Annual Report & Accounts

Leeds Building Society

2008

Leeds
Building Society

Financial Highlights

For the year ended 31 December 2008

£10.1 billion
in assets

£6.6 billion
total savings balances

£1.3 billion
new mortgage lending

£20.3 million
pre-tax profits

£526 million
capital and reserves

Leeds

Contents

Directors

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

S. Rodger G. Booth, MA, DL
(*Vice Chairman*)

Ian W. Ward FCIB
(*Chief Executive*)

John N. Anderson QA CBE

Peter A. Hill, ACIB
(*Operations Director*)

Carol M. Kavanagh, BA, MA

Ian Marshall, MA, FCA

David Pickersgill, FCA
(*Deputy Chief Executive*)

Abhai Rajguru, BSC (Hons), ACMA

Ian Robertson, CA, CCMI

Robert W. Stott

Secretary

Andrew J. Greenwood, LLB

Chairman's statement

For the year ended 31 December 2008

2008 will be remembered as a year of unprecedented change in world economies. The Governor of the Bank of England, Mervyn King, said: "Instability in banking and financial markets intensified to levels not seen for almost a century." I am, therefore, pleased to be able to report that, against this background, Leeds Building Society operated profitably, grew its membership and increased savings balances and assets to their highest ever levels.

At a time when banks and savings organisations have been urgently looking for more capital, Leeds Building Society has maintained a level of capital and reserves substantially in excess of what is required by the regulators. For 2009, the Board is continuing with this policy and we have deliberately adopted a prudent approach to the level of provisioning in the 2008 accounts. It is against this background that Fitch, one of the principal external rating agencies, reaffirmed our credit rating on 21 November 2008 due to our 'solid capital base, good profitability and cost management'.

Turning to the past year's trading, financial services organisations faced very difficult trading conditions, with the need to attract retail savings deposits continuing to dominate and, therefore, causing them to become increasingly expensive. Customers still required mortgage finance but the volume of products available in the market reduced considerably as many specialist lenders ceased to trade and the criteria for loans tightened. Net mortgage lending in the UK was down substantially to £40bn in 2008 compared to £108bn the previous year.

Your Society's response to these conditions was to concentrate on our traditional values of lending the funds that we attracted from our savers and keeping a vigilant control of costs to preserve our operating profits. This was to ensure that we could maintain our already strong capital position and add to our reserves from the profit generated without requiring any external assistance.

We had another successful year on retail savings, with balances rising by over £500m to £6.6bn. This was more than £400m above the net amount that we lent and, therefore, we became even less reliant on wholesale funding. All our increase in lending since the beginning of 2006 has been financed entirely by our savers.

We have always operated a prudent approach to lending but we applied some additional restrictions to criteria in 2008 in view of the uncertain economic conditions and the fall in house prices (which was 16% in 2008 as measured by the Halifax house price index). The Society's reaction to the market changes resulted in new advances of £1.3bn, much less than the £2.1bn advanced in 2007. However, despite adopting a more cautious approach, we made every effort to retain existing borrowers, which resulted in the Society having less redemptions than the average figure reported by the Council of Mortgage Lenders (CML).

The deteriorating economic situation has resulted in a small, but inevitably growing, number of our borrowers having difficulty meeting their repayments. At 31 December 2008, only 0.83% (2007 0.28%) of mortgages were over three months in arrears, which is considerably lower than the CML average. However, in view of the current level of uncertainty in the UK, it is likely that the situation will deteriorate further in 2009 and we have, therefore, reflected this in our provisions which the Board is satisfied are at a prudent level. I comment on this later in this report. Whenever possible, we adopt a flexible and sympathetic approach to members with financial worries and we encourage them to contact the Society at the earliest opportunity to enable our expert staff to discuss their individual circumstances.

Our total assets rose by over £900m to £10.1bn, with the majority of this increase being the higher level of liquid assets at the end of 2008 – £2.3bn compared to £1.9bn a year earlier. We successfully launched a Covered Bond Programme to enable us to participate in the Bank of England's Special Liquidity Scheme. This, together with other activity, provided additional wholesale funding. Our liquid assets continue to be invested in short-term cash deposits and marketable financial instruments. We have no investments in US mortgages, collateralised debt obligations (CDOs) or structured investment vehicles (SIVs). Our investments in marketable financial instruments include Floating Rate Notes and UK Mortgage Backed Securities.

The interest margin on our core activities reduced from 1.09% to 0.96% to the overall benefit of members. There was a small decrease in our level of costs in the year and consequently our cost/asset ratio improved to 48p per £100 of assets compared to 53p a year ago. Our cost/income ratio was the lowest of any building society in 2007, and this ratio has again been maintained at 40%. We achieved another strong operating profit before impairment losses and provisions of £68.6m, this being similar to the 2007 total of £69.4m.

There were, however, two unexpected items of expenditure in 2008.

The first was a provision of £9.7m being the full amount imposed under the Financial Services Compensation Scheme (FSCS). This was, in effect, a levy on the Society in order to compensate the savers in failed banks, including Bradford & Bingley, London Scottish and three Icelandic banks with UK subsidiaries. It is extremely galling for building societies, which run less risky business models, to meet these costs particularly as there has been no compensation whatsoever paid to the members of any society under the FSCS. In our opinion, the particular unfairness of the scheme has been that it effectively imposes the highest levy on those organisations, such as building societies, which have the greatest proportion of savers' balances. Therefore, an organisation run in a similar manner to Northern Rock (when it was an independent bank) would have paid considerably less as it relied extensively on wholesale funding. Building societies have made strong representations for a more equitable scheme.

Secondly, we have made a £10m provision in respect of our possible gross exposure

“The ratings of Leeds Building Society reflect its solid capital base, good profitability and cost management”

to Kaupthing Singer and Friedlander. Although there has been much talk in the press about the ‘Icelandic Banks’, Kaupthing Singer and Friedlander was (until it went into administration in October 2008) a long-established UK bank which, although ultimately owned by an Icelandic Bank, was regulated by the UK authorities. We are waiting to see the background to the events surrounding its sudden demise. In the meantime, however, we have taken the prudent action of making this level of provision although there is a possibility that the ultimate loss may be less.

The significant deterioration in the UK economy, and the bleak outlook for 2009 with possible further reductions in house prices and rising unemployment, has led us to increase our total residential and commercial mortgage provisions. We started the year with a level of £17m and we increased this by £27m to £44m at 31st December 2008. Our total provisions for mortgage and liquidity losses, liabilities and charges at the end of the year rose to £65m from £22m at the end of 2007. This prudence is consistent with our approach to the running of the Society over many years.

The combination of factors set out above has resulted in our pre-tax profits falling to £20.3m compared to the 2007 level of £63.2m. We believe that this represents a sound performance in the context of the overall results of financial services organisations, particularly as the figure would have been almost £10m higher were it not for the FSCS levy for failed banks.

The accumulated profits from the Society, which is a mutual, independent, member owned business, are held as reserves and give us our capital strength. Our higher than average level of profitability during recent years has resulted in our requirement for borrowed capital (on which interest has to be paid) being much lower than most other banks and building societies. Despite the economic situation, we added to our capital and reserves again in 2008, and they now amount to £526m (2007 – £511m). The Society’s Tier 1 capital ratio at the end of last year was 11.5%, this being significantly in excess of the minimum regulatory requirements.

In November 2008, we were one of only two societies, amongst those assessed at that time by the credit rating agency Fitch, that did not have their ratings downgraded. Fitch said: “The ratings of Leeds Building Society were affirmed and reflect its solid capital base, good profitability and cost management, as well as the Society’s small credit risk which is reflected in its relatively small proportion of specialist lending and the focus on lower LTV lending. In Fitch’s view, Leeds’ strong cost efficiency and low credit risk profile should help the Society to withstand the negative impact of an economic downturn on its profitability, asset quality and capital.”

Following the successful completion of the refurbishment of our Head Office, we were very pleased to welcome His Royal Highness, the Duke of York, formally to re-open our building. He visited us in December and spent a considerable amount of time meeting our staff. When unveiling the commemorative plaque, he said: “I have a great deal to do with the financial services sector generally and I have to talk knowledgeably about various aspects of the current situation in the UK and also the nature of businesses in the financial services sector. May I just say to Leeds Building Society that this visit has been a wonderful course in understanding how a building society should be run properly.”

There have been a number of Board changes during the year. Frank Dee retired at the Annual General Meeting in April after nine years service as a non-executive director, undertaking the role of Vice Chairman in his last year. Edward Ziff resigned to concentrate full-time on his other business interests. We were very sorry to lose both Frank and Edward and would like to record our thanks to them for their very valuable service to the Society. As a consequence, we advertised for new non-executive directors and had many applications from highly experienced individuals. After a rigorous selection process, we were pleased to appoint Abhai Rajguru, Ian Robertson and Bob Stott. I am delighted to welcome these new non-executive directors, who bring a significant amount of relevant experience, and their personal details are contained on page 7. All three are subject to election at the Annual General Meeting.

It has taken a tremendous amount of skill and commitment to achieve these results in unprecedented turbulent market conditions. I wish to record my thanks to the Society’s professional and dedicated staff, under the leadership of Chief Executive Ian Ward, for their hard work during the year. Notwithstanding this, significantly reduced awards have been made this year under the senior executives’ bonus scheme. This is the result of their performance, good as it was, being measured against testing criteria specified by the Board at the outset in the context of challenging market conditions. Further information is contained in the Remuneration Committee’s report on pages 15 and 16. I am also very grateful to my Board colleagues, for their continued support.

We remain confident that the prudent approach that we have taken over many years has not only delivered our solid performance in 2008 but has also put us in a strong position, with capital of £526m, to deal with the challenging economic outlook for 2009 and beyond.

The support of our members has been key to keeping our business successful and stable despite unprecedented stresses from the broader economy. The Board remains strongly committed to Leeds Building Society delivering the strategy enshrined in its mission statement of being “a successful, independent building society, providing excellent value through quality customer service, efficiency and competitive products.”

Thank you for your continued membership.

Robin Smith
Chairman
25 February 2009

Chief Executive's Review

For the year ended 31 December 2008

2008 Business Highlights:

- Savings balances rose by over £500m to a record level of £6.6bn.
- For the third successive year, our growth in lending has been entirely funded by retail investments.
- Quality of lending remains good with the average loan to value (LTV) on 2008 advances being just 52%. The average LTV on all our residential mortgages is only 49%, even after the fall in house prices.
- Efficiency improved even further with a small decrease in our costs in 2008. Our superior efficiency was also confirmed by:
  - Cost asset ratio reducing to 48p per £100 of assets from 53p in 2007.
  - Cost income ratio remaining at 40% – the same as 2007's level which was the most favourable of any building society.
- 58,000 new members attracted, taking our total membership up to 667,000
- Assets rose by over £900m to £10.1bn.
- Operating profit before impairment losses and provisions remained very strong at £68.6m (2007 £69.4m).
- After a prudent increase in our provisions, the Society's pre-tax profit before the Financial Services Compensation Scheme Levy remained solid at £30m (2007 £63.2m).
- Capital and reserves rose to record a level of £526m (2007 £511m).

Leeds Building Society delivered another set of good financial results for its members in the context of a market that has been characterised by uncertainty and declining confidence. The successful, sustainable business model, that has delivered strong financial performances over many years, ensured that we were able to operate profitably and strengthen our balance sheet further in 2008.

Savings

The savings from our members are a vital component of our traditional, mutual, building society model and I am very pleased to report that we attracted 44,000 new saving members in 2008, which was even higher than our 2007 total. Balances rose by over £500m to their highest ever level of £6.6bn, with our branch network being key to this strong performance.

In addition, we retained over 80% of our maturing savings balances, which was particularly pleasing in a market where the competition for retail savings was very high.

It became clear that savers were seeking reassurance and a safe home for their investments in 2008. The failure of many financial institutions caused a rapid decline in confidence and the protection under the UK Financial Services Compensation Scheme was raised from £35,000 to £50,000 in October. The general nervousness of investors in the UK, particularly those with substantial deposits, caused many of them to spread their savings between various banks and building societies. However, despite this we retained and attracted a high level of large balance customers with the number of accounts with £35,000 or more rising by over 10,000 during the year. This demonstrated the high level of confidence that savers have in Leeds Building Society.

We are extremely conscious of the impact of falling interest rates on our savers, many of whom rely on the interest for their income. The Bank of England base rate has already reduced to a historic low level of 1%, having fallen by 4.5% since the beginning of 2008. Our response to these changes has included very detailed consideration of our variable rate terms, especially for customers with lower levels of savings. It is important that we protect investors as far as possible and the average reduction that we have applied is less than the fall in Bank Base rate.

Our fixed rate bonds have continued to be very popular as they give a fair return to savers whilst providing flexibility wherever possible. For example, many of these bonds offer the peace of mind of penalty free withdrawals on part or all of the balance, a feature that is not commonly available on this type of investment.

In November, the Society received the award for the most promising new product in the Institute of Financial Services Innovation Awards. Our success was for the Inflation Buster Bond that offers a guarantee to deliver an above inflation return. Customers who took out the first issue in 2007 have received a rate of 7.32%, outperforming the average UK savings rate by 1.57%. An Institute of Financial Services judge said: "Leeds Building Society demonstrates an excellent approach to organic funding and a great planning strategy. At a time when we all need to trust in financial services organisations, the Leeds repays this with this product and excellent service standards."

Mortgage Lending

At the beginning of the year, we set a flexible objective to deliver an appropriate level of lending, having regard to the prevailing market conditions. With the changes and uncertainty in the UK housing and mortgage markets in 2008, this proved to be a sensible strategy.

New advances in 2008 were £1.28bn and with total repayments of £1.20bn, net lending was £80m, a substantial reduction from £807m in 2007.

Since the start of the 'credit crunch' in 2007, the relative cost of both wholesale and retail funding has increased and it has, therefore, been necessary to reflect this in the price of our mortgages. We have also lowered our risk profile by taking a range of actions that includes reducing our maximum loan to value (LTV) on residential lending to 85%, on buy to let to 70% and on Spanish and Irish lending to 65% and 70% respectively. In addition, we withdrew entirely from the non-conforming and 100% markets, which only represent a very small percentage of our mortgage balances.

Our lending policies have consistently been very prudent and this is demonstrated by our average LTV on new lending in 2008 of 52%. Also, on a quarterly basis, we calculate the value of all our properties in mortgage against the Halifax house price index. At the end of 2008, this showed that the average LTV was only 49% and, therefore, most of our customers still have substantial equity in their properties. This is a positive position for the Society and our mortgage customers, many of whom will benefit from reduced repayments as a consequence of lower rates.

Buy to let loans accounted for 14% of completions in 2008 and are also now 14% of total balances. Our overseas lending represents 4.5% of our outstanding mortgages.

We curtailed our commercial lending activities from mid-2007, when asset prices in this sector began to fall. During 2008, new commercial advances were just £32m whilst repayments have totalled £43m, thereby reducing overall balances to £626m. The Chairman refers to the overall mortgage provisions figure at the end of 2008 being £44m. This sum includes £21m for commercial loans.

Other Income

We had another strong performance on Other Income that totalled £21.7m, only slightly less than the 2007 figure of £22.1m.

Our Other Income is partly generated through our subsidiary, Leeds Financial Services (LFS), which sells investment and protection products through our partnerships with Norwich Union and Credit Suisse. In 2008, LFS achieved a rise of over £500,000 in its earnings to a record annual total of £8.15m. This was a very strong performance in a year when equity prices fell sharply with the FTSE 100 reducing by over 30%, its biggest ever annual decline.

General Insurance income increased slightly to £6.16m (from £6.13m) despite new lending volumes being lower. However, the proportion of customers choosing to take our Homecover buildings and contents policy with their mortgage increased in all our sales channels. Also, more of our existing customers have taken out a policy with us in the last twelve months with sales rising by 55%.

Some societies have high levels of Other Income from their diversifications but have considerably higher expenses as a consequence. KPMG, in its annual performance review of building societies, shows net costs (costs less Other Income) as a key measure. We had the second most favourable ratio of any building society in 2007 and expect to maintain that position, particularly as there was no increase in our costs in 2008.

Customer Service

Leeds Building Society is an independent mutual business that is owned by its members. The delivery of good customer service is central to our values and I have highlighted in this section of my review some examples of how this has been achieved.

In 2008, the Financial Services Authority (FSA), under its Treating Customers Fairly (TCF) objective, required all financial services organisations to have the correct management information to monitor that customers are being treated fairly and be able to demonstrate this. We met these requirements and have a full programme in place to ensure that TCF is embedded in our business.

A key measure of customer service for many years has been our telephone customer satisfaction surveys that are undertaken independently every month. During 2008, the Society's high ratings were maintained and in the latter part of the year we changed our approach to focus on those customers who recently dealt with us. The results showed that overall satisfaction increased to 95%.

The Society achieved a four star rating in the 2008 Financial Advisor Service Awards, which are nominated by independent mortgage advisors and IFAs. This was only the second occasion that we had been awarded four stars and reflects the significant amount of effort and attention given to the service that we deliver to our intermediary partners.

We treat any customer complaints that we receive very seriously, as they are important in helping us identify areas where our service, policies or procedures can be improved. Please feel free to contact me if there is any matter that you wish to bring to my attention. It is encouraging that the number of complaints reduced by almost 25% in 2008.

We remain committed to distributing our products and services through our branch network, online, by post and by telephone to meet the varying needs of our customers. In 2008, branches were particularly successful as customers appreciated the opportunity to talk face-to-face with staff in the uncertain and changing economic climate. It is pleasing to report that the number of members increased in 2008 and now totals 667,000. The Society has continued to invest in branches with refurbishments at three locations in the North East and we also opened a branch in Dublin in July. This enabled us to become the first UK building society to open a branch in Ireland and accept Euro deposits.

Our Leeds based Call Centre operates from 8am to 8pm, 7 days a week. We pride ourselves on the quality of this operation, with all calls being answered personally by a member of staff. The average time to answer calls in 2008 was just 23 seconds.

We moved our telephone-based mortgage unit from Leeds to our existing offices near Newcastle, which we acquired when we merged with Mercantile Building Society.

Supporting our communities

Our main responsibility to the communities within which we operate is to remain a strong, independent business that provides a safe place to invest for existing and future customers and helps people buy their own homes. However, our additional support of local communities and charities remains very important.

The Society's Caring Saver account pays 1% of the average balance held over the year to our partner charities – Help the Aged, Save the Children, Marie Curie Cancer Care and the Leeds Building Society Charitable Foundation. In 2008, the charities received £46,000 taking the total over the last 6 years to £600,000. The Charitable Foundation made 155 donations, totalling £112,000 to charities based near our branches, and has now given £800,000 since 1999.

The second year of our main sponsorship of Leeds Rhinos was very successful, with the team retaining the Super League title by defeating St Helens in the final at Old Trafford in front of a crowd of 70,000. Also, the Rhinos became World Club Champions by beating Melbourne Storm. We have received extensive media coverage as main shirt sponsors (with Leeds Building Society on the front of the players' shirts) throughout the season. We had over 100 press mentions and 20 live matches appeared on television.

I strongly endorse the comments made by the Chairman in his Statement that the commitment and professionalism of all of the Society's staff has been vital to our success in the challenging economic climate that prevailed in 2008. The very loyal support of members was equally important. My sincere thanks to you all in ensuring that Leeds Building Society is a successful independent, mutual business.

Ian Ward
Chief Executive
25 February 2009

The Board of Directors

"the Society remains a stable and respected home for savings"


Robin **Smith**


Ian **Ward**


John **Anderson**


Rodger **Booth**


Peter **Hill**


Carol **Kavanagh**


Ian **Marshall**


David **Pickersgill**


Abhai **Rajguru**


Ian **Robertson**


Bob **Stott**

Robin Smith (66)
I have been a Director since 1998 and Chairman since March 2007. Notwithstanding challenging market conditions, the Society remains a stable and respected home for savings, and provider of mortgage finance, and I remain determined that the Board should continue to adhere to the principles of prudence, mutuality, independence and efficiency which have secured this outcome. After a career as a solicitor with what is now DLA Piper, I was invited to join some company boards. I am now the Deputy Chairman of Town Centre Securities plc, a non-executive Director of Bartlett Group (Holdings) Limited and of the Yorkshire County Cricket Club. I continue to maintain my links with the Territorial Army and with a number of local and national charities.

Ian Ward (59)
All my working life has been spent in retail financial services. I started my career in banking and this was followed by a number of different roles in building societies before I joined the Society in 1995 as Chief Executive. Despite the very challenging economic environment, it is very satisfying that we have continued to provide competitive products and high quality service to members. The Society is independent, mutual and financially strong. I am a member of the Building Societies Association Council and Vice President of Leeds Chamber of Commerce & Industry. I have been married for 36 years to Gill and we have two sons. Our family home is in Yorkshire and we thoroughly enjoy living in this lovely area of the UK. I am very interested in sport and during the last year have enjoyed watching Leeds Rhinos become the Super League Champions for the second successive year and also the World Club Champions.

John Anderson (63)
I was delighted to be invited to join the Board as a result of the merger between the Leeds Building Society and the Mercantile Building Society, of which I was Chairman. I am a great believer in mutuality and I am delighted to have joined a Board which is totally committed to mutual status. My main business interest was in the motor trade where I was Chairman of a North East garage group that represented 14 car manufacturers and employed over 500 people. I hold several public/private partnership directorships and Chair two local radio stations. I am Chairman of City Hospitals Sunderland Foundation Trust and Regional Chairman of Coutts and I am also the Executive Chairman of a training company that assists young people in achieving employment through modern apprenticeships.

Rodger Booth (65)
I was asked to join the Board at the end of 2000. After training in the computer industry as a systems analyst, my main career has been in the printing industry, latterly as Chief Executive and Chairman of Bemrose Corporation. For the Society, I currently specialise in the areas of commercial lending, remuneration and pensions. I also Chair the Trustees of the University of Hull Pension Scheme. I am an enthusiastic watcher and participant of sport, particularly cricket and golf. I believe strongly in the real and sustained benefits which mutuality can provide for members.

Peter Hill (47)
I joined the Society in 2001, and was invited to join the Board as Operations Director in August 2006. I am responsible for the smooth running of the Society's Head Office customer service units, IT and Property. I believe that the Society gets its edge by delivering outstanding service to our members, so this is my highest priority. As a chartered banker, I have nearly 30 years' experience in the financial services industry. My interests outside work revolve around my family, having two young sons. I am also a keen golfer. I believe that the Society is best able to meet the needs of its membership by remaining independent and I am therefore 100% committed to mutuality.

Carol Kavanagh (46)
I was delighted to be invited to join the Board at the end of 2005 as a non-executive Director. I am currently a member of the Society's Remuneration Committee. The opportunity to work for a highly successful, independent building society based in Leeds, where I was born and have close family connections, was very appealing. I believe that my 20 years' experience of retailing and HR expertise provides value to customers and staff alike. I hold another position as Executive Group HR Director for Travis Perkins plc. The Group operates a network of over 1,200 branches and employs over 15,000 staff. I devote most of my spare time to my family. I am a firm believer in the benefits of mutuality and believe that this is the key to the continuing success of the Society and a major differentiator in the wider financial services sector.

Ian Marshall (61)
I joined the Society's Board in 2004 and chair the Audit Committee. I am also on the Assets and Liabilities and Group Risk Committees. After qualifying as a chartered accountant I have spent most of my working life in banking, insurance and property investment. I have worked with both the Financial Ombudsman Service and the Financial Services Authority. I have always been a firm believer in building societies because they are in an excellent position to offer competitive rates and fair treatment to customers. Outside of the Society, I am a non-executive Board member of a London market insurance company and Honorary Treasurer of the children's charity Barnardo's. In my spare time, I am a keen football supporter and an occasional windsurfer.

David Pickersgill (55)
I joined the Society in 1986 and became a member of the Board, as Finance Director, in 1995. Nine years ago, I was appointed Deputy Chief Executive. My key areas of responsibility are finance, cost control, treasury, planning and risk management. I am very proud to have worked for over twenty years for a successful independent building society that is able to offer members competitive rates due to its focus on efficiency and its mutual status. A chartered accountant by profession, my working life has been in accountancy and building societies. Outside work, I am a trustee of Smartrisk Foundation UK, a charity dedicated to preventing injury amongst young people, and a member of the Court of the University of Leeds. I am a keen supporter of sport and particularly enjoy watching football, rugby and cricket.

Abhai Rajguru (43)
I was invited to join the Board in April 2008 as a non-executive Director. I have spent my entire career in the financial services sector, having worked for a stockbroker, fund manager, building society and an accountancy firm. I hold a number of directorships at present, which include a mutual health insurer and a hospital trust. As an accountant with capital markets experience, I serve on the Society's Assets & Liabilities and Group Risk Committees. I am proud to be a member of the Board of the Society, which, as a mutual, has remained focused on delivering value to its members. Much of my time outside work is taken up by my young son, but I do enjoy music, films and motorsports.

Ian Robertson (61)
I was appointed to the Board in December 2008 and am a member of the Audit and Credit Committees. Having previously spent some fourteen years living in West Yorkshire, I was delighted to join such a highly regarded local institution and look forward to working with the Society in further enhancing its reputation as a leading example of the benefits of mutuality. I previously worked for Terry's of York and Northern Dairies/Northern Foods. Thereafter, I was Finance Director, then Chief Executive of Wilson Bowden plc, housebuilders and property developers. I was President of the Institute of Chartered Accountants of Scotland (ICAS) in 2004/5 and I am currently a member of the Audit Advisory Board of the Scottish Parliament Corporate Body and a non-executive Director of the new Homes and Communities Agency for England. I am a keen reader, love music, and continue to serve ICAS through membership of its Ethics Committee.

Bob Stott (65)
I was privileged to be appointed to the Board in December 2008, following a successful career with Wm Morrison Supermarkets plc, Geest plc and Mars Inc. For the Society, I currently serve on the Audit and Remuneration Committees. I am a non-executive Director of the Governing Body of the Rugby Football League and a Trustee of the Yorkshire County Cricket Club Charitable Youth Trust. My wife and I have lived in Leeds most of our married life and we are proud of our two children and six grandchildren. I am pleased through this particular appointment that I am able to put something back into this City and the surrounding area. Mutuality to me means that your Society's endeavours can be focused entirely on our members and I intend to play my part in keeping it this way – whilst assisting your Society's continuing progress. My business and sporting interests have tended to be the basis of my interests outside work and I also enjoy overseas travel.

The Directors have pleasure in presenting their Annual Report, together with the Annual Accounts and Business Statement of the Society and its subsidiaries ('the Group') for the year ended 31 December 2008.

Business Objectives and Activities

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

The Group's business and future plans are reviewed in more detail by the Chairman and Chief Executive on pages 2 to 5.

Performance for the Year and Future Developments

The performance and development of the Society is measured by reference to a range of performance indicators. For 2008, the key performance indicators were as follows:

Post-tax profit as a percentage of mean total assets

The post tax profit ratio was 0.15% (0.51% in 2007). The pre-tax profit of the Group decreased by 68% to £20.3m compared with £63.2m in 2007.

Growth in total assets

During the year, total assets grew to £10.1bn from £9.2bn, an increase of 10%. Mortgage balances increased by 4%, reflecting the more cautious approach to lending in the year. Mortgage advances were £1.28bn, compared to £2.1bn in 2007. Liquid assets were £2.3bn, representing a ratio of 24.95% of shares and borrowings. During the year the Society increased its holdings of readily realisable liquid assets, which led to a decrease in cash and cash equivalents as set out on page 24. The Directors consider that the level of liquidity is generally appropriate to the activities of the Group.

Growth in share balances to members

During the year, share balances to members increased by £529m to £6.6bn (2007: £757m to £6.0bn), an increase of 9% from the end of 2007.

Management expenses ratios

Management expenses were £46.1m, a reduction from 2007's level of £46.2m. The management expense ratio improved to 0.48% from 0.53% in 2007. Management expenses as a percentage of total income was 40% the same as in 2007 and net costs (management expenses less non interest income) as a percentage of mean assets improved to 0.25%.

Capital strength

At 31 December 2008, gross capital, represented by general and other reserves, revaluation reserves, subordinated liabilities and subscribed capital, amounted to £530m, 5.74% of shares and borrowings, which the Directors consider is appropriate to the activities of the Group. Free capital, represented by gross capital together with the collective loss provision, less tangible fixed assets, amounted to £514m, 5.58% of shares and borrowings. Overall, the capital ratios reflect the continued financial strength of the Group.

Other performance measures

Net interest income reduced by £1.2m to £92.7m from £93.9m in 2007, with a net interest margin of 0.96% (1.09% in 2007), as the Society continued to pass the benefits of mutuality to its members through competitively priced products.

Non interest income was £22m compared to £22.1m in 2007.

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

The impairment provision for mortgage losses for loans and advances to customers was £44.3m (2007: £17.5m). This increase is principally due to the increase in mortgage arrears during 2008.

At 31 December 2008, there were 115 (2007: 36) mortgage accounts 12 months or more in arrears. The total mortgage arrears in these cases were £1.4m and the total of principal loans outstanding was £15.6m.

Principal Risks and Uncertainties

A summary of the principal risks and uncertainties facing the Society and its subsidiary undertakings and the procedures put in place to manage them is set out below and in more detail in note 34 to the financial statements.

Credit risk

The Society is exposed to the potential risk that a customer or counterparty will not be able to meet its obligations to the Society as they fall due. Credit risk arises primarily from mortgage lending to individuals, commercial lending to corporate bodies and lending of liquid assets to financial institutions.

Credit risk arising from mortgage and commercial lending is managed through a comprehensive analysis of both the creditworthiness of the borrower and the proposed security. Following completion, the performance of all mortgages and commercial loans are monitored closely and action taken to manage the collection and recovery process. Risk arising from lending to financial institutions is managed through restriction of lending primarily to institutions with external ratings confirming the highest credit quality.

Market risk

Market risk is the risk that the value of, or income arising from, assets and liabilities change principally as a result of changes in interest rates. Interest rate risk arises from the savings and mortgage products that the Society offers. This risk is managed through the use of derivatives including interest rate swaps and caps in a manner which ensures compliance with the Building Societies Act 1986.

Liquidity risk

Liquidity risk is the risk that the Society will be unable to meet current and future financial commitments as they fall due. These commitments include investor's deposits, mortgage advances and other borrowings. The risk is managed principally by the holding of cash and other easily realisable liquid assets and a diversified funding structure.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational losses can result from fraud, errors by employees, failure to comply with regulatory requirements, equipment failures or natural disasters. These risks are managed as an integral part of the operations of each of the Society's business units.

Going concern

The going concern basis has continued to be adopted in preparing the Annual Report and Accounts as outlined in the Directors' Responsibilities section on page 17.

"The Society consults with members each month and the outcome is reported to the Board"

Directors

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

Mr R. A. Smith
(Chairman)

Mr S. R. G. Booth
(Vice Chairman from 2 April 2008)

Mr F. R. Dee
(Vice Chairman until retirement on 2 April 2008)

Mr I. W. Ward
(Chief Executive)

Mr J. N. Anderson

Mr P. A. Hill
(Operations Director)

Mrs C. M. Kavanagh

Mr I. Marshall

Mr D. Pickersgill
(Deputy Chief Executive)

Mr A. Rajguru
(from 2 April 2008)

Mr I. Robertson
(from 8 December 2008)

Mr R. W. Stott
(from 8 December 2008)

Mr E. M. Ziff
(until 28 April 2008)

Details of the Directors of the Society at 31 December 2008 and who continue in office are shown on pages 6 and 7.

In accordance with the Rules, Mr A. Rajguru, Mr I. Robertson, and Mr R. W. Stott offer themselves for election, and Mrs C. M. Kavanagh, and Mr D. Pickersgill offer themselves for re-election by the members at the Annual General Meeting.

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

Corporate Governance

Statements on Corporate Governance and Directors' Responsibilities are set out on pages 12 to 14 and 17.

Auditors

On 1 December 2008 Deloitte & Touche LLP changed its named to Deloitte LLP. The auditors, Deloitte LLP, have expressed their willingness to continue in office and in accordance with Section 77 of the Building Societies Act 1986, a resolution for their reappointment as auditors will be proposed at the Annual General Meeting.

Charitable and Political Donations

The Group made a charitable donation of £100,000 to the Leeds Building Society Charitable Foundation. Our CaringSaver account enabled further donations of £46,000 to be made to charities. Other charitable donations in the year amounted to £25,000. No contributions were made for political purposes. Further details are included in the Chief Executive's Review.

Environmental Policy

The Society recognises that it has a responsibility to protect the environment for its members and the community and appreciates that its activities may sometimes have an impact on the environment. The Society has, therefore, an agreed policy, which seeks to identify and sympathetically consider environmental issues in all activities and areas of the business. In the course of the Head Office re-development programme, the new lifts, air conditioning and lighting have been designed to incorporate energy efficient technologies. The amount of waste paper recycled has been significantly increased, by means of measures to recycle all waste. Specifically, the Society has an active recycling waste management policy and, where available, uses electricity from renewable sources. The Society works in partnership with its suppliers to manage and minimise carbon emissions.

Communication with members

The Society consults with members each month using an independent market research company and the outcome is reported quarterly to the Board. Through its subsidiary, Leeds Financial Services Limited, the Society hosts a number of seminars for new and existing members to discuss their financial needs and this also provides an opportunity to discuss more general issues. In addition, senior management undertakes a regular programme of branch visits to meet both staff and customers. A formal framework also exists for written communications with members.

The Society encourages all eligible members to participate in the AGM, either by attending in person or voting by proxy. In order to encourage voting at the 2009 AGM, members will, for the second year, be able to vote on-line using the internet and a charitable donation is being made for each vote cast. In this regard, a choice of charitable recipients is being offered. In 2008, 10% of members who voted used the internet. All voting members receive a copy of the 'Highlights' magazine which provides information and updates on the Society's activities, together with the Summary Financial Statement.

Staff

The Society has maintained and developed systems during the year for effective communication with employees. The provision of information continues through the Intranet, e-mail, circulars, staff newspaper, meetings, presentations and team briefings to ensure staff are aware of the Society's performance and objectives and the business environment in which it operates. There is a Staff Association, through which members of staff make their views known on matters that affect their employment and, in addition, there is also a regular staff satisfaction survey.

It is the Society's policy to consider employment applications, provide access to training, career development and promotion opportunities to all, regardless of their gender, sexual orientation, marital or civil partner status, gender-re-assignment, race, religion or belief, colour, nationality, ethnic or national origin, disability or age, pregnancy, trade union membership or part-time or fixed term status. Wherever possible, staff who become disabled continue their employment with appropriate training or redeployment where necessary and reasonable adjustments accommodated.

Creditor Payment Policy

The Group's policy is to agree terms and conditions with suppliers, under which business is to be transacted, to ensure that suppliers are aware of the terms of payment and to pay in accordance with its contractual and other legal obligations. The creditor days stood at 11 days at 31 December 2008 (2007: 9 days).

Post Balance Sheet Event

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

By order of the Board

Andrew J. Greenwood

Andrew J. Greenwood
Secretary
25 February 2009

Corporate Governance Report

For the year ended 31 December 2008

Leeds Building Society voluntarily has regard to best practice, as recommended by the Combined Code on Corporate Governance, issued by the Financial Reporting Council, which applies to listed companies. The most recent version was published in June 2008. The Combined Code sets out principles for ensuring the effectiveness of non-executive directors and contains guidance in relation to audit committees. This report explains the Society's approach to Corporate Governance, and sets out details of the principal Board Sub-Committees, together with attendance records for those Committees.

The Board

At 31 December, 2008, the Board comprised three executive and eight non-executive Directors. The offices of Chairman and Chief Executive are distinct and held by different individuals. The Chairman is principally responsible for leading the Board and is not involved in the day-to-day management of the Society. The Chief Executive's responsibilities are focused on running the Society and implementing strategy.

In accordance with criteria set out in the Combined Code, all non-executive Directors are free of any relationship which could materially interfere with the exercise of their independent judgement. All Directors have access to the advice of the Secretary and, if necessary, are able to take independent professional advice at the Society's expense. A brief biography of each Director is on pages 6 and 7. The Board considers that the Directors' skills and expertise complement each other to provide the appropriate balance in terms of protecting members' interests and addressing the requirements of the business. The role of Senior Independent Director under the Combined Code, insofar as it applies to the Society, is undertaken by the Vice Chairman.

The Board operates through meetings of the full Board, as often as necessary for the proper conduct of business, normally at monthly intervals and its main committees which are detailed on pages 13 to 14. At least annually, the non-executive Directors meet without the executive Directors being present. The Board's focus is on the formulation of strategy and the monitoring and control of business performance. A framework of delegated authorities is in place, which extends to the Society's Officers, management and various management committees. This was reviewed and updated during the year.

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

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

Internal Control and Risk Management

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

The Audit Committee has regularly reviewed the effectiveness of the Society's systems of internal control for the year to 31 December 2008, on behalf of the Board, and has taken account of any material developments that may have taken place since the year end. These systems of control are designed to manage, rather than eliminate, the risk of failure to achieve business objectives and to provide reasonable assurance as to the safeguards protecting the business against the risk of material error, loss or fraud. A report setting out the work of the Committee is provided annually to the Board.

Board and Board Committee Membership attendance record

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

Director	Board	Audit Committee	Remuneration Committee	Nominations Committee	Credit Committee	Assets & Liabilities Committee	Group Risk Committee
R. A. Smith (Chairman)	11(11)	–		4(4)	4(4)	–	–
F. R. Dee (Vice Chairman until retirement on 2 April 2008)	2(2)	2(2)	–	1(1)	–	–	–
S. R. G. Booth (Vice Chairman from 2 April 2008)	11(11)	–	3(3)	3(3)	9(10)	–	–
I. W. Ward (Chief Executive)	11(11)	–	–	4(4)	4(4)	12(12)	4(4)
J. N. Anderson	11(11)	7(7)	3(3)	–	–	–	–
P. A. Hill (Operations Director)	11(11)	–	–	–	9(10)	10(12)	4(4)
C. M. Kavanagh	11(11)	–	3(3)	–	–	–	–
I. Marshall	11(11)	7(7)	–	–	–	12(12)	4(4)
D. Pickersgill (Deputy Chief Executive)	11(11)	–	–	–	10(10)	11(12)	4(4)
A. Rajguru (appointed 2 April 2008)	7(9)	3(5)	–	–	–	7(9)	4(4)
I. Robertson (appointed 8 December 2008)	1(1)	–	–	–	–	–	–
R. W. Stott (appointed 8 December 2008)	1(1)	–	–	–	–	–	–
E. M. Ziff (resigned 28 April 2008)	1(3)	–	–	–	3(4)	–	–

Audit Committee

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

- monitor the integrity of the financial statements of the Society and any formal announcements relating to the Society's financial performance, reviewing significant financial judgements contained in them;
- ensure the Society's internal financial and business control and risk management systems have operated as defined in control documentation and comply with policies, procedures, laws, regulations and other relevant requirements;
- monitor and review the effectiveness of the Society's Internal Audit function;
- make recommendations to the Board in relation to the appointment and remuneration of the external auditor and to monitor and review the external auditor's independence, objectivity and effectiveness;
- review how the Society complies with best practice with regard to corporate governance and to report annually thereon to the Board.

During the year, the Chairman of the Committee was Mr I. Marshall and the other members were Mr J. N. Anderson, Mr F. R. Dee, and Mr A. Rajguru. The Committee invites the presence of internal and external auditors and members of management when considered helpful for the conduct of its Terms of Reference. At least annually, the Audit Committee meets with the external auditor without executive management being present. The Board is satisfied that the composition of the Committee provides recent and relevant financial experience.

Group Risk Committee

The Group Risk Committee, a sub-committee of the Board, met four times in 2008, and will meet at least quarterly during 2009, to review all Group risk management activities and appraise all Group capital requirements.

The Committee oversees the allocation of capital requirements to risk types, formulates and recommends to the Board the Internal Capital Adequacy Assessment Process and assesses the overall appropriateness and effectiveness of risk systems and management information. During the year, the Chairman of the Group Risk Committee was Mr F. R. Dee, until he retired from the Board, when he was succeeded by Mr A. J. Greenwood, General Manager and Secretary. The Board members of the Committee were Mr I. Marshall, Mr I. W. Ward, Mr D. Pickersgill, Mr P. A. Hill, and Mr A. Rajguru.

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

Assets and Liabilities Committee

The Assets and Liabilities Committee, which meets monthly, is a sub-committee of the Board and oversees treasury policy, in particular, wholesale and liquidity investment and borrowing strategies, hedging, counterparty and interest rate risk management and counterparty credit criteria. The Chairman of the Assets and Liabilities Committee was Mr D. Pickersgill. The other Board members of the Committee were Mr I. W. Ward, Mr P. A. Hill, Mr I. Marshall and Mr A. Rajguru.

Nominations Committee

The Nominations Committee is a sub-committee of the Board and makes recommendations to it. During the year, its members were Mr R. A. Smith (Chairman), Mr S. R. G. Booth, Mr F. R. Dee and Mr I. W. Ward.

Its main responsibility is to make recommendations on appointments to the Board, so that it comprises sufficient Directors who are fit and proper and can meet the collective and individual responsibilities of the Board members, both efficiently and effectively. It considers succession planning, taking account of the challenges and opportunities facing the Society and what skills and expertise are, therefore, needed on the Board in the future. In considering appointments, the Committee will take account of the requirements under the Building Societies Act, the Society's Rules and the Combined Code on Corporate Governance. Before any recommendations on appointment are made to the Board, the Committee will formally assess the aptitude, qualifications and experience of individual candidates. All appointments to the Board are made on merit and against objective criteria.

During the year, the Nominations Committee met on four occasions. Following a review of Board composition, it was decided to appoint two additional non-executive Directors. An advertisement was placed in a national newspaper, and a selection process undertaken, following which Mr I. Robertson, and Mr R. W. Stott were appointed. Both appointments have been approved by the Financial Services Authority and Messrs Robertson and Stott will offer themselves for election at the 2009 Annual General Meeting. Mr A. Rajguru, who went through the selection process in 2007, but took up his appointment in 2008, will also be offering himself for election at the 2009 Annual General Meeting.

Any future appointments will also be subject to approval by the FSA and election by the Society's members at the AGM in the next financial year after appointment.

Credit Committee

The Credit Committee is a sub-committee of the Board, and in 2008 met quarterly and additionally as required. Its Terms of Reference relate to the formulation of policy pertaining to asset quality and credit risk within the Society for approval by the Board. The Credit Committee also considers significant commercial lending proposals. The Chairman of the Credit Committee was Mr G. M. Mitchell, General Manager Finance and Risk. The Board members of the Committee were Mr S. R. G. Booth, Mr D. Pickersgill, Mr P. A. Hill, Mr R. A. Smith, Mr I. W. Ward and Mr E. Ziff.

Remuneration Committee

Detailed information on the work and composition of the Remuneration Committee is set out in the Directors' Remuneration Report at pages 15 and 16.

Auditors

The Society has a policy on the use of the external auditor for non-audit work, which is implemented by the Audit Committee. The purpose of this policy is to ensure the continued independence and objectivity of the external auditor. The external auditor, Deloitte LLP, undertook a number of non-audit related assignments in 2008 and these were conducted in accordance with the policy and are considered to be consistent with the professional and ethical standards expected of the external auditor. Details of the fees paid to the external auditor for audit and non-audit services are set out in Note 8 to these Accounts.

Directors' Development and Performance Evaluation

The Society's Chairman, on behalf of the Nominations Committee, annually reviews and evaluates the performance of the non-executive Directors (taking into account the views of other Directors), the Board and its Committees. The performance of the Chairman is reviewed by the full Board, in his absence. Ongoing training and development requirements for non-executive Directors are identified through the performance evaluation process. All newly appointed non-executive Directors undertake a comprehensive, tailored, induction programme. Executive Directors are evaluated within the performance evaluation framework for employees generally and by the Remuneration Committee with regard to their remuneration.

Terms of Reference

Copies of the Terms of Reference for the Audit, Group Risk, Assets and Liabilities, Nominations, Remuneration and Credit Committees are available on the Society's website, or on written request from the Society's Secretary.

Andrew J. Greenwood

Andrew J. Greenwood
Secretary
25 February 2009

Directors' Remuneration Report

For the year ended 31 December 2008

Introduction

This report, together with the details in Note 9 to the Accounts, aims to provide information about the Society's policies on remunerating directors and senior executives and discloses the remuneration of the Directors. The report considers all the areas set out in the Combined Code on Corporate Governance relating to remuneration, insofar as they are considered relevant to building societies. A summary of this report will be sent to all members eligible to vote at the 2009 Annual General Meeting, who will have the opportunity to participate in an advisory vote on the report.

The Remuneration Committee is responsible for the Society's policy on the remuneration of the Society's Chairman, executive Directors and senior executives. Changes to the level of fees for non-executive Directors (excluding the Society's Chairman), reflecting the time commitment and responsibilities of the role, are received from the executive Directors.

Bonuses have been awarded this year in accordance with the senior executives' bonus scheme, which is an integral part of their remuneration packages, although the amounts are significantly reduced compared with previous years. This reflects executives' performance being measured against testing criteria specified by the Board in the context of challenging market conditions.

Composition and Scope of the Remuneration Committee

The Remuneration Committee comprises solely non-executive Directors, who do not have any day-to-day involvement in the operations of the Society and no personal financial interest in the recommendations. The Chairman of the Committee is Mr S. R. G. Booth, and the other members are Mr J. N. Anderson and Mrs C. M. Kavanagh. No executive Directors or other employees are members of the Remuneration Committee. Executive Directors and other members of senior management are invited to attend by the Committee as appropriate. The Society's Deputy Secretary, Mr G. Jennings, acts as Secretary to the Committee.

The Committee reports to the Board on the remuneration and terms of engagement of executive Directors and other members of senior management, together with wider aspects of remuneration policy for all members of staff and the fees for the Society's Chairman. All recommendations are considered by the full Board, but no Director participates in discussions when decisions relating to his or her own remuneration are made.

In 2008, the issues considered by the Committee included the design of, and setting of objectives for, the 2008 executive bonus scheme, an overview of the rewards and benefits for all members of the Society's staff, and the pay awards for the executive Directors and the Society's Chairman. In addition, the Committee's Terms of Reference were reviewed. In all matters discussed, consideration is always given to best practice within the financial services industry.

Remuneration Policy for Executive Directors

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

The executive Directors' remuneration comprises an annual salary, annual performance related bonus, long-term incentive plan, pension scheme membership and health care insurance. The bonus schemes are designed to recognise corporate and personal success on both an annual and longer term basis, whilst at the same time ensuring that any objectives agreed are consistent with sound risk management. A significant proportion of the executive Directors' remuneration is, therefore, linked to the Society's and the individual's performance.

Under the annual bonus scheme for executive Directors, an amount of up to 40% of basic salary may be awarded at the discretion of the Board of Directors (there is no minimum prescribed bonus award). This is based on achievement against corporate and personal objectives of a financial and non-financial nature. These are agreed in advance by the Committee and the Board, and are all closely linked to the achievement of the Society's strategic objectives. Recommendations to the Board, of the amount payable under the scheme, are made by the Committee following a detailed review of performance against the agreed objectives.

The executive Directors also participate in long-term (three year) incentive plans (LTIPs), the latest of which matured on 31 December 2008. A maximum of 20% of basic salary may be accrued under each LTIP and a payment made only if a participant reaches the pre-determined performance level over the three year period.

Any bonus payments awarded are not pensionable.

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

Salaries and Benefits

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

Directors' Remuneration Report

For the year ended 31 December 2008

Service Contracts

The Chief Executive, Deputy Chief Executive and Operations Director have service contracts which contain provision for twelve months notice by either the Society or the Director. No other Director has a service contract with the Society.

Pensions

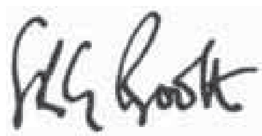
The Chief Executive and Deputy Chief Executive, in common with other employees who are members of the Society's defined benefits pension scheme, are entitled to pensions based on final salary and length of service with the Society, with a maximum pension of two-thirds of final salary. Pension entitlements for the executive Directors in the defined benefits scheme are accrued at a rate of 1/45th of the final year's basic salary for each year of service. The Operations Director is a member of the defined contribution scheme.

Policy for non-executive Directors

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

Directors' Remuneration – year ended 31 December 2008

Full details of Directors' remuneration for 2008 and prior year comparatives, all of which form part of the Report, are provided in Note 9 to the Accounts on pages 33 to 34.



S. Rodger G. Booth
Chairman of the Remuneration Committee
25 February 2009

Directors' Responsibilities

For the year ended 31 December 2008

Directors' Responsibilities for Preparing the Annual Accounts

The following statement, which should be read in conjunction with the statement of the Auditor's responsibilities on page 19, is made by the Directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report.

The Directors are required by the Building Societies Act 1986 (the Act) to prepare, for each financial year, annual accounts which give a true and fair view:

- of the state of the affairs of the Society and the Group as at the end of the financial year;
- of the income and expenditure of the Society and the Group for the financial year.

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

In preparing those Accounts, the Directors are required to:

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

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

Directors' Responsibilities for Accounting Records and Internal Control

The Directors are responsible for ensuring that the Society and its subsidiary undertakings:

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

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

Going Concern

The current economic conditions present increased risks and uncertancies for all businesses. In response to such conditions, the Directors have carefully considered these risks and the extent to which they might affect the preparation of the Financial Statements on a going concern basis. By way of background, the Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chairman's report on pages 2 and 3, the Chief Executive's Report on pages 4 and 5 and in the Directors' Report on pages 8 to 11. Information concerning the policies and processes for managing its capital, its financial risk management objectives, details of its financial instruments and hedging activities, and its exposures to credit risk and liquidity risk are also included in the Directors' Report and in note 34 to the accounts. Using this information, the directors consider that:

- the Group maintains an appropriate level of liquidity, sufficient to meet both the normal demands of the business and the requirements which might arise in stressed circumstances. It also maintains a borrowing facility to supplement liquidity if required;
- the availability and quality of liquid assets are structured so as to ensure funds are available to repay any maturing wholesale funds and exceptional demand from retail investors. These assets are principally invested with banks and building societies which meet the requirements of the Group Financial Risk Management Policy. The Policy is regularly reviewed and updated to take into account changes to the credit risk assessment of each counterparty;
- the Group's other assets are primarily in the form of mortgages on residential property. Regular assessment of the recoverability of all mortgage assets is undertaken and provision made where appropriate. The Directors consider that the Group is not exposed to losses on these assets which would affect their decision to adopt the going concern basis;
- reasonable profits have been maintained in order to keep gross capital at a suitable level to meet regulatory requirements. In the current environment, profitability is reduced because of the effect of low interest rates on net interest receivable, increased impairment losses on loans and advances to customers and because of exceptional costs arising from the Group's contribution to the Financial Services Compensation Scheme. Therefore, having reviewed its plans and forecasts for the coming period, the Directors consider that the Group is able to generate adequate profits to enhance the capital of the Society, and to improve its solvency in the future.

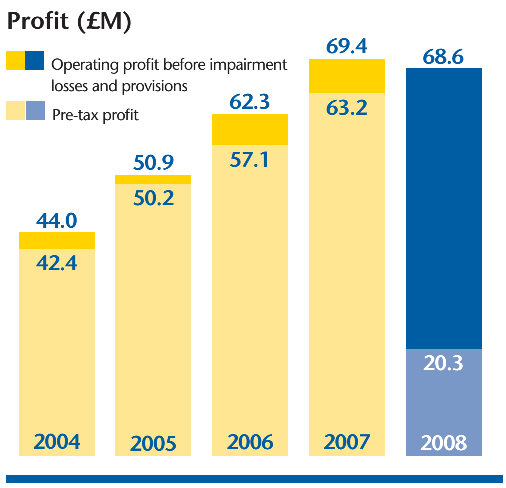
The Directors, therefore, consider that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and Accounts.

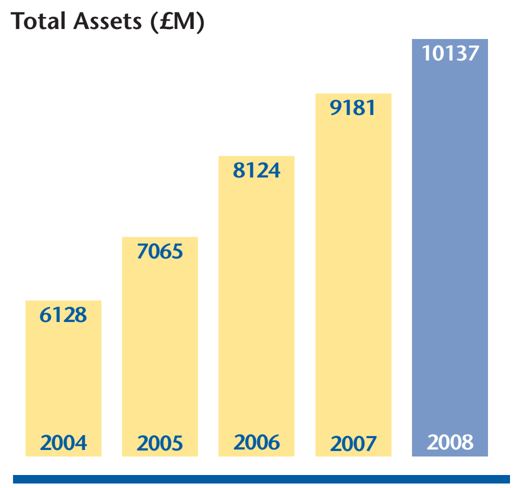
R. A. Smith

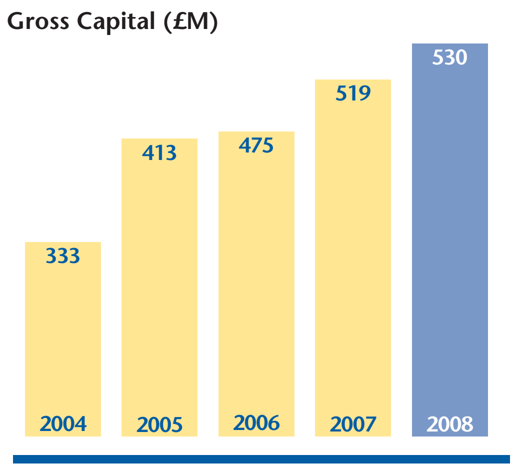
Robin Smith
Chairman
25 February 2009

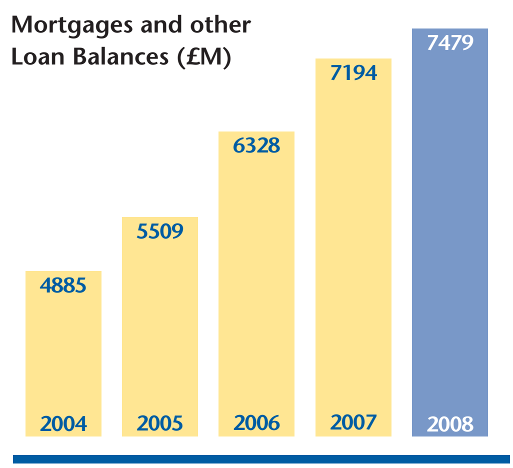
Five Year Highlights

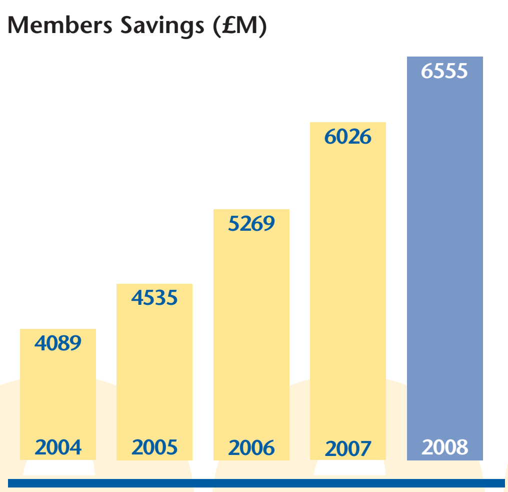
"The Society achieved another strong operating profit performance."

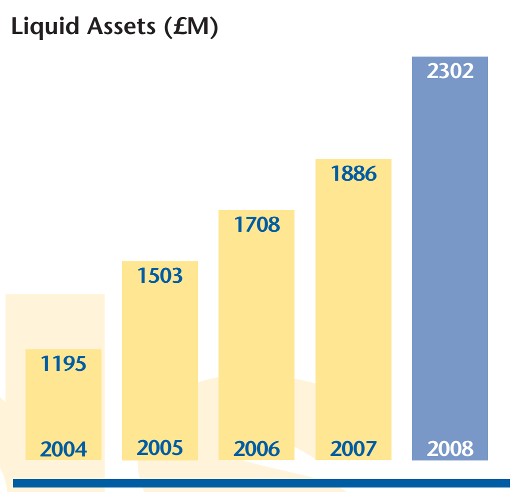












Independent Auditor's Report

To The Members of Leeds Building Society

We have audited the Group and Society Annual Accounts (the "Annual Accounts") of Leeds Building Society for the year ended 31 December 2008 which comprise the Group and Society Income Statements, the Group and Society Statements of Recognised Income and Expense, the Group and Society Balance Sheets and the Group and Society Cash Flow Statements and the related notes 1 to 34. 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 auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

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

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

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

We also report to you if, in our opinion, the Society has not kept proper accounting records or if we have not received all the information and explanations that we require for our audit.

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

Basis of audit opinion

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

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

Opinion

In our opinion:

a) the Annual Accounts give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of affairs of the Group and of the Society as at 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.

Deloitte LLP

Deloitte LLP
Chartered Accountants and
Registered Auditors
Leeds

25 February 2009

Group Income Statement

For the year ended 31 December 2008

	Notes	Group Profit before FSCS levy 2008 £M	FSCS levy 2008 £M	Profit after FSCS levy 2008 £M	2007 £M
Interest receivable and similar income	3	583.1		583.1	538.9
Interest payable and similar charges	4	(490.4)		(490.4)	(445.0)
Net interest receivable		**92.7**		**92.7**	**93.9**
Fees and commissions receivable	5	20.4		20.4	20.5
Fees and commissions payable	5	(0.1)		(0.1)	(0.1)
Fair value gains less losses from derivative financial instruments	6	0.3		0.3	(0.4)
Other operating income	7	1.4		1.4	1.7
Total income		**114.7**		**114.7**	**115.6**
Administrative expenses	8	(44.8)		(44.8)	(44.6)
Depreciation and amortisation	18	(1.3)		(1.3)	(1.6)
Operating profit before impairment losses and provisions		**68.6**		**68.6**	**69.4**
Impairment losses on loans and advances to customers	11	(32.1)		(32.1)	(5.9)
Losses on investment securities	16	(10.0)		(10.0)	–
Losses from financial guarantee contracts		–		–	(0.5)
Provisions for liabilities and charges:					
Other	26	3.5		3.5	0.2
FSCS levy	26	–	(9.7)	(9.7)	–
Operating profit and profit on ordinary activities before income tax		**30.0**	**(9.7)**	**20.3**	**63.2**
Income tax expense	12	(8.7)	2.7	(6.0)	(19.4)
Profit for the financial year		**21.3**	**(7.0)**	**14.3**	**43.8**

All amounts relate to continuing operations.

The notes on pages 25 to 62 are an integral part of these consolidated financial statements.

Society Income Statement

For the year ended 31 December 2008

	Notes	Society Profit before FSCS levy 2008 £M	Society FSCS levy 2008 £M	Society Profit after FSCS levy 2008 £M	2007 £M
Interest receivable and similar income	3	581.9		581.9	538.9
Interest payable and similar charges	4	(490.4)		(490.4)	(445.0)
Net interest receivable		**91.5**		**91.5**	**93.9**
Dividend from subsidiary undertaking		–			11.0
Fees and commissions receivable	5	12.4		12.4	13.2
Fees and commissions payable	5	(0.1)		(0.1)	(0.1)
Fair value gains less losses from derivative financial instruments	6	0.3		0.3	(0.4)
Other operating income	7	1.4		1.4	1.7
Total income		**105.5**		**105.5**	**119.3**
Administrative expenses	8	(41.6)		(41.6)	(41.5)
Depreciation and amortisation	18	(1.3)		(1.3)	(1.6)
Operating profit before impairment losses and provisions		**62.6**		**62.6**	**76.2**
Impairment losses on loans and advances to customers	11	(31.2)		(31.2)	(5.4)
Losses on securities available for sale	16	(10.0)		(10.0)	–
Losses from financial guarantee contracts		–		–	(0.5)
Provisions for liabilities and charges:					
Other	26	3.5		3.5	0.2
FSCS levy	26	–	(9.7)	(9.7)	–
Operating profit and profit on ordinary activities before income tax		**24.9**	**(9.7)**	**15.2**	**70.5**
Income tax expense	12	(7.2)	2.7	(4.5)	(17.7)
Profit for the financial year		**17.7**	**(7.0)**	**10.7**	**52.8**

All amounts relate to continuing operations.

The notes on pages 25 to 62 are an integral part of these consolidated financial statements.

Balance Sheets

As at 31 December 2008

	Notes	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Assets					
Cash in hand and balances with the Bank of England	13	2.1	4.1	2.1	4.1
Loans and advances to credit institutions		250.0	613.5	249.6	613.5
Derivative financial instruments	14	195.5	59.4	195.5	59.4
Loans and advances to customers	15				
Loans fully secured on residential property		6,673.5	6,383.3	6,493.4	6,241.1
Other loans		805.5	810.3	805.5	810.3
Investment securities	16				
Available for sale		1,239.3	1,252.3	1,239.3	1,252.3
At fair value through profit and loss		42.1	–	42.1	–
Loans and receivables		768.2	–	768.2	–
Other liquid assets		–	15.7	–	15.7
Investments in subsidiary undertakings	17	–	–	199.7	162.0
Other investments	17	0.1	0.1	0.1	0.1
Property, plant and equipment	18	33.4	32.0	33.4	32.0
Current income tax assets		4.6	–	6.2	–
Deferred income tax assets	19	3.8	4.9	3.0	4.2
Other assets, prepayments and accrued income	20	118.5	5.2	117.6	4.5
Total Assets		**10,136.6**	**9,180.8**	**10,155.7**	**9,199.2**
Liabilities					
Shares	21	6,555.0	6,026.1	6,555.0	6,026.1
Derivative financial instruments	14	227.2	40.4	227.2	40.4
Amounts owed to credit institutions	22	688.8	383.7	688.8	383.7
Amounts owed to other customers	23	739.2	867.6	767.4	893.2
Debt securities in issue	24	1,243.2	1,297.1	1,243.2	1,297.1
Current income tax liabilities		–	5.9	–	4.2
Deferred income tax liabilities	19	6.1	3.6	6.1	3.6
Other liabilities and accruals	25	136.5	39.6	134.1	37.2
Provision for liabilities	26	10.7	4.7	9.9	3.9
Retirement benefit obligations	32	3.0	1.5	3.0	1.5
Subordinated liabilities	27	41.4	39.8	41.4	39.8
Subscribed capital	28	25.0	25.0	25.0	25.0
		9,676.1	**8,735.0**	**9,701.1**	**8,755.7**
Reserves	29				
Cash flow hedge reserve		6.9	(0.6)	6.9	(0.6)
Available for sale reserve		(11.3)	(7.2)	(11.3)	(7.2)
Revaluation reserve		16.9	16.9	16.9	16.9
Other reserve		14.3	14.3	14.1	14.1
General reserve		433.7	422.4	428.0	420.3
Total Reserves and Liabilities		**10,136.6**	**9,180.8**	**10,155.7**	**9,199.2**
Memorandum items					
Commitments: Irrevocable undrawn loan facilities	31	2.5	7.2	2.5	7.2

These financial statements were approved by the Board of Directors on 25 February 2009.
Signed on behalf of the Board of Directors

Robin Smith
Chairman

Ian W. Ward
Chief Executive

David Pickersgill
Deputy Chief Executive and Finance Director

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
Property revaluation		–	(1.8)	–	(1.8)
Available for sale investment securities	29				
Fair value changes taken to reserves		(8.9)	(10.3)	(8.9)	(10.3)
Amortisation/disposals post 1 July 2008		3.1	–	3.1	–
Cash flow hedges	29				
Gains taken to reserves		10.4	3.3	10.4	3.3
Actuarial (loss)/gain on retirement benefit obligations	32	(4.1)	1.2	(4.1)	1.2
Tax on items taken directly to or transferred from reserves		(0.1)	2.3	(0.1)	2.3
Net income/(expense) recognised directly in reserves		**0.4**	**(5.3)**	**0.4**	**(5.3)**
Profit for the financial year		14.3	43.8	10.7	52.8
Total recognised income and expense for the year		**14.7**	**38.5**	**11.1**	**47.5**

Cash Flow Statements

For the year ended 31 December 2008

	Notes	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Profit before tax		20.3	63.2	15.2	70.5
Adjustments for changes in:					
Impairment provision		26.8	5.3	25.9	4.8
Provisions for liabilities and charges		6.0	(0.5)	6.0	(0.5)
Depreciation and amortisation		1.3	1.6	1.3	1.6
Interest on subscribed capital		3.3	3.3	3.3	3.3
Interest on subordinated debt		2.3	2.3	2.3	2.3
Cash generated from operations		**60.0**	**75.2**	**54.0**	**82.0**
Changes in operating assets and liabilities:					
Loans and advances to customers		(312.2)	(870.9)	(273.4)	(786.2)
Other liquid assets		15.7	(5.7)	15.7	(5.7)
Derivative financial instruments		58.2	(20.7)	58.2	(20.7)
Loans and advances to credit institutions		95.4	(64.3)	95.8	(64.5)
Investment in subsidiaries		–	–	(38.4)	(84.8)
Other operating assets		(113.2)	(1.9)	(113.0)	(1.7)
Shares		528.9	756.6	528.9	756.6
Credit institutions and other		176.7	273.2	180.0	265.5
Debt securities		(58.0)	(9.3)	(58.0)	(9.3)
Other operating liabilities		95.4	0.8	95.2	0.5
Taxation paid		(13.0)	(18.2)	(11.1)	(16.9)
Net cash inflow from operating activities		**533.9**	**114.8**	**533.9**	**114.8**
Returns on investments and servicing of finance		9.8	5.1	9.8	5.1
Purchase of securities		(3,987.8)	(2,233.4)	(3,987.8)	(2,233.4)
Proceeds from sale and redemption of securities		3,176.7	2,318.9	3,176.7	2,318.9
Purchase of property and equipment		(2.7)	(2.1)	(2.7)	(2.1)
Net cash flows from investing activities		**(804.0)**	**88.5**	**(804.0)**	**88.5**
Net (decrease)/increase in cash and cash equivalents		**(270.1)**	**203.3**	**(270.1)**	**203.3**
Cash and cash equivalents at beginning of year		**504.5**	**301.2**	**504.5**	**301.2**
Cash and cash equivalents at the end of year	30	**234.4**	**504.5**	**234.4**	**504.5**

Notes to the Accounts

For the year ended 31 December 2008

1. Accounting Policies

Basis of preparation

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

The accounts have been prepared on the going concern basis as outlined in the Directors' Responsibilities section on page 17.

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

At the date of authorisation of these financial statements, the following standards and Interpretations, which have not been applied in these financial statements were in issue but not yet effective:

IFRS 8 Operating Segments

IAS 1 Revised 'Presentation of Financial Statements'

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will not have a material impact on the financial statements of the Society, except for additional segment disclosures when IFRS 8 comes into effect for periods commencing on or after 1 January 2009.

Accounting convention

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

Basis of consolidation

The Group accounts consolidate the accounts of Leeds Building Society and all its subsidiaries.

Where subsidiaries are acquired during the period, their results are included in the Group accounts from the date of acquisition. Uniform accounting policies are applied throughout the Group.

Investment in subsidiaries

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

Financial Instruments

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

(a) Loans and receivables

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

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

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

1. Accounting Policies (continued)

(b) At fair value through profit and loss

The Group uses derivative financial instruments to hedge its exposure to interest rate risk from operational, financing and investment activities. In accordance with its treasury policy the Group does not hold derivative instruments for trading purposes. Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into, and are subsequently remeasured at their fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

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

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

(c) Available-for-sale

Available-for-sale assets are non-derivative financial assets that are not classified into either of the two categories above. Changes in the fair value of available for sale assets are recognised in equity, except for impairment losses.

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

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

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

(d) Financial liabilities

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

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

(e) Sale and repurchase agreements

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

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

(f) Derecognition of financial assets and liabilities

Financial assets are only derecognised when the contractual rights to receive cash flows from them have expired or when the Group has transferred substantially all risks and rewards of ownership. The Group has not derecognised the mortgage loans which have been used to secure its issue of covered bonds as substantially all the risks and rewards are retained by the Group.

Financial liabilities are only derecognised when the obligation is discharged, cancelled or has expired.

Cash flow hedges

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

Fair value hedges

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

Notes to the Accounts continued

For the year ended 31 December 2008

1. Accounting Policies (continued)

Fair value hedges (continued)

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

Impairment of financial assets

Impairment of loans and advance to customers and investment securities

Individual assessments are made of all mortgage loans in possession and investment securities where there is objective evidence that all cashflows will not be received. Based upon these assessments an individual impairment reduction of these assets is made.

In addition, an impairment reduction is made against those loans and advances to customers where objective evidence indicates that it is likely that losses may ultimately be realised. The impairment value is calculated by applying various factors to each loan. These factors take into account the Group's experience of default and delinquency rate, loss emergence periods, regional house price movements and adjustments to allow for forced sale values. Impairment provisions are made to reduce the value of other impaired loans and advances to the amount that is considered to be ultimately received based upon objective evidence.

Interest income and expense

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

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

Fees and commission income

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

Fees integral to the loan yield are included within interest income and expense as part of the effective interest rate calculation.

Commission may be repaid when certain policies are cancelled. A provision is included in the accounts to cover the estimate of the amount of clawbacks that will become payable in the future, based on products that have been sold and commissions received prior to the year end.

Property, plant and equipment

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

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

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

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

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

Pension benefits

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

For defined benefit retirement benefit schemes, the cost of providing benefits is determined using the Projected Unit Method, with actuarial valuations updated at each year-end. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the income statement and presented in the Statement of Recognised Income and Expense. The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation less the fair value of Scheme assets.

Notes to the Accounts continued

For the year ended 31 December 2008

1. Accounting Policies (continued)

Leases

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

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

Borrowings

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

Income tax

Income tax on the profits for the period comprises current tax and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in reserves, in which case it is recognised in reserves. Current tax is the expected tax payable on the taxable income for the year, using tax rates applicable at the balance sheet date and any adjustment to tax payable in respect of previous years.

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

Foreign Currency

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

Notes to the Accounts continued

For the year ended 31 December 2008

2. Critical Accounting Estimates and Judgements

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

Impairment losses on loans and advances and investment securities

The Group reviews its loan portfolios and investment securities to assess impairment at least on a quarterly basis, in determining whether an impairment loss should be recorded in the Income Statement. In undertaking this review, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status or borrower's local economic conditions that correlate with defaults on assets in the Group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

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

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

Retirement Benefit Obligations

The Income Statement cost and Balance Sheet liability of the defined benefit pension scheme are assessed in accordance with the advice of a qualified actuary. Assumptions are made for inflation, the rate of increase in salaries and pensions, the rate used to discount scheme liabilities, the expected return on scheme assets and mortality rates. Changes to any of the assumptions could have an impact on the Balance Sheet liability and to the costs in the Income Statement.

Effective Interest Rate

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

In respect of residential mortgages, all discounts, premiums, incremental fees and costs associated with the origination of a mortgage are deferred and amortised over the estimated mortgage life. Mortgage life is based upon historic observable data, amended for management's estimation of future economic conditions.

Financial Services Compensation Scheme (FSCS)

As a result of notifications it has received from the Financial Services Authority, the Society has recognised in this year's results a provision for a levy of £9.7m covering the full period of the levy from October 2008 to March 2011. The amount has been determined by reference to the path of future interest rates applicable at the balance sheet date. Changes in interest rates over the period of the levy will impact the final amount of the payment.

Notes to the Accounts continued

For the year ended 31 December 2008

3. Interest Receivable and Similar Income

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
On loans fully secured on residential property	381.8	366.3	372.8	360.2
On other loans	55.4	48.7	55.4	48.7
On subsidiary undertakings	–	–	7.8	6.1
On debt securities				
Interest and other income	92.4	80.6	92.4	80.6
On other liquid assets				
Interest and other income	31.5	21.7	31.5	21.7
Net income on financial instruments	22.0	21.6	22.0	21.6
Total interest income	**583.1**	**538.9**	**581.9**	**538.9**
Interest received on amounts included in the cost of qualifying assets:				
From instruments held at fair value through profit and loss	41.1	44.1	41.1	44.1
From instruments not held at fair value through profit and loss	542.0	494.8	540.8	494.8
Total interest income	**583.1**	**538.9**	**581.9**	**538.9**

Included within interest receivable and similar income is interest accrued on impaired financial assets of £7.7m (2007 – £1.8m).

4. Interest Payable and Similar Charges

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
On shares held by individuals	310.9	271.2	310.9	271.2
On other shares	0.4	1.4	0.4	1.4
On subscribed capital	3.3	3.3	3.3	3.3
On subordinated debt	2.3	2.3	2.3	2.3
On deposits and other borrowings	150.9	137.2	150.9	137.2
Net expense on financial instruments	22.6	29.6	22.6	29.6
Total interest expense	**490.4**	**445.0**	**490.4**	**445.0**
Interest expense on amounts included in the cost of qualifying assets:				
From instruments held at fair value through profit and loss	24.9	31.9	24.9	31.9
From instruments not held at fair value through profit and loss	465.5	413.1	465.5	413.1
Total interest expense	**490.4**	**445.0**	**490.4**	**445.0**

Leeds

Notes to the Accounts continued

For the year ended 31 December 2008

5. Fees and Commissions Receivable and Payable

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

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Fees and commission receivable – at fair value	3.3	2.3	–	–
Fees and commission receivable – not at fair value	17.1	18.2	12.4	13.2
Fees and commission payable	(0.1)	(0.1)	(0.1)	(0.1)
	20.3	**20.4**	**12.3**	**13.1**

6. Fair Value Accounting Volatility

The fair value volatility accounting gain of £0.3m (2007: £0.4m loss) represents the net fair value gain on derivative instruments that are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The gain or loss is primarily due to timing differences in income recognition between the derivative instruments and the hedged assets and liabilities. This gain or loss will trend to zero over time and this is taken into account by the Board when considering the Group's underlying performance.

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

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Change in fair value of financial assets designated as at fair value through profit and loss	39.9	(1.6)	39.9	(1.6)
Change in fair value of financial liabilities designated as at fair value through profit and loss	(40.2)	0.1	(40.2)	0.1
Derivatives in designated fair value hedge accounting relationships	(120.1)	(20.8)	(120.1)	(20.8)
Adjustment to hedged items in designated fair value hedge accounting relationships	119.8	21.8	119.8	21.8
Derivatives in designated cashflow hedge accounting relationships	10.4	3.4	10.4	3.4
Adjustments to hedged items in cashflow hedge accounting relationships	(9.6)	(3.4)	(9.6)	(3.4)
Cross currency swap	0.1	0.1	0.1	0.1
	0.3	**(0.4)**	**0.3**	**(0.4)**

The net gain on the cross currency swap includes a fair value gain on the cross currency swap of £81.1m (2007: £6.3m loss) and an exchange loss of £81.0m (2007: £6.4m gain) on retranslation of the related Euro liabilities. The cross currency swap has been entered into to reduce the exchange risk from funding in foreign currency.

7. Other Operating Income

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Rent receivable	0.5	0.6	0.5	0.6
Pension fund income	0.8	1.0	0.8	1.0
Net gain on exchange rate movements	0.1	0.1	0.1	0.1
	1.4	**1.7**	**1.4**	**1.7**

Notes to the Accounts continued

For the year ended 31 December 2008

8. Administrative Expenses

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Staff costs				
Wages and salaries	22.4	22.5	20.0	20.1
Social Security costs	2.3	2.3	2.0	2.0
Other pension costs	2.6	2.6	2.4	2.5
Remuneration of auditors (see below)	0.3	0.2	0.3	0.2
Other administrative expenses	17.2	17.0	16.9	16.7
	44.8	44.6	41.6	41.5
Depreciation and amortisation	1.3	1.6	1.3	1.6
	46.1	**46.2**	**42.9**	**43.1**

The analysis of auditors' remuneration is as follows:

	Group & Society 2008 £'000	Group & Society 2007 £'000
Fees payable to the society's auditors for the audit of the society's annual accounts	118	111
Fees payable to the society's auditors for the audit of the society's subsidiaries pursuant to legislation	9	9
Total audit fees	**127**	**120**
Other services pursuant to legislation		
Tax services	75	49
Further assurance services	23	33
Other services	54	23
Total non-audit fees	**152**	**105**
Fees payable to the society's auditors and their associates in respect of associated pension schemes	5	5

Fees payable to Deloitte LLP and their associates for non-audit services to the Society are not required to be separately disclosed because the consolidated financial statements are required to disclose such fees on a consolidated basis.

Notes to the Accounts continued

For the year ended 31 December 2008

9. Directors' Emoluments

(a) Remuneration of Directors

A separate Report of the Remuneration Committee setting out remuneration policy for directors is on pages 15 to 16. Emoluments of the Society's directors, from the Society and its subsidiary undertakings, are detailed below.

	Salary £'000	Bonus £'000	Long term bonus £'000	Benefits £'000	Sub-total £'000	Increase in accrued Pension £'000	Total £'000
Executive Directors – 2008							
I. W. Ward	311	54	48	–	413	10	423
D. Pickersgill	221	40	34	–	295	8	303
P. A. Hill	161	29	25	–	215	–[(1)]	215
	693	**123**	**107**	**–**	**923**	**18**	**941**

	Salary £'000	Bonus £'000	Long term bonus £'000	Benefits £'000	Sub-total £'000	Increase in accrued Pension £'000	Total £'000
Executive Directors – 2007							
I. W. Ward	296	105	61	–	462	17	479
D. Pickersgill	210	73	43	–	326	9	335
P. A. Hill	153	54	32	–	239	–	239
	659	**232**	**136**	**–**	**1,027**	**26**	**1,053**

Non-executive directors	2008 Fees £'000	2007 Fees £'000
R. A. Smith	67	60
S. R. G. Booth	45	38
I. Marshall	40	38
C. M. Kavanagh	35	34
J. N. Anderson	35	34
A. Rajguru – appointed on 2 April 2008	27	–
I. Robertson – appointed on 8 December 2008	3	–
R. W. Stott – appointed on 8 December 2008	3	–
F. R. Dee – retired on 2 April 2008	12	44
E. M. Ziff – resigned on 28 April 2008	12	34
R. D. Wade – retired on 30 March 2007	–	15
	279	**297**

Note:

[(1)] P. A. Hill is a member of the defined contribution scheme as noted in 9(b).

Notes to the Accounts continued

For the year ended 31 December 2008

9. Directors' Emoluments (continued)

(b) Pension benefits earned by Executive Directors

Defined benefit scheme

	Increase in accrued pension During 2008(2)	Accrued pension as at 31 December 2008(2)	Transfer value of accrued pension transferred in at 31 December 2007(3)	Transfer value of accrued pension with Leeds Building Society 2007(3)	Transfer value of accrued pension transferred in at 31 December 2008(3)	Transfer value of accrued pension with Leeds Building Society 2008(3)	Increase in transfer value over the year net of Directors' contributions
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
I. W. Ward	10	199	1,775	1,394	1,917	1,583	308
D. Pickersgill	8	92	–	1,147	–	1,377	213

Notes:

1. The increase in accrued pension during the year excludes any increase for inflation.
2. The accrued pensions are the amounts which the directors would be entitled to from normal retirement age if they left service at the relevant date.
3. The transfer values have been calculated in accordance with Guidance Note, GN11, published by the Institute of Actuaries and Faculty of Actuaries.
4. Members of the fund have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the table.
5. The accrued pensions and transfer values set out in the table include benefits that are to be provided through an Employer Retirement Scheme as well as those through Leeds Building Society Staff Pension Scheme.

Defined contribution scheme

The Society's contributions to the defined contribution scheme in respect of P. A. Hill were £35,400 (2007: £21,500).

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

The aggregate amount outstanding at 31 December 2008 in respect of loans from the Society or a subsidiary undertaking to Directors of the Society or persons associated with Directors was £127,404 being one mortgage to a director and one mortgage to a person connected with a Director (2007: £65,360 to a connected person). These loans are at normal commercial rates. A register of loans and transactions with Directors and their connected persons is maintained at the Head office of the Society and may be inspected by members. There were no significant contracts between the Society or its subsidiaries and any Director of the Society during the year.

10. Staff Numbers

	Group 2008 No	Group 2007 No	Society 2008 No	Society 2007 No
The average number of persons employed during the year was as follows:				
Head office	513	491	513	491
Branch offices	475	496	421	442
	988	**987**	**934**	**933**

Notes to the Accounts continued

For the year ended 31 December 2008

11. Impairment Losses on Loans and Advances to Customers

Group	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loans £M	Total £M
At 1 January 2008				
Collective impairment	6.3	5.1	2.3	13.7
Individual impairment	1.4	–	2.4	3.8
	7.7	**5.1**	**4.7**	**17.5**
Income and expenditure account				
Charge for the year				
Collective impairment	2.7	1.9	0.3	4.9
Individual impairment	8.7	17.2	1.7	27.6
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(0.4)	–	–	(0.4)
	11.0	**19.1**	**2.0**	**32.1**
Amount written off during the year				
Individual impairment	1.5	3.2	0.6	5.3
At 31 December 2008				
Collective impairment	9.0	7.0	2.6	18.6
Individual impairment	8.2	14.0	3.5	25.7
	17.2	**21.0**	**6.1**	**44.3**

Society	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loan £M	Total £M
At 1 January 2008				
Collective impairment	5.8	5.1	2.3	13.2
Individual impairment	1.4	–	2.4	3.8
	7.2	**5.1**	**4.7**	**17.0**
Income and expenditure account				
Charge for the year				
Collective impairment	2.6	1.9	0.3	4.8
Individual impairment	7.9	17.2	1.7	26.8
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(0.4)	–	–	(0.4)
	10.1	**19.1**	**2.0**	**31.2**
Amount written off during the year				
Individual impairment	1.5	3.2	0.6	5.3
At 31 December 2008				
Collective impairment	8.4	7.0	2.6	18.0
Individual impairment	7.4	14.0	3.5	24.9
	15.8	**21.0**	**6.1**	**42.9**

Notes to the Accounts continued

For the year ended 31 December 2008

12. Income Tax Expense

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Analysis of charge in the year				
Current tax				
UK corporation tax on profits of the year	4.8	19.4	3.3	17.7
Adjustments in respect of previous years	0.2	–	0.2	(0.2)
Total current tax	5.0	19.4	3.5	17.5
Deferred tax				
Origination and reversal of timing differences	1.0	(0.1)	1.0	0.2
Adjustment in respect of previous years	–	0.1	–	–
Total deferred tax	1.0	–	1.0	0.2
Tax on profit on ordinary activities	**6.0**	**19.4**	**4.5**	**17.7**
Factors affecting current tax charge for the year:				
Profit on ordinary activities before tax	20.3	63.2	15.2	70.5
Profit on ordinary activities multiplied by standard rate of corporate tax in the UK of 28% (2007: 30%)	5.7	19.0	4.3	21.1
Effects of:				
Expenses not deductible for tax purposes	0.1	0.2	0.1	0.2
Adjustment in respect of prior years	0.2	0.1	0.2	–
Transfer pricing adjustment	–	–	(0.1)	(0.3)
Non taxable income	–	–	–	(3.3)
Movement in unprovided deferred tax	–	0.1	–	–
	6.0	**19.4**	**4.5**	**17.7**

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

13. Cash and Balances with the Bank of England

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Cash in hand	2.1	4.1	2.1	4.1
Balances with the Bank of England	–	–	–	–
Included in cash and cash equivalents (see note 30)	**2.1**	**4.1**	**2.1**	**4.1**

Balances with the Bank of England do not include mandatory reserve deposits of £6.6m (2007: £8.3m) which are not available for use in the Group's day to day operations.

Leeds

Notes to the Accounts continued

For the year ended 31 December 2008

14. Derivative Financial Instruments

Derivatives are contracts or arrangements whose value is derived from one or more underlying price, rate or index inherent in the contract or arrangement, such as interest rates, exchange rates or stock market indices. Derivatives are only used by the Group in accordance with Section 9A of the Building Societies Act 1986, to reduce the risk of loss arising from changes in interest rates or other factors of a prescribed description which affect the business. Accordingly, such instruments are not used in trading activity or for speculative purposes.

The Group utilises the following derivative instruments for hedging purposes:

	Group and Society 2008			Group and Society 2007		
	Contract or underlying principal amount	Fair values		Contract or underlying principal amount	Fair values	
		Assets	Liabilities		Assets	Liabilities
	£M	£M	£M	£M	£M	£M
Derivatives held for hedging						
Derivatives designated as fair value hedges	5,033.1	30.6	(149.6)	5,782.1	27.2	(19.7)
Derivatives designated as cash flow hedges	450.0	10.6	(0.7)	677.0	1.2	(2.6)
Other derivatives held for hedging	1,586.4	154.3	(76.9)	1,009.0	31.0	(18.1)
Total	**7,069.5**	**195.5**	**(227.2)**	**7,468.1**	**59.4**	**(40.4)**

Other derivatives held for hedging are used for financial assets that are economically hedged but where it is not practical to apply hedge accounting.

The net fair value of cashflow hedges of £9.9m (2007 – £(1.4m)) will be reported in income in 2009 to 2010. There was nil (2007 – nil) charge to income and expenditure in respect of hedging ineffectiveness during the year.

There were no transactions for which cashflow hedge accounting had to cease in 2008 or 2007 as a result of the cashflows no longer being expected to occur.

Types of derivatives and uses

In certain circumstances the Group has taken advantage of the hedging rules set out in IAS 39 to designate derivatives as accounting hedges to reduce accounting volatility. The Group's market risk policy and application of economic hedging is, however, materially unchanged. The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the types of derivatives which are typically used in managing such risks. These risks may alternatively be managed using on balance sheet instruments or natural hedges that exist in the Group balance sheet.

Activity	Risk	Type of Derivative
Fixed rate savings products	Sensitivity to falls in interest rates	Receive fixed interest rate swaps
Fixed rate mortgage lending	Sensitivity to increases in interest rates	Pay fixed interest rate swaps
Fixed rate funding	Sensitivity to falls in interest rates	Receive fixed interest rate swaps
Fixed rate asset investments	Sensitivity to increases in interest rates	Pay fixed interest rate swaps

Derivative products which are combinations of more basic derivatives are used only in circumstances where the underlying position being hedged contains the same risk features. For example, the mortgages linked to US interest rates originated by the Group may be hedged with a single contract incorporating both the interest rate and foreign exchange risk involved. In such cases the derivative used will be designed to match exactly the risks of the underlying asset. Exposure to market risk on such contracts is therefore fully hedged.

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

Notes to the Accounts continued

For the year ended 31 December 2008

14. Derivative Financial Instruments (continued)

Control of derivatives

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

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

The following table analyses the derivatives by type of contract and residual maturity:

	Group and Society 2008			Group and Society 2007		
	Notional principal amount £M	Credit risk weighted amount £M	Replacement cost £M	Notional principal amount £M	Credit risk weighted amount £M	Replacement cost £M
Interest rate swaps	6,285.8	85.9	59.6	7,011.2	65.4	41.8
Cross currency swaps	777.9	170.1	135.9	448.9	36.1	17.6
Cap/collars and floors	5.8	–	–	8.0	–	–
	7,069.5	**256.0**	**195.5**	**7,468.1**	**101.5**	**59.4**
Under one year	2,643.5	18.9	17.6	3,222.9	18.3	16.4
Between one and five years	3,688.0	221.6	173.5	3,493.2	65.9	36.0
Over five years	738.0	15.5	4.4	752.0	17.3	7.0
	7,069.5	**256.0**	**195.5**	**7,468.1**	**101.5**	**59.4**

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

Notes to the Accounts continued

For the year ended 31 December 2008

15. Loans and advances to customers

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
(a) Loans and receivables				
Loans fully secured on residential property	6,397.3	6,222.9	6,215.8	6,080.2
Other loans				
Loans fully secured on land	625.8	633.3	625.8	633.3
Other loans	15.7	24.5	15.7	24.5
Fair value adjustment for hedge risk	148.3	3.3	148.3	3.3
	7,187.1	**6,884.0**	**7,005.6**	**6,741.3**
(b) At fair value through profit and loss				
Loans fully secured on residential property	145.0	164.9	145.0	164.9
Other loans	191.2	162.2	191.2	162.2
	336.2	**327.1**	**336.2**	**327.1**
Less:				
Impairment losses	(44.3)	(17.5)	(42.9)	(17.0)
	7,479.0	**7,193.6**	**7,298.9**	**7,051.4**

The Society has purchased certain mortgage portfolios from a third party. The Society retains certain, but not all, risks arising from these loans, and as a consequence these residential mortgages have been recognised as a collateral loan to a third party within other loans at fair value through profit and loss. The net gain on loans and advances which are designated as fair value through profit and loss was £24m (2007: £1.3m loss) for both the Group and Society. Loans and advances to customers include £1.5bn (2007 – nil) for both the Group and Society which have been transferred from the Society to Leeds Building Society Covered Bonds LLP, a limited Liability Partnership which is consolidated by the Group. The loans secure £1.25bn of covered bonds issued by the Society. The loans are retained on the Society's balance sheet as the Society substantially retains the risk and reward relating to the loans. As the covered bonds have been immediately purchased by the Society they have not been recognised in the accounts of the Group or the Society as they do not create a liability to a third party, thereby not changing the underlying risk profile of the Group.

16. Investment Securities

	Group and Society 2008 £M	Group and Society 2007 £M
Debt securities		
Listed	1,012.3	852.0
Unlisted	1,037.3	400.3
Total investment securities	**2,049.6**	**1,252.3**

Investment securities reduced by £3.8m in 2008 (2007: £10.3m) due to changes in fair value. This movement was recorded in equity or through profit and loss. Investment securities are stated after a provision of £10m against one exposure to a UK subsidiary of an Icelandic Bank.

The movement in investment securities is summarised as follows:	Available for Sale £M	Fair value through profit and loss £M	Loans and receivables £M	**Total £M**
Group and Society				
At 31 December 2007	1,252.3	–	–	1,252.3
Additions	3,947.7	40.1	–	3,987.8
Disposals (sale and redemption)	(3,113.8)	–	(62.9)	(3,176.7)
Transfers	(828.0)	–	828.0	–
Change in fair value	(8.9)	2.0	3.1	(3.8)
Provision for losses	(10.0)	–	–	(10.0)
At 31 December 2008	**1,239.3**	**42.1**	**768.2**	**2,049.6**

Notes to the Accounts continued

For the year ended 31 December 2008

16. Investment Securities (continued)

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

The assets were reclassified as the Society considered that, due to adverse conditions in financial markets, the market for the sale and purchase of mortgage backed securities and floating rate notes had become inactive. This was evidenced by significant fluctuations in the quoted market value of these instruments and that these instruments were no longer being actively traded.

The market value of the assets reclassified on 1 July was £828m, which included £15.8m fair value losses recognised during the period directly in reserves. The carrying value of the assets at 31 December 2008 was £768.2m and this compares with the market value of £699m. The fair value loss that would have been recorded directly in reserves if the assets had not been reclassified was £64m.The Society intends to hold these instruments to maturity and expects to receive cash flows equivalent to the nominal value of the assets, which amounts to £786m.

The net loss, after deferred tax, of £18.6m recognised in the available for sale reserve at 1 July 2008 is released to profit and loss as part of the effective interest rate based on the maturity profile of the underlying instruments.

17. Investments in subsidiary undertakings

	Society 2008 £M	Society 2007 £M
(a) Shares held in subsidiary undertakings		
Cost		
At 1 January 2008	19.6	19.6
At 31 December 2008	**19.6**	**19.6**
(b) Loans to subsidiary undertakings		
Cost		
At 1 January 2008	142.4	57.6
Additions	37.7	84.8
Repayments	–	–
At 31 December 2008	**180.1**	**142.4**
Total investments in subsidiary undertakings	**199.7**	**162.0**

(c) Other investments

	Group and Society 2008 £M	Group and Society 2007 £M
Investments in Mutual Vision Technologies Ltd	0.1	0.1

(d) Interest in subsidiary undertakings

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

Name	Major activities	Class of Shares held	Interest of Society
Leeds Financial Services Ltd	Provision of Financial Services	Ordinary £1 shares	100%
Leeds Financial Services (Overseas) Ltd	Provision of Financial Services	Ordinary £1 shares	100%
Leeds Mortgage Funding Ltd	Provision of Mortgage Finance	Ordinary £1 shares	100%
Leeds Overseas (Isle of Man) Ltd	Provision of Mortgage Finance	Ordinary £1 shares	100%
Mercantile Asset Management Ltd	Purchase of mortgage assets	Ordinary £1 shares	100%
Countrywide Rentals 1 Ltd	Non-trading	Ordinary 50p shares	100%
Countrywide Rentals 2 Ltd	Non-trading	Ordinary 50p shares	100%
Countrywide Rentals 3 Ltd	Non-trading	Ordinary 50p shares	100%
Countrywide Rentals 4 Ltd	Non-trading	Ordinary 50p shares	100%
Countrywide Rentals 5 Ltd	Non-trading	Ordinary 50p shares	100%
Leeds Building Society Covered Bonds LLP	Provision of Mortgage Assets and guarantor of covered bonds	*	*

*The Society's interest is in substance equal to being a 100% owned subsidiary. Consequently it has been consolidated in the Group accounts

Notes to the Accounts continued

For the year ended 31 December 2008

17. Investments in subsidiary undertakings (continued)

(e) Interest in other investments

The Society has an interest in the following unlisted company, which is registered in the UK.

Name	Major activities	Class of Shares held	Interest of Society
Mutual Vision Technologies Ltd	Computer software development	Ordinary 1p shares	13.87%

18. Property, plant and equipment

	Freehold premises £M	Long leasehold premises £M	Short leasehold premises £M	Office & computer equipment £M	Motor vehicles £M	Total £M
(a) Group						
Cost or valuation						
At 1 January 2008	27.5	0.4	1.4	19.9	0.3	49.5
Additions	1.2	–	–	1.5	–	2.7
Revaluations	–	–	–	–	–	–
Disposals	–	–	–	–	(0.2)	(0.2)
At 31 December 2008	**28.7**	**0.4**	**1.4**	**21.4**	**0.1**	**52.0**
Depreciation						
At 1 January 2008	–	–	1.2	16.1	0.2	17.5
Charged in year	–	–	0.1	1.1	0.1	1.3
Disposals	–	–	–	–	(0.2)	(0.2)
At 31 December 2008	**–**	**–**	**1.3**	**17.2**	**0.1**	**18.6**
Net book value						
At 31 December 2008	**28.7**	**0.4**	**0.1**	**4.2**	**–**	**33.4**
At 31 December 2007	**27.5**	**0.4**	**0.2**	**3.8**	**0.1**	**32.0**
(b) Society						
Cost or valuation						
At 1 January 2008	27.5	0.4	1.4	19.9	0.2	49.4
Additions	1.2	–	–	1.5	–	2.7
Revaluations	–	–	–	–	–	–
Disposals	–	–	–	–	(0.2)	(0.2)
At 31 December 2008	**28.7**	**0.4**	**1.4**	**21.4**	**–**	**51.9**
Depreciation						
At 1 January 2008	–	–	1.2	16.1	0.1	17.4
Charged in year	–	–	0.1	1.1	0.1	1.3
Disposals	–	–	–	–	(0.2)	(0.2)
At 31 December 2008	**–**	**–**	**1.3**	**17.2**	**–**	**18.5**
Net book value						
At 31 December 2008	**28.7**	**0.4**	**0.1**	**4.2**	**–**	**33.4**
At 31 December 2007	**27.5**	**0.4**	**0.2**	**3.8**	**0.1**	**32.0**

The freehold and long leasehold premises were valued as at 31 December 2007 by Jones Lang LaSalle on the basis of existing use value.

18. Property, plant and equipment (continued)

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
(c) The amount of freehold and long leasehold premises (included above at valuation) determined according to the historical cost accounting convention is as follows:				
Freehold premises	9.8	8.6	9.8	8.6
Long leasehold premises	0.1	0.1	0.1	0.1
Net book value	**9.9**	**8.7**	**9.9**	**8.7**
(d) Land and buildings occupied by the Group and Society for its own activities				
Net book value	**21.9**	**20.1**	**21.9**	**20.1**

The cost of equipment, fixtures and vehicles held under finance leases was £0.7m (2007: £0.7m). The related cumulative depreciation of £0.7m (2007: £0.7m) includes £nil charged during the year (2007: £nil).

19. Deferred income tax

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Deferred tax				
At 1 January 2008	1.3	3.0	0.6	2.5
Amount recognised directly in equity	(2.6)	(1.7)	(2.6)	(1.7)
Income and expenditure movement during the year	(1.0)	–	(1.1)	(0.2)
At 31 December 2008	**(2.3)**	**1.3**	**(3.1)**	**0.6**

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Deferred income tax liabilities				
Gain on revaluation	2.1	2.2	2.1	2.2
Cash flow hedges	2.7	–	2.7	–
Other temporary differences	1.3	1.4	1.3	1.4
	6.1	**3.6**	**6.1**	**3.6**
Deferred income tax assets				
Pensions and other post retirement benefits	0.8	0.5	0.8	0.5
Cash flow hedges	–	0.2	–	0.2
Excess of capital allowances over depreciation	0.2	0.3	0.2	0.3
Other provisions	2.8	3.9	2.0	3.2
	3.8	**4.9**	**3.0**	**4.2**

Notes to the Accounts continued

For the year ended 31 December 2008

19. Deferred income tax (continued)

The deferred tax charge in the income statement comprises the following temporary differences:

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Accelerated tax depreciation	0.1	0.1	0.1	0.1
Other provisions	0.9	(0.1)	1.0	–
	1.0	**–**	**1.1**	**0.1**

20. Other assets, prepayments and accrued income

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Other assets, prepayments and accrued income	118.5	5.2	117.6	4.5
	118.5	**5.2**	**117.6**	**4.5**

Other assets includes £104m (2007: nil) owed by credit institutions on cash collateralisation of swaps.

21. Shares

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Held by individuals	6,502.8	6,007.8	6,502.8	6,007.8
Other shares	14.0	15.4	14.0	15.4
Fair value adjustment for hedge risk	38.2	2.9	38.2	2.9
	6,555.0	**6,026.1**	**6,555.0**	**6,026.1**

Shares have either variable or fixed interest rates.

22. Amounts owed to credit institutions

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Amounts owed to credit institutions	**688.8**	**383.7**	**688.8**	**383.7**

All amounts owed to credit institutions have fixed interest rates.

Amounts owed to credit institutions include £400m (2007: nil) for both the Group and Society for which the underlying security was the covered bond programme secured on certain loans and advances to customers.

Notes to the Accounts continued

For the year ended 31 December 2008

23. Amounts owed to other customers

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Amounts owed to subsidiary undertakings	–	–	28.2	25.6
Other deposits	739.2	867.6	739.2	867.6
	739.2	**867.6**	**767.4**	**893.2**

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

24. Debt securities in issue

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Certificates of deposit	345.9	530.3	345.9	530.3
Floating rate notes	897.3	717.4	897.3	717.4
Commercial paper	–	49.4	–	49.4
	1,243.2	**1,297.1**	**1,243.2**	**1,297.1**

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

25. Other liabilities and accruals

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Income tax	21.2	21.2	21.2	21.2
Accruals	8.6	8.3	8.3	8.0
Other creditors	106.7	10.1	104.6	8.0
	136.5	**39.6**	**134.1**	**37.2**

Included within other creditors is a liability for financial guarantee contracts of £3.2m (2007: £3.2m).

Other creditors includes £96m (2007: nil) owed to credit institutions on cash collateralisation of swaps.

Notes to the Accounts continued

For the year ended 31 December 2008

26. Provision for Liabilities and Charges

Group	FSCS levy £m	Customer redress and other related provisions £M	Commission Clawback £M	Total £M
(a) Other provisions				
At 1 January 2008	–	3.9	0.8	4.7
Amounts written off during the year	–	(0.2)	–	(0.2)
Provision (credit)/charge for the year	9.7	(3.5)	–	6.2
At 31 December 2008	**9.7**	**0.2**	**0.8**	**10.7**
Society				
At 1 January 2008	–	3.9	–	3.9
Amounts written off during the year	–	(0.2)	–	(0.2)
Provision (credit)/charge for the year	9.7	(3.5)	–	6.2
At 31 December 2008	**9.7**	**0.2**	**–**	**9.9**

Financial Services Compensation Scheme (FSCS)

As a result of notifications it has received from the Financial Services Authority, the Society has recognised in this year's results a provision for an FSCS levy of £9.7m covering the period from October 2008 to March 2011. Further details of the basis of the levy is provided in note 31(a).

Customer redress and other provisions

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

Commission clawback

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

27. Subordinated Liabilities

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Subordinated debt notes 2015	40.0	40.0	40.0	40.0
Fair value hedging adjustment	1.4	(0.2)	1.4	(0.2)
	41.4	**39.8**	**41.4**	**39.8**

The subordinated debt has a fixed interest rate of 5.75%. The Society has an option to repay the debt on 9 March 2010. The debt is subordinated to the claims of members and all other creditors.

28. Subscribed Capital

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
13⅜% permanent interest bearing shares	**25.0**	**25.0**	**25.0**	**25.0**

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

29. Reserves

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
(a) Cash flow hedge reserve				
At 1 January	(0.6)	(2.9)	(0.6)	(2.9)
Change in fair value	10.4	3.3	10.4	3.3
Deferred tax	(2.9)	(1.0)	(2.9)	(1.0)
At 31 December	**6.9**	**(0.6)**	**6.9**	**(0.6)**
(b) Available for sale reserve				
At 1 January	(7.2)	–	(7.2)	–
Change in fair value	(8.9)	(10.3)	(8.9)	(10.3)
Amortisation/disposals post 1 July 2008	3.1	–	3.1	–
Deferred tax	1.7	3.1	1.7	3.1
At 31 December	**(11.3)**	**(7.2)**	**(11.3)**	**(7.2)**
(c) Revaluation reserve				
At 1 January	16.9	16.9	16.9	16.9
At 31 December	**16.9**	**16.9**	**16.9**	**16.9**
(d) Other reserve				
At 1 January	14.3	14.3	14.1	14.1
At 31 December	**14.3**	**14.3**	**14.1**	**14.1**
(e) General reserve				
At 1 January	422.4	377.7	420.3	366.6
Profit for the financial year	14.3	43.8	10.7	52.8
Pension fund actuarial loss net of tax	(3.0)	0.9	(3.0)	0.9
At 31 December	**433.7**	**422.4**	**428.0**	**420.3**

30. Cash and Cash Equivalents

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

	Group and Society	
	2008 £M	2007 £M
Cash in hand and balances with the Bank of England (note 13)	2.1	4.1
Loans and advances to credit institutions	232.3	500.4
	234.4	**504.5**

Notes to the Accounts continued

For the year ended 31 December 2008

31. Guarantees and Other Financial Commitments

(a) Financial Services Compensation Scheme

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

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

(b) Subsidiary Undertakings

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

(c) Capital commitments

There were no capital commitments at 31 December 2008 (2007: £2.2m) contracted but not provided for.

(d) Leasing commitments

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

	Group and Society	
	2008 £M	**2007 £M**
Land and buildings		
Commitment expiring:		
Within one year	0.2	0.3
Between two and five years inclusive	0.3	0.4
After five years	1.1	1.1
	1.6	**1.8**
Other operating leases		
Commitment expiring:		
Within five years	1.2	–
After five years	–	1.2
	1.2	1.2
(e) Irrevocable loan facility commitments	**2.5**	**7.2**

Notes to the Accounts continued

For the year ended 31 December 2008

32. Retirement Benefit Obligations

The Society operates both defined benefit and defined contribution schemes including the Mercantile Building Society Retirement and Death Benefit Plan. In addition, the Society has, for two individuals in the UK, an unfunded unapproved benefits scheme. The schemes have been accounted for under IAS19 covering employee benefits. IAS19 requires disclosure of certain information about the schemes as follows.

The defined benefit section of the Scheme provides benefits based on final salary for certain employees. The assets of the Scheme are held in a separate trustee-administered fund. Contributions to the defined benefit section are assessed in accordance with the advice of an independent qualified actuary using the projected unit method. The defined benefit section was closed to new entrants from 1 January 2000.

Actuarial gains and losses are recognised immediately in full, through the Statement of Recognised Income and Expense.

The major assumptions used by the actuary were (in nominal terms):

	Group and Society				
	2008	**2007**	**2006**	**2005**	**2004**
Rate of increase in salaries	5.30%	5.40%	5.00%	4.55%	4.45%
Rate of increase for pensions in payment*	3.25%	3.40%	3.00%	2.80%	2.70%
Rate of increase for deferred pensions*	3.30%	3.40%	3.00%	2.80%	2.70%
Discount rate	6.20%	5.80%	5.20%	4.80%	5.30%
Inflation assumption	3.30%	3.40%	3.00%	2.80%	2.70%
Expected return on assets	5.86%	7.00%	6.90%	7.20%	7.30%

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

The most significant non-financial assumption is the assumed rate of longevity, which has been changed to the SAPS tables known as S1PXA, projected in line with members' years of birth including the medium cohort effect and a 1% (0.5%) underpin for male (female) members. The table below shows the life expectancy assumptions used in the accounting assessments based on the life expectancy of a member aged 63.

	2008		**2007**		**2006**	
	Pensioner	**Non-pensioner**	**Pensioner**	**Non-pensioner**	**Pensioner**	**Non-pensioner**
Male	23	25	23	24	22	23
Female	25	27	26	27	25	26

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

	Group and Society			
Category of assets	**2008**	**2007**	**2006**	**2005**
Equities	54.4%	59.0%	70.0%	75.3%
Property	6.8%	3.5%	4.2%	1.8%
Government bonds	26.0%	24.9%	15.7%	10.3%
Corporate bonds	12.6%	11.6%	6.7%	6.1%
Cash/other	0.2%	1.0%	3.4%	6.5%

Notes to the Accounts continued

For the year ended 31 December 2008

32. Retirement Benefit Obligations (continued)

Reconciliation of funded statement	Group and Society			
	2008 £M	2007 £M	2006 £M	2005 £M
Present value of pension scheme's liabilities	(60.7)	(64.3)	(64.2)	(57.5)
Assets at fair value	57.7	62.8	58.6	45.9
Deficit	**(3.0)**	**(1.5)**	**(5.6)**	**(11.6)**

The amounts recognised in the income statement are as follows:

	Group and Society	
	2008 £M	2007 £M
Current service cost	1.8	1.9
Interest cost	3.7	2.8
Expected return on plan assets	(4.5)	(3.3)
Total cost – defined benefit scheme	**1.0**	**1.4**

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

Experience recognised in the Statement of Recognised Income and Expense (SORIE)

	Group and Society			
	2008 £M	2007 £M	2006 £M	2005 £M
Experience gain/(loss) on pension scheme liabilities	7.6	2.7	3.0	(10.6)
Percentage of scheme liabilities (%)	12.4%	4.2%	4.7%	(18.4%)
Experience (loss)/gain on assets	(11.7)	(1.5)	1.8	4.2
Percentage of scheme liabilities (%)	(18.6%)	(2.4%)	3.1%	9.2%
Total (losses)/gains recognised in SORIE during the year	**(4.1)**	**1.2**	**4.8**	**(6.4)**

Notes to the Accounts continued

For the year ended 31 December 2008

32. Retirement Benefit Obligations (continued)

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

	Group and Society	
	2008 £M	**2007 £M**
At 31 December 2007	64.3	64.2
Current service cost	1.8	1.9
Interest cost	3.7	3.2
Employee contributions	0.1	0.3
Actuarial gain	(7.6)	(2.7)
Benefits paid	(1.6)	(2.6)
At 31 December 2008	**60.7**	**64.3**

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

	Group and Society	
	2008 £M	**2007 £M**
At 31 December 2007	62.8	58.6
Expected return	4.5	4.2
Actuarial loss	(11.7)	(1.5)
Contribution by employer	3.6	3.8
Employee contributions	0.1	0.3
Benefits paid	(1.6)	(2.6)
At 31 December 2008	**57.7**	**62.8**

Estimated contributions for 2009 financial year

	2009 £M
Estimated contributions in Financial Year 2009	1.6
Estimated employee contributions in Financial Year 2009	0.1
Estimated Total contributions in Financial Year 2009	**1.7**

Notes to the Accounts continued

For the year ended 31 December 2008

33. Related Party Transactions

Group

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

Society

Details of the Society's shares in group undertakings are given in note 17.

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

	Society subsidiaries		Directors and connected persons	
	2008 £M	**2007 £M**	**2008 £M**	**2007 £M**
Loans payable to the Society				
Loans outstanding at 1 January 2008	142.4	57.6	0.1	0.3
Net movement during the year	37.7	84.8	–	(0.2)
Loans outstanding at 31 December 2008	**180.1**	**142.4**	**0.1**	**0.1**
Deposits payable to the Society				
Deposits outstanding at 1 January 2008	25.6	33.3	1.5	3.0
Net movement during the year	2.6	(7.7)	0.2	(1.5)
Deposits outstanding at 31 December 2008	**28.2**	**25.6**	**1.7**	**1.5**
Net interest income				
Interest receivable	7.8	6.1	–	–
Interest expense	–	–	0.1	0.1
Other income and expenses				
Fees and expenses paid by the Society	–	0.1	–	–

	2008 £M	**2007 £M**
Directors' emoluments		
Short-term benefits	1.2	1.3

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

Two Directors are members of the defined benefit section of the Leeds Building Society Pension Scheme (2007: two). One Director is a member of the defined contribution section of the Leeds Building Society Pension Scheme (2007: one).

Notes to the Accounts continued

For the year ended 31 December 2008

34. Risk Management and Control

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

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

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

Credit risk

Credit risk is the risk of financial loss where counterparties are not able to meet their obligations as they fall due. The Group is firmly committed to the management of this risk in both its retail and commercial lending activities and its investment of liquid assets.

The Group employs appropriate underwriting and fraud detection techniques to support sound decision making and minimise losses in its lending activities. In addition, a proactive approach to the control of bad and doubtful debtors is maintained within the collections area.

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

Comprehensive management information on movement and performance within the various personal and wholesale portfolios ensure that credit risk is effectively controlled, and any adverse trends are identified before they impact on performance. Group performance is also measured against the industry, where appropriate, to ensure debt default levels remain below that of the industry average. This management information is distributed widely across the Group and monitored within tight boundaries at Board and Sub Board policy committees. The Credit Committee is responsible for the formulation of policy pertaining to asset quality and credit risk for approval by the Board.

Policy statements covering, amongst other things, criteria to be used in considering limits on counterparties and countries, are reviewed at least quarterly by the ALCO and Board. Authorised limits on a counterparty are determined following rigorous analysis giving due consideration to both internal and external credit ratings.

There has been no change in the year to the manner in which the Group manages and measures credit risk.

Notes to the Accounts continued

For the year ended 31 December 2008

34. Risk Management and Control (continued)

The table below provides further information on the Group's loans and advances to customers by payment due status as at 31 December 2008. The balances exclude the fair value adjustment for hedge risk and impairment losses.

	Group		Group	
	2008	2008	2007	2007
	£M	%	£M	%
Not impaired:				
– neither past due nor impaired	6,837.8	92.6	6,919.7	96.0
– Past due up to 3 months but not impaired	348.4	4.7	233.7	3.3
Impaired:				
– Past due 3 to 6 months	107.1	1.5	38.0	0.5
– Past due 6 to 12 months	50.0	0.7	8.4	0.1
– Past due over 12 months	5.2	0.1	1.0	–
– Possessions *	26.5	0.4	7.0	0.1
	7,375.0	**100.0**	**7,207.8**	**100.0**

*Against possession cases, £28m (2007: £10m) of collateral is held.

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

The fair value of impaired assets not in possession is £349m (2007 – £88m). The fair value is based on an indexed valuation.

£28m (2007: £23m) of loans that would be past due or impaired have had their terms renegotiated.

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

The average LTV of the residential loan portfolio is 49%, based on an indexed valuation (2007: 38%).

The average LTV of the commercial loan portfolio is 73% based on the latest valuation held (2007: 66%).

Market risk

Market risk is the potential adverse change in Group income or the value of Group net worth arising from movements in interest rates, exchange rate or other market prices. Market risk exists to some extent in all the Group's businesses. The Group recognises that the effective management of market risk is essential to the maintenance of stable earnings and the preservation of member value.

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

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

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

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

Interest rate risk

The primary market risk faced by the Group is interest rate risk. The net interest income and market value of the Group is exposed to movements in interest rates. This exposure is managed on a continuous basis, within limits set by the Board, using a combination of derivatives.

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

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

Notes to the Accounts continued

For the year ended 31 December 2008

34. Risk Management and Control (continued)

The following table provides a summary of the interest rate repricing profile of the Group's assets and liabilities as at 31 December 2008. Assets and liabilities have been allocated to time bands by reference to the earlier of the next interest rate reset date and the contractual maturity date.

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

31 December 2008	Not more than 3 months £M	More than 3 months but not more than 6 months £M	More than 6 months but not more than 1 year £M	More than 1 year but not more than 5 years £M	More than 5 years £M	No specific reprice date £M	Non interest bearing £M	Total £M
Assets								
Liquid assets	2,029.0	30.8	12.6	182.0	24.0	–	23.3	2,301.7
Loans fully secured on residential property and other loans	3,716.7	216.0	528.3	2,289.6	561.3	–	167.1	7,479.0
Property, plant and equipment	–	–	–	–	–	–	33.4	33.4
Other assets	–	–	–	–	–	–	322.5	322.5
Total assets	**5,745.7**	**246.8**	**540.9**	**2,471.6**	**585.3**	**–**	**546.3**	**10,136.6**
Liabilities								
Shares	3,751.3	637.9	867.6	1,050.4	67.0	–	180.8	6,555.0
Amounts owed to credit institutions, other customers and debt securities in issue	2,453.2	84.0	62.0	46.5	–	–	25.5	2,671.2
Other liabilities	–	–	–	–	–	–	383.5	383.5
Subordinated debt	–	–	–	41.4	–	–	–	41.4
Subscribed capital	–	–	–	–	–	25.0	–	25.0
Reserves	–	–	–	–	–	–	460.5	460.5
Total liabilities	**6,204.5**	**721.9**	**929.6**	**1,138.3**	**67.0**	**25.0**	**1,050.3**	**10,136.6**
Effect of derivative items	740.0	363.2	647.4	(1,266.3)	(484.3)	–	–	–
Interest rate sensitivity gap	281.2	(111.9)	258.7	67.0	34.0	(25.0)	(504.0)	–

Notes to the Accounts continued

For the year ended 31 December 2008

34. Risk Management and Control (continued)

31 December 2007	Not more than 3 months £M	More than 3 months but not more than 6 months £M	More than 6 months but not more than 1 year £M	More than 1 year but not more than 5 years £M	More than 5 years £M	No specific reprice date £M	Non interest bearing £M	Total £M
Assets								
Liquid assets	1,704.5	95.6	44.4	1.8	–	–	39.3	1,885.6
Loans fully secured on residential property and other loans	3,613.9	191.0	572.7	2,231.4	584.6	–	–	7,193.6
Property, plant and equipment	–	–	–	–	–	–	32.0	32.0
Other assets	59.4	–	–	–	–	–	10.2	69.6
Total assets	**5,377.8**	**286.6**	**617.1**	**2,233.2**	**584.6**	**–**	**81.5**	**9,180.8**
Liabilities								
Shares	3,044.2	448.1	850.1	1,497.8	57.3	–	128.6	6,026.1
Amounts owed to credit institutions, other customers and debt securities in issue	2,183.3	195.2	87.8	54.9	3.0	–	24.2	2,548.4
Other liabilities	40.4	–	–	–	–	–	55.3	95.7
Subordinated debt	–	–	–	39.8	–	–	–	39.8
Subscribed capital	–	–	–	–	–	25.0	–	25.0
Reserves	–	–	–	–	–	–	445.8	445.8
Total liabilities	**5,267.9**	**643.3**	**937.9**	**1,592.5**	**60.3**	**25.0**	**653.9**	**9,180.8**
Effect of derivative items	18.0	381.3	513.5	(403.1)	(509.7)	–	–	–
Interest rate sensitivity gap	127.9	24.6	192.7	237.6	14.6	(25.0)	(572.4)	–

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

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

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

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

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

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
100 basis point increase				
Profit or loss	(5.5)	(7.7)	(5.5)	(7.7)
Other equity	12.7	4.8	12.7	4.8
100 basis point decrease				
Profit or loss	5.1	7.5	5.1	7.5
Other equity	(24.6)	(10.5)	(24.6)	(10.5)

34. Risk Management and Control (continued)

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

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

Foreign currency risk

The Group's policy is not to run material, speculative foreign exchange positions.

The Group issues Euro mortgages as well as receiving funding via its commercial paper programme in foreign currencies, hence exposures to exchange rate fluctuations arise. Cross-currency interest rate swaps are utilised to reduce both the interest rate and exchange rate risk exposures that come from funding in foreign currency.

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

	Liabilities		Assets	
	2008 £M	2007 £M	2008 £M	2007 £M
Euro	1,035.8	594.9	1,035.8	594.9

At the year end the group has hedges in place to match 100% of its foreign currency exposures. Therefore any movement in foreign currency through profit or loss and other equity will be minimised.

Other price risk

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

Liquidity risk

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

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

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

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

In addition, it is the Group's policy to maintain undrawn committed borrowing facilities in order to provide flexibility in the management of the Group's liquidity. At the year end the Group had committed facilities of £90m with two banks (2007: £175m with three banks) of which £nil (2007: £150m) was drawn at the year end. The weighted average period until maturity of those facilities was 2.4 years (2007: 1.9 years).

Notes to the Accounts continued

For the year ended 31 December 2008

34. Risk Management and Control (continued)

The Group's liquidity is invested with highly rated counterparties and in investment grade securities. The Group's holdings of listed securities comprise investment grade floating rate notes issued by financial institutions and highly rated UK residential mortgage backed securities. Of the mortgage backed securities held 98.6% are in AAA rated tranches with the remainder in AA rated tranches.

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

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

The subscribed capital has a fixed rate of interest of 13⅜ths payable semi-annually for an indeterminate period.

31 December 2008	Not more than 3 months £M	More than 3 months but not more than 6 months £M	More than 6 months but not more than 1 year £M	More than 1 year but not more than 5 years £M	More than 5 years £M	Total £M
Liabilities						
Shares	5,007.5	395.9	1,026.4	250.4	0.2	6,680.4
Amounts owed to credit institutions, other customers and debt securities in issue	1,719.9	91.9	282.9	671.1	–	2,765.8
Subordinated debt	2.3	–	–	42.3	–	44.6
Other liabilities	156.3	–	–	–	–	156.3
Subscribed capital	–	–	–	–	25.0	25.0
Reserves	–	–	–	–	460.5	460.5
Total liabilities	**6,886.0**	**487.8**	**1,309.3**	**963.8**	**485.7**	**10,132.6**

31 December 2007	Not more than 3 months £M	More than 3 months but not more than 6 months £M	More than 6 months but not more than 1 year £M	More than 1 year but not more than 5 years £M	More than 5 years £M	Total £M
Liabilities						
Shares	5,170.2	81.0	224.2	753.7	–	6,229.1
Amounts owed to credit institutions, other customers and debt securities in issue	1,481.6	215.6	166.4	732.3	13.2	2,609.1
Subordinated debt	2.3	–	–	44.6	–	46.9
Other liabilities	55.3	–	–	–	–	55.3
Subscribed capital	–	–	–	–	25.0	25.0
Reserves	–	–	–	–	445.8	445.8
Total liabilities	**6,709.4**	**296.6**	**390.6**	**1,530.6**	**484.0**	**9,411.2**

The following table details the Group's expected maturity for its derivative financial instruments. The table has been drawn up based on the undiscounted net cash inflows/(outflows) on the derivative instruments that settle on a net basis and the undiscounted gross inflows and (outflows) on those derivatives that require gross settlement. When the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to the conditions existing at the reporting date.

Notes to the Accounts continued

For the year ended 31 December 2008

34. Risk Management and Control (continued)

For example, interest rates have been projected as illustrated by the yield curves existing at the reporting date and where the amount varies with changes in an index, the amount disclosed may be based on the level of the index at the reporting date.

	Not more than 3 months £M	More than 3 months but not more than 6 months £M	More than 6 months but not more than 1 year £M	More than 1 year but not more than 5 years £M	More than 5 years £M
31 December 2008					
Swap contracts	23.0	22.5	57.2	102.8	19.7
31 December 2007					
Swap contracts	11.4	3.5	5.3	35.2	3.1

Operational risk

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

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

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

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

Counterparty risk

The table below shows the Group's exposures to customer groups.

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Loans secured on residential mortgages	6,673.5	6,383.3	6,493.4	6,241.1
Other loans	805.5	810.3	805.5	810.3
Total	**7,479.0**	**7,193.6**	**7,298.9**	**7,051.4**

Notes to the Accounts continued

For the year ended 31 December 2008

34. Risk Management and Control (continued)

Fair values of financial assets and liabilities

The following tables summarise the carrying amounts and fair values of those financial assets and liabilities not presented on the Group and Society balance sheets at their fair value.
Where available, market values have been used to determine fair values. Where market values are not available, fair values have been calculated for other financial instruments by discounting cash flows at prevailing interest rates.

	Group 2008		Society 2008	
	Carrying value £M	Fair value £M	Carrying value £M	Fair value £M
Financial assets				
Loans and advances to customers	7,479.0	7,574.2	7,298.9	7,394.1
Loans and advances to credit institutions	250.0	250.0	249.6	249.6
Financial liabilities				
Shares	6,555.0	6,610.3	6,555.0	6,610.3
Due to credit institutions	688.8	688.8	688.8	688.8
Due to customers	739.2	739.5	767.4	767.7
Debt securities in issue	1,243.2	1,247.4	1,243.2	1,247.4

	Group 2007		Society 2007	
	Carrying value £M	Fair value £M	Carrying value £M	Fair value £M
Financial assets				
Loans and advances to customers	7,193.6	7,222.0	7,051.4	7,079.6
Loans and advances to credit institutions	613.5	613.5	613.5	613.5
Financial liabilities				
Shares	6,026.1	6,035.1	6,026.1	6,035.1
Due to credit institutions	383.7	383.7	383.7	383.7
Due to customers	867.6	867.5	893.2	894.3
Debt securities in issue	1,297.1	1,294.2	1,297.1	1,294.2

Due to and from credit institutions

The fair value of floating rate and overnight deposits is approximately equal to their carrying amount. The estimated fair value of fixed rate loans and deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.

Loans and advances to customers, shares and amounts due to customers

Loans and advances to customers, shares and amounts due to customers are recorded in the balance sheet using the effective interest rate method, less provisions for impairment together with the fair value adjustment for hedged items as required by IAS 39. This value is considered to be a good approximation of fair value.

Investment securities, debt securities in issue and other borrowed funds

Fair values are based on quoted market prices. For instruments where quoted market prices are not available, the market price is based on discounted cash flows using interest rates for securities with similar credit, maturity and yield characteristics.

Notes to the Accounts continued

For the year ended 31 December 2008

34. Risk Management and Control (continued)

Financial assets and liabilities classification

The following table analyses the financial assets and liabilities into which category they have been classified.

	Group 2008 £M	Group 2007 £M	Society 2008 £M	Society 2007 £M
Financial assets held at fair value through profit and loss				
Designated as such upon initial recognition	366.5	281.1	366.5	281.1
Derivatives held for hedging	195.5	59.4	195.5	59.4
Loans and receivables				
Loans and receivables not in fair value hedging relationships	5,508.7	3,537.8	5,328.2	3,395.6
Loans and receivables in fair value hedging relationships	2,770.2	3,988.2	2,770.2	3,988.2
Available for sale				
Investment securities	1,239.3	1,252.3	1,239.3	1,252.3
Financial liabilities held at fair value through profit and loss				
Designated as such upon initial recognition	398.5	255.8	398.5	255.8
Derivatives held for hedging	227.2	40.4	227.2	40.4
Financial liabilities measured at amortised cost				
Financial liabilities not in fair value hedging relationships	7,658.0	4,838.8	7,686.2	4,864.4
Financial liabilities in fair value hedging relationships	1,265.7	3,479.9	1,265.7	3,479.9

The financial assets designated as at fair value through profit and loss consist of mortgages which have been classified as such to avoid an accounting mismatch. As discussed in the accounting policies these are economically hedged but where it is not practical to apply hedge accounting. The maximum exposure to credit risk of these loans and receivables at 31 December 2008 was £292.9m (2007: £275.9m), which is equal to the carrying value of the assets. Maximum credit risk exposure at 31 December 2008 approximates to the carrying value for all assets and loan commitments apart from loans and advances to customers where the carrying value included an increase of £148.3m (2007 – increase of £3.3m) in respect of hedged interest rate risk. The Group's mortgage assets are secured on residential property. Due to the nature of the Society's business there is a lack of significant concentrations of credit risk and, hence, no credit derivatives or similar products are held to mitigate this risk. There is no material movement in the fair value of these assets in relation to credit risk.

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

In accordance with the security arrangements on derivative liabilities cash assets to the value of £104m (2007 £1.1m), have been pledged as security. The holder of the security does not have the right to sell or re-pledge the assets.

Segmental reporting

The business is comprised of only one segment, which is the core building society activities of mortgages, personal loans, other loans and savings and investments. No geographical analysis is presented because substantially all activity is in the UK, and all material exposures are UK resident.

Notes to the Accounts continued

For the year ended 31 December 2008

34. Risk Management and Control (continued)

Remaining maturity profile

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

31 December 2008	Repayable on demand £M	Less than 3 months £M	3 months to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Assets						
Cash and balances with the Bank of England	2.1	–	–	–	–	2.1
Loans and advances to credit institutions	–	232.3	13.9	1.0	2.8	250.0
Derivative financial instruments	–	1.8	15.8	173.5	4.4	195.5
Loans and advances to customers:						
Loans fully secured on residential property	1.4	54.2	107.0	714.4	5,796.5	6,673.5
Other loans	–	6.6	39.7	249.5	509.7	805.5
Investment securities		1,060.8	124.2	477.6	387.0	2,049.6
Other investments	0.1					0.1
Property, plant and equipment	33.4	–	–	–	–	33.4
Deferred income tax assets	3.8	–	–	–	–	3.8
Other assets, prepayments, accrued income and current tax	123.1	–	–	–	–	123.1
Total Assets	**163.9**	**1,355.7**	**300.6**	**1,616.0**	**6,700.4**	**10,136.6**
Liabilities						
Shares	4,597.4	396.2	1,345.4	215.9	0.1	6,555.0
Derivative financial instruments	–	18.5	16.3	108.6	83.8	227.2
Amounts owed to credit institutions	–	687.0	1.8	–	–	688.8
Amounts owed to other customers	46.4	528.8	160.8	3.2	–	739.2
Debt securities in issue	–	393.4	206.2	643.6	–	1,243.2
Deferred income tax liabilities	6.1	–	–	–	–	6.1
Provision for liabilities, accruals and deferred income	137.5	–	–	9.7		147.2
Retirement benefit obligations	3.0	–	–	–	–	3.0
Subordinated liabilities	–	–	–	41.4	–	41.4
Subscribed capital	–	–	–	–	25.0	25.0
Cash flow hedge reserve	6.9	–	–	–	–	6.9
Available for sale reserve	(11.3)	–	–	–	–	(11.3)
Revaluation reserve	16.9	–	–	–	–	16.9
General and other reserves	448.0	–	–	–	–	448.0
Total Reserves and Liabilities	**5,250.9**	**2,023.9**	**1,730.5**	**1,022.4**	**108.9**	**10,136.6**

Notes to the Accounts continued

For the year ended 31 December 2008

34. Risk Management and Control (continued)

31 December 2007	Repayable on demand £M	Less than 3 months £M	3 months to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Assets						
Cash and balances with the Bank of England	4.1	–	–	–	–	4.1
Loans and advances to credit institutions	–	524.0	83.9	2.9	2.7	613.5
Derivative financial instruments	–	9.2	7.0	36.0	7.2	59.4
Loans and advances to customers:						
Loans fully secured on residential property	1.0	37.4	94.1	646.5	5,604.3	6,383.3
Other loans	–	13.9	42.2	268.2	486.0	810.3
Securities available for sale	–	313.7	130.6	365.0	443.0	1,252.3
Other liquid assets	–	15.7	–	–	–	15.7
Other investments	0.1	–	–	–	–	0.1
Property, plant and equipment	32.0	–	–	–	–	32.0
Deferred income tax assets	4.9	–	–	–	–	4.9
Other assets, prepayments and accrued income	5.2	–	–	–	–	5.2
Total Assets	**47.3**	**913.9**	**357.8**	**1,318.6**	**6,543.2**	**9,180.8**
Liabilities						
Shares	5,003.0	77.0	216.9	729.2	–	6,026.1
Derivative financial instruments	–	4.2	7.0	14.4	14.8	40.4
Amounts owed to credit institutions	–	196.1	37.2	150.4	–	383.7
Amounts owed to other customers	42.8	632.2	141.9	50.7	–	867.6
Debt securities in issue	–	480.1	427.3	16.6	373.1	1,297.1
Current income tax liabilities	5.9	–	–	–	–	5.9
Deferred income tax liabilities	3.6	–	–	–	–	3.6
Provision for liabilities, accruals and deferred income	44.3	–	–	–	–	44.3
Retirement benefit obligations	1.5	–	–	–	–	1.5
Subordinated liabilities	–	–	–	39.8	–	39.8
Subscribed capital	–	–	–	–	25.0	25.0
Cash flow hedge reserve	(0.6)	–	–	–	–	(0.6)
Available for sale reserve	(7.2)	–	–	–	–	(7.2)
Revaluation reserve	16.9	–	–	–	–	16.9
General and other reserves	436.7	–	–	–	–	436.7
Total Reserves and Liabilities	**5,546.9**	**1,389.6**	**830.3**	**1,001.1**	**412.9**	**9,180.8**

Annual Business Statement

For the year ended 31 December 2008

1. Statutory Percentages

	Ratio at 31 December 2008	Statutory Limit
Lending limit	16.6%	25%
Funding limit	29.5%	50%

Explanation

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

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

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

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

2. Other percentages

	Ratio at 31 December 2008	Ratio at 31 December 2007
As a percentage of shares and borrowings:		
Gross capital	5.74%	6.05%
Free capital	5.58%	5.83%
Liquid assets	24.95%	21.99%
Profit for the financial year as a percentage of mean total assets	0.15%	0.51%
Management expenses as a percentage of mean total assets	0.48%	0.53%

The above percentages have been prepared from the Society's consolidated accounts and in particular:

- 'Shares and borrowings' represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.
- 'Gross capital' represents the aggregate of general reserve, other reserve, revaluation reserve, subordinated liabilities and subscribed capital.
- 'Free capital' represents the aggregate of gross capital and collective impairment provisions for loans and advances to customers less tangible fixed assets.
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- 'Liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment securities.
- 'Management expenses' represent the aggregate of administration expenses, depreciation and amortisation.

Annual Business Statement continued

For the year ended 31 December 2008

3. Information Relating to the Directors and Other Officers

Name	Occupation	Date of Birth	Date first appointed
Chairman			
R. A. Smith	Solicitor	15.02.43	18.05.98
Vice Chairman			
S. R. G. Booth	Company Director	18.04.43	01.12.00
Chief Executive			
*I. W. Ward	Chief Executive	04.05.49	25.09.95
Directors			
J. N. Anderson	Company Director	20.08.45	01.08.06
*P. A. Hill	Operations Director	28.07.61	01.08.06
C. M. Kavanagh	Company Director	30.03.62	13.12.05
I. Marshall	Company Director	27.05.47	30.03.04
*D. Pickersgill	Deputy Chief Executive	05.04.53	18.12.95
A. Rajguru	Company Director	14.09.65	02.04.08
I. Robertson	Company Director	10.08.47	08.12.08
R. W. Stott	Company Director	22.03.43	08.12.08

(*Executive Directors)

The Executive Directors of the Society have one year rolling service contracts with the Society, which can be terminated on twelve months notice.

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

Details of Directors – Other Directorships

(*Society Subsidiary)

R. A. Smith	Bartlett Group (Holdings) Ltd Catholic Trust of England and Wales Diocese of Leeds Trustee (Limited by Guarantee) Hinsley Properties Ltd Hinsley Properties No. 2 Ltd TCS Trustees Ltd Town Centre Securities plc Yorkshire County Cricket Club Ltd
I. W. Ward	Leeds Chamber of Commerce and Industry (Limited by Guarantee) Leeds Financial Services Ltd* Leeds Overseas (Isle of Man) Ltd* Leeds Mortgage Funding Ltd*
J. N. Anderson	Active Ability Ltd Anderson Business College Ltd City Hospitals Sunderland Foundation Trust Durham FM Ltd Leeds Building Society Staff Pension Scheme Ltd Milltech Training Ltd Normand Trustees Ltd North East Business Innovation Centre North East of England Business and Innovation Centre Ltd Sun FM Ltd Sunderland Arc Ltd 1Tyne & Wear Education Business Link
S. R. G. Booth	Leeds Building Society Staff Pension Scheme Ltd

Annual Business Statement continued

For the year ended 31 December 2008

P. A. Hill	Mercantile Asset Management Ltd*
C. M. Kavanagh	Leeds Building Society Staff Pension Scheme Ltd Travis Perkins Trading Company Ltd
I. Marshall	Barnado's Ian Marshall Ltd Markel International Insurance Company Ltd Markel Syndicate Management Ltd Microventures Trading Ltd
D. Pickersgill	Countrywide Rentals 1, 2, 3, 4, 5 Ltd (Dormant)* Leeds Financial Services Ltd* Leeds Financial Services (Overseas) Ltd* Leeds Overseas (Isle of Man) Ltd* Leeds Mortgage Funding Ltd* Mercantile Asset Management Ltd* Smartrisk Foundation UK
A. Rajguru	Alexander Ross Ltd Kettering Hospital NHS Foundation Trust Northampton College Simplyhealth Access
I. Robertson	Homes and Communities Agency for England
R. W. Stott	Rugby Football League (Governing Body) Ltd Yorkshire County Cricket Club Charitable Youth Trust

Executive Management

Name	Occupation	Directorships (*Society Subsidiary)
Kim L. Rebecchi	Director of Sales & Marketing	Leeds Financial Services Ltd* Leeds Financial Services (Overseas) Ltd* Leeds Building Society Staff Pension Scheme Ltd
Andrew J. Greenwood	General Manager & Secretary	Leeds Financial Services Ltd*
Paul M. Kaye	General Manager Sales	None
Gary M. Mitchell	General Manager Finance & Risk	Countrywide Rentals 1, 2, 3, 4, 5 Ltd (Dormant)* Leeds Overseas (Isle of Man) Ltd* Leeds Mortgage Funding Ltd* Leeds Building Society Staff Pension Scheme Ltd
Martin J. Richardson	General Manager Marketing & Business Development	Mercantile Asset Management Ltd*
Geoffrey Turnbull	General Manager Management Services	Mutual Vision Technologies Ltd
Karen Wint	General Manager Customer Services	None

notes

Where to find us

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