callcredit Information Group Limited Callcredit Limited Clark Thomson Financial Planning Limited Commercial Mortgage Systems Limited Connells Limited Enable Mortgage & Insurance Adviser Network Limited EuroDirect Database Marketing Limited GMAP Limited

J G Goodfellow (continued)		Homeloan Management Limited Inhoco 2826 Limited Jade Software Corporation UK Limited Jade Software Corporation Limited KB Analytics Limited Leeds Share Shop Limited Medical Insurance Agency Financial Services Limited Medical Insurance Agency Group Limited MIA Computing Limited MIA Financial Services Limited MIA Group Limited MBO 1994 Limited Mortgage Marque Limited Mortgage Systems Limited Mutual One Limited N & P Limited Northwest Investments NZ Limited Parnell Fisher Child & Co. Limited Pearson Jones Plc Savings Management Limited Sequence (UK) Limited Skipton Business Finance Limited Skipton Financial Services Limited Skipton Group Holdings Limited Skipton Group Limited Skipton Investments Limited Skipton Limited Skipton Mortgage Corporation Limited Skipton Mortgages Limited Skipton Premier Mortgages Limited Skipton Premises Limited Skipton Share Dealing Services Limited Skipton Trustees Limited Sterling International Brokers Limited Student Loan Company Limited Symington Glass (1) Limited Symington Glass (2) Limited The Private Health Partnership Limited Thomson Shepherd Limited Wooljon Limited Yorkshire Factors Limited
P R Hales	Chartered Insurer	Just Retirement (Holdings) Plc Just Retirement Limited Just Retirement Solutions Limited Skipton Group Holdings Limited UNUM Limited
P M Hay-Plumb	Company Director	Forensic Science Services Limited National Australia Group CIF Trustee Limited Skipton Group Holdings Limited

C N Hutton	Solicitor	Ben Rhydding Sports Club Limited Hammond Support Systems Limited Hammonds Direct Limited MY Web Conveyancing Limited MY Web HIP Limited Skipton Group Holdings Limited
W H Jack	Retired Managing Director	Skipton Group Holdings Limited
A B E Kinney	Retired Partner of a Leading Firm of Chartered Accountants and Consultants	Financial Services Compensation Scheme Limited Skipton Group Holdings Limited
J B Rawlings	Banker	Ansbacher & Co Limited Ansbacher Group Holdings Limited Sarl Ansbacher Pension Trust Limited Ansbacher UK Group Limited QNB International Holdings Limited Sarl Skipton Group Holdings Limited
R J Twigg	Building Society Group Finance Director	Amber Credit Limited Amber Homeloans Limited Callcredit Information Group Limited Connell Financial Services Limited Connells Limited Inhoco 2826 Limited Medical Insurance Agency Financial Services Limited Medical Insurance Agency Group Limited MIA Computing Limited MIA Financial Services Limited MIA Group Limited Mortgage Marque Limited Northwest Investments NZ Limited Sequence (UK) Limited Skipton Building Society Charitable Foundation Skipton Business Finance Limited Skipton Covered Bonds Finance (Holdings) Limited Skipton Covered Bonds LLP Skipton Guernsey Limited Skipton Group Holdings Limited Skipton Investments Limited Skipton Mortgage Corporation Limited Skipton Mortgages Limited Skipton Premises Limited

Messers Cutter and Twigg have service contracts entered into on 1 January 2000 and 1 March 2002 respectively which may be terminated by either party giving one year's notice.

Directorships of the Society's officers at 31 December 2008 were as follows:

S E Aldous	Skipton Premises Limited

P M Craddock	Clark Thomson Financial Planning Limited Customer First UK Limited HE Grant (Holdings) Limited HE Grant Limited Incresco Limited Life Policies Direct Limited Medical Care Direct Limited North East Trustees Limited Pace Financial Solutions Limited Pace Mortgage Solutions Limited Parnell Fisher Child & Co. Limited Pearson Jones Plc PS Employee Benefits Limited RED ARC Assured Ltd Skipton Financial Services Limited Skipton Group Holdings Limited Skipton Trustees Limited Symington Glass (1) Limited Symington Glass (2) Limited The Independent Mortgage Shop Limited The Private Health Partnership Limited Thomson Shepherd Limited Torquil Clark Holdings Limited Torquil Clark Limited Torquil Clark Pension Trustees Limited Torquil Clark Professional Connections Limited TQ Management Services Limited Wooljon Limited
G M Davidson	Skipton Covered Bonds LLP Skipton Premises Limited Skipton Pension Trustees Limited
J J Gibson	Advance Mortgage Funding Limited BDS Mortgage Group Limited Bailey Computer Services Limited Baseline Capital Limited Connell Financial Services Limited Mutual One Limited Skipton Group Holdings Limited Skipton Pension Trustees Limited
E N Law	MBO 1994 Limited Skipton Group Holdings Limited Sterling International Brokers Limited
A C Robinson	Alegra Fine Products Limited Alegra Limited

No other officers held any Directorships

Stock code 10-8419/27/02/09/APS

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mutualmatters