

WITH OUR MUTUAL HERITAGE WE PUT CUSTOMERS FIRST

A report from your Chief Executive, Chris Pilling.



HAS IT BEEN A GOOD YEAR?

For almost 150 years we've brought savers and home buyers together for the benefit of all. As we are owned by our members, not external shareholders, we can do what is right - invest in the business for the long term and plan for our future success. That's why I am proud to report another excellent performance for 2012.

As my predecessor Iain Cornish explained in 2008, we entered what we now know to be the global financial crisis in a strong position. I am pleased to say we are navigating our way through the crisis exactly as intended, as a profitable and reliable Society with a reputation for great customer service.

Using skilful and prudent management, particularly in credit risk, liquidity and treasury-related activities in the wholesale markets, we have continued to offer attractive products at competitive rates. This provides long-term value and financial security to our members.

I have been in the business for over a year now and I am proud to be part of an organisation which has:

Our vision is: 'To be the most trusted provider of financial services in the UK'.

- Loyal members who trust us.
- Great people who are committed and passionate.
- A very solid financial base.
- A robust governance process.
- Strong regional brands across the UK.
- A commitment to the local communities we serve.

These factors have played a crucial role in achieving our excellent 2012 results which include; organic growth of our mortgage book, an increase in our savings balances and a stable net interest margin reflecting the long-term value of our products. Our profits remain at a high level and we have maintained robust capital and liquidity positions.

WHAT IS THE VISION FOR OUR SOCIETY?

Because our Society is financially strong, we have been able to take advantage of merger and acquisition opportunities during the crisis, with 2012 being our first full year incorporating our Norwich & Peterborough (N&P) and Egg businesses. Thanks to the successful way we've taken the opportunities

open to us, our strategy is now evolving from acquisition and integration into a journey of transformation.

In 2012 the Board carried out a strategic review resulting in a new vision for our Society. One that supports our belief that trust is critical and that it is this that makes us different from the competition.

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This is underpinned by five strategic priorities that will take us to the next stage of our development. They will allow our Society to continue seizing opportunities and moving forward as a progressive and trusted business.

Our five strategic priorities are:

- Attract and retain the best talent with a leading people experience built on our culture of mutual trust.
- Deliver a market-leading customer experience built on empathy, simplicity and trust.
- Deliver a sustainable financial performance that ensures real financial security for our customers, within our risk appetite.
- Deliver products, processes and systems for all our channels and brands that are easy and simple to use.
- Be 'locally famous' and meaningfully engaged in our communities.

We are now focusing our energies on a £160m transformation programme, £60m of which will be invested in 2013. The wide-ranging programme will cover investment in our systems (including our risk and financial control systems), network, people and products. The scale of the investment will be reflected in increased costs in 2013 and beyond, and the likelihood therefore of a reduced level of profits in the next few years. This is a natural consequence of making

such an important commitment to building the business for the future and helping to secure the long-term sustainability of the Group.

WHAT MAKES THE YORKSHIRE DIFFERENT?

We have an amazing team of committed and enthusiastic people who have demonstrated their ability to rise to new challenges. We aim to recruit the best people and train them well so that they can protect and serve our members' interests.

A recent internal survey showed an impressive 82% of our people¹ are satisfied with the Yorkshire as their employer. This in turn leads to our lower absence and turnover rates, meaning we spend less of our members' money on recruitment.

It also means our members benefit from the continuity of well-trained people in their local branches, who are able to develop trusted relationships with them. It is important that we continue to develop our supportive and caring culture through regular face-to-face contact by me and my senior leadership team with all of our people.

Through recent mergers our numbers have increased from 2,327 employees in 2008 to 4,111 in 2012. Despite challenging economic times we have created over 250 new jobs in 2012 across the business.

I would like to take this opportunity to thank all our people for their continued commitment to serving the needs of our members and all their contributions to another excellent set of financial results.

HOW IMPORTANT IS CUSTOMER SERVICE?

Our commitment to delivering a consistent, market-leading customer experience is at the

¹Our N&P colleagues were not included in the sample for this survey question due to timing of the survey

core of our strategy. This is the reason why 9 out of 10 of our customers are happy to recommend us to their family or friends. Exceptional personal service across our branch and agency network and through our internet and phone channels is also demonstrated by continued high scores in our customer satisfaction surveys. Our Net Promoter Score² ranges from 32% to 54% across our main high street brands - compared to an average of just 15%³ for the banking industry.

Although we understand that being trusted by 100% of people 100% of the time is tremendously ambitious, and that we may never achieve it, this is the goal we strive for.

I believe that our Society has gained trust by being different from the high street banks. For example, unlike many others, we have continued to invest in our network of branches and agencies. In 2012 we opened four new branches and increased our agency network to 96, giving us 324 locations to serve our members across the UK.

To maintain this trust, it is vital we keep our promises and take corrective action if and when we make any mistakes or have inherited issues from mergers with other societies. We have reviewed and dealt with the payment protection insurance (PPI) issues we inherited in our mergers with the Chelsea and N&P and will continue to do this for any other such issues that arise.

We have kept our promise made to members at the time of the merger with the Barnsley Building Society. The Barnsley had invested £10m with two Icelandic banks that went into administration, leading to the merger

“We are proud of the customer experience we offer through all of our brands and channels.”

with the Yorkshire on 31 December 2008. At the time, the Yorkshire made a commitment to recovering these monies and, if successful, to consider making an ex-gratia payment from the proceeds to eligible Barnsley members. In the event, we recovered a total of £8.8m, which is the largest possible amount we could reasonably expect to realise. In 2012 we distributed funds to around 28,000 people who were members of the Barnsley at the time of the merger announcement and have remained members of the Yorkshire since.

Disappointingly, we had to spend a lot of time and money in 2012 administering the high volume of PPI and mortgage payment protection insurance (MPPI) mis-selling claims we received, largely at the hands of aggressive claims management companies and on policies that we had not sold. In over 90% of cases referred to the Financial Ombudsman Service they found no evidence of mis-selling and all of these cases have been overturned in our favour. Despite this, the cost to the Group of administering these claims has reached almost £1m. We feel strongly that this is unfair to our members.

We are proud of the customer experience we offer through all of our brands and channels and in 2012 we achieved a Financial Ombudsman Service overturn rate that's much better than the industry average⁴. We will continue to manage complaints to the highest standards, treating members fairly and resolving issues at their root cause.

WHAT DID WE ACHIEVE IN 2012?

- Our customer base grew by 6% to 3.5m.

- Our market share of new lending increased to a record 3.2%⁵ (from 2.9% in 2011).
- We opened over 340,000 new savings accounts - a record number. Our savers get real value, with the average rate across our savings range paid in 2012 being 2.45% compared to the latest available market average of 1.97%⁶. Members can also use our in-branch comparison tool to see how much better off they could be by saving with us.
- Our number of best buy⁷ mentions continued at high levels with 816 savings best buys and 2,399 mortgage best buys. That's an increase of almost 14% on 2011.
- We saw a significant increase in people switching to our N&P current account.
- We helped first time buyers, who accounted for nearly 40% of our total lending to home buyers. We also lent £0.5bn to borrowers with a loan-to-value of over 85%, supporting those buyers with smaller deposits.
- We showed our commitment to lend prudently to small and medium enterprise borrowers in our local communities by investing in the commercial lending arm of N&P and increasing lending by 82% on 2011.
- We strengthened our core capital position by executing a buyback of £235m of our remunerated capital. This does not provide the same quality of capital as retained earnings (and would have matured or become ineligible for regulatory purposes over the next five years). The buyback exercise was positively received by investors and generated £62m of profit for the Society in 2012.

- Through our Share Plans business we opened a further 101,000 accounts and consolidated our position as a major player in the SAYE and SIP markets - now serving 243 companies ranging from small enterprises to global companies. We also achieved success with our clients, winning five awards at the Employee Share Ownership Centre Awards and the Ifs ProShare Awards, including Best New Plan for Stagecoach Group plc.
- We won an impressive number of awards across the business:

CONSUMER MONEYFACTS AWARD

- **Best High Street Savings Provider**

MONEYNET AWARDS

- **Best Overall Mortgage Provider**
- **Best Offset Mortgage Provider**
- **Best Fixed Rate Mortgage Provider**
- **Best Debit Card for use Abroad**

MONEYFACTS AWARDS

- **Best Short Term Fixed Rate Mortgage Provider**
- **Best Long Term Fixed Rate Mortgage Provider**
- **Best Building Society Mortgage Provider**

MONEYWISE MORTGAGE AWARDS

- **Best Lender for Fixed Rates**
- **Innovator of the Year**

MORTGAGE FINANCE GAZETTE

- **Customer Service/Treating Customers Fairly**
- **Best Overall Lender**
- **Best National Building Society**
- **Best Online Lender**

²The Net Promoter Score refers to the net percentage of customers who, when responding to the question "how likely is it that you would recommend us to a friend or colleague?" would either strongly recommend or strongly detract from the organisation. ³Source: Sametrix 2012 Net Promoter® Benchmark Study of Consumers in France, Germany and the UK. ⁴Source: Financial Ombudsman Service, latest

published complaints data for the six months to June 2012. The overturn rate is the percentage of resolved cases where the ombudsman service made a change in favour of the consumer. ⁵Source: Bank of England secured gross lending to individuals and housing associations as at 31 Dec 2012. ⁶Average rates based on Savings Stock from CACI's Current Account and Savings Database (CSDB), currently covering 83% of retail savings market. Data as at last working day of November 2012. ⁷Source: Presswatch Financial from Kantar Media.

This success comes from always listening to our members and tailoring our products to meet your needs. We have successfully adopted Egg's leading-edge internet facility to bring extra benefits to our members. Secure Messaging and the Egg Money Manager facility are now available to all our customers who transact through the Yorkshire's website. We have also extended our relationship with Legal & General and they are now the sole provider of third-party financial advice, structured deposits and protection insurance products across the Group. We are committed to continuing to offer a wide range of financial services to our customers in the new, post Retail Distribution Review, world.

We listen to our members in a variety of ways including our ongoing programme of Member Panel surveys, our Member Forum, Member Question Time meetings and regular branch visits. These things help us to develop products and services that meet our customers' needs.

WHAT IS OUR MAIN FINANCIAL AIM?

Our aim is to deliver a sustainable financial performance to ensure real financial security for our members. We achieved this in 2012 with another profitable year for our Society. The key highlights include:

- Statutory profit before tax of £157m (2011: £130m).
- Core operating profit of £137m (2011: £163m).
- Strengthening our capital base with a Core Tier 1 ratio of 13.6% (2011: 12.6%).
- Achieving positive mortgage growth.
- Improving our asset quality and lowering arrears to well below the industry average⁸.

⁸Source: Council of Mortgage Lenders as at end 2012.

- Maintaining prudent levels of liquidity well above the regulatory requirement.

Our strength has also been verified by our external stakeholders. Our position from the three rating agencies - Moody's, Fitch and Standard and Poor's - has remained stable throughout 2012. We also achieved two highly successful wholesale funding transactions via the securitisation and covered bond markets.

The various processes that we use to periodically assess the Group's financial strength through a series of severe stress tests have verified our view that we have strong capital and funding positions with robust outcomes.

HOW ARE WE IMPROVING OUR SERVICE?

In my report last year, I set out plans for significant investment in many of our systems and processes. During 2012 this included:

- The successful integration of Egg customers into the Group.
- Improving the management of mortgage arrears through our Arrears Transformation Programme to help members who find themselves in difficulties.
- Beginning the integration of N&P processes and policies to standardise them across the business.
- Continued improvement of our mobile and e-commerce technology.

We also sold the business of our subsidiary Norwich and Peterborough Insurance Brokers Ltd. This sale was aimed at simplifying our business whilst ensuring our members continue to get the best possible products, service and value across all our

high street brands. We believe that they are now getting this across the whole Group through our relationships with Legal & General and RSA.

This was only the start of our transformation journey and we have now embarked on our major investment programme as mentioned earlier. We are continuing to simplify our core systems to make it easier for our members to do business with us. The Board's decision to approve the investment plans shows our commitment to maintain the momentum of the Group's development and drive towards achieving our vision and strategy for the long term.

ARE WE SUPPORTING OUR LOCAL COMMUNITIES?

As a mutual building society we genuinely care about the communities we live and work in, and will continue to support and invest in them. Our branch revitalisation programme has been a great success, with local marketing programmes increasing awareness of our services right at the heart of the communities in which we operate.

We are the employer of choice for many with around 2,400 people in our head office sites in Bradford, Cheltenham and Peterborough.

Our people continue to be good corporate citizens and regularly volunteer in their local communities. In 2012, they raised over £170,000 for both national and local charities and other good causes. We donated a total of £721,000 via the Society's Charitable Foundation, taking total donations to over £5m since its establishment in 1999.

We care about the environment and now recycle around 90% of our head office waste and over 80% from our branches. We have installed smart meters across the branch

network to monitor our energy use, and are improving efficiency as part of our branch refurbishment programme.

As well as our recycling and energy commitments, we now have a thriving bee community in the grounds of our head office and produce our own honey!

We are also supporting the broader community financially by remaining an active player in the social housing market as well as providing commercial mortgages to small and medium enterprises through our N&P Commercial Lending business.

SO WHAT'S NEXT?

With a number of the major banks still in crisis, now is the time for the Yorkshire to show that we are part of a new generation of better financial service providers. With our heritage of financial strength, passion for customers and our mutual heartbeat, we are perfectly placed to succeed and be the most trusted provider in the UK.

Chris Pilling
Chief Executive
20 February 2013