ANNUAL REPORT AND ACCOUNTS

Year Ended 31 March 2010

WEST BROMWICH
BUILDING SOCIETY

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Key Financial Highlights

- Core Tier 1 ratio increased from 6.8% to 11.8%
- Retail savings inflows of £2.9bn
- Prudential Liquidity increased from 20.3% to 25.5%
- Wholesale funding ratio decreased from 19.3% to 11.0%
- Residential mortgage arrears of 1.55% – a 12 month low
- Management expenses ratio down from 0.58% to 0.53%
- Underlying management expenses ratio down to 0.49%

> **“The last financial year, as our results reveal, has seen the Society taking positive and decisive steps to ensure we are equipped to take advantage of improved market conditions.”**

Chairman's Statement

Mark Nicholls

I was delighted to become Chairman of the West Brom in January 2010, taking over from my predecessor, Dr Brian Woods-Scawen, who stepped down after serving on the Board of the Society for more than five years. On behalf of the Board I thank Brian for his contribution.

I take up my appointment as Chairman at a time when the economic outlook remains uncertain and the West Brom is facing the challenges common to the sector. However, as Robert Sharpe outlines in his Chief Executive's Review, we are implementing changes which promise an exciting future for the Society, based on a Back to Basics strategy, where the Society plays to its strengths as a leading independent regional building society.

The year in focus

Against this economic backdrop, and with interest rates at an all-time low, building societies experienced intense competition for retail savings and severe compression of net interest margins. Despite this competition, the Society attracted some £2.9bn in new savings balances.

Our Back to Basics strategy has seen the Society's withdrawal from new commercial and non-prime residential lending and the repayment of around £800m of wholesale funding. Total assets were at £8.3bn at the end of the financial year.

In June 2009, the Society's capital position was significantly strengthened when we exchanged our entire Tier 2 Subordinated debt for Profit participating deferred shares (PPDS). This gave us one of the strongest Core Tier 1 ratios in the sector.

We continued to make steady progress over the year, including a notable decrease in the level of new provisions required to cover potential credit losses, primarily in respect of our commercial loans exposure. I believe this demonstrates the benefits of the rigorous approach of the new management team during the last financial year.

Board changes

It is vital to have a Board comprising individuals with the necessary skills and experience to oversee the Society's progress, particularly in the areas of risk management and corporate governance. Jonathan Westhoff joined the Society in May last year as the Group Finance Director. We also welcomed Martin Ritchley and Richard Sommers as new Non-Executive Directors in September and October 2009 respectively.

Jonathan, who joined us from Newcastle Building Society where he held a similar position, comes to the Society with a wealth of experience from more than 27 years in the industry. Martin is highly respected within the building society sector, having presided over the growth of the Coventry Building Society until his retirement as Chief Executive and Director in 2006. Richard brings to the Board extensive knowledge and expertise from nearly three decades in the financial services sector, most notably with the Barclays Group.

Mark Stansfeld stood down in October while John Bywater left the Board in December. We thank them both for their contribution to the Society.

As part of our succession arrangements, both Ed Hucks, currently Deputy Chairman and Senior Independent Director, and Bharat Shah will be retiring at the AGM in July. I am grateful to them for their service to the Society and the support they have given to me since I was appointed. As a result of their departure we will be seeking two additional Non-Executive Directors to join the Board.

Looking ahead

The past year, whilst not without its considerable challenges, has demonstrated that the West Brom's Back to Basics strategy is having the desired effect in steering us through the worst of the recession.

It is difficult to predict when the economy will begin to pick up in a sustained fashion. However, I believe our strategy will give us a firm foundation as we take the West Brom forward with confidence for the benefit of our members and the communities we serve.

I would like to take this opportunity to praise the considerable efforts of the new management team. They have not only ensured your Society continues as an independent and strongly capitalised entity, but have made significant progress in positioning the Society for the long term.

In closing, I would like to thank you, our members, for your continuing support. I look forward to an exciting and successful future as the economic climate improves and our Back to Basics strategy takes hold.

Mark Nicholls
Chairman
26 May 2010

Chief Executive's Review


Robert Sharpe

Introduction

It has now been just over 18 months since I joined the Society as Chief Executive. When I wrote last year's Review, my new Executive team and I had not, at that time, completed the planning to implement fully the Back to Basics strategy. This new strategy underpins the re-launching of the core building society and putting into run-off the non-core and, in some cases, loss-making activities into which the Group had diversified over the last 10 years. Whilst our trading results are again disappointing, they are markedly improved on the previous year, especially as the ultra-low interest rate environment has had a tremendous impact on our margin as we continued to support our savers by offering interest returns well above the Official Bank Rate. However, we have made significant progress during the last 12 months repositioning the Society and it is the detail of this progress that I want to share with members in this Review.

Economic overview – an uncertain recovery

Before going into the detail of my update it is appropriate to summarise the economic conditions in which we continue to operate. Despite some evidence that the UK economy moved out of recession in the final quarter of 2009, any recovery is still tentative, with unemployment remaining a threat and the housing and mortgage markets both showing only modest activity. Most significantly, the fragility of the recovery is evidenced by the Monetary Policy Committee maintaining Bank Rate at 0.5%, the lowest in the Bank's 316-year history. This backdrop, and the way in which the new Coalition Government deals with the country's deficit, will have a critical influence on the sector going forward.

Performance – progress in our Back to Basics strategy

Last year we set ourselves on a very clear course to reposition the West Brom to emerge from these unprecedented times as a traditional, strong and independent regional building society. This required us to focus on a number of key strategic objectives:

Exit non-core activities

The diversification I referred to earlier resulted in an expansion into commercial lending, mortgage broking, second charge mortgage lending and residential property letting. As the Business Review in the next section identifies, these activities have become a significant profit drain on the Society in recent years although, in the case of commercial lending, it did contribute positively up to 2007/8 and, whilst we have put this into run-off, we do expect to be able to return most of this lending to profit over the next two years.

During the period of run-off, we will conduct an orderly wind down of the non-core businesses, meaning that:

- We will not commit any further lending to the commercial property sector. This has indeed been the case since July 2008 when we announced our exit. Furthermore, we will look for repayment of all loans as they fall due and we have a clear policy of not offering new or extended terms. Whilst we have had very few scheduled maturities in the year, we have reduced our exposure by 5% and have declined requests for extensions to facilities. We have only renegotiated terms on 1% of commercial loans. In 31 cases, when repayment has not been made on the due maturity, we have taken full control of the assets under a LPA receivership.

- In the case of West Bromwich Homes, the Board concluded that it would not add any further investments and would, over time, respond to any opportunities to dispose of properties where it was economically advantageous to do so. In the meantime, we have reshaped the business and its suppliers and we forecast making the company's first trading profit in 2010/11. Previous profits have been attributable only to house price inflation. We believe that, going forward, the business must deliver a positive return on the rental activity rather than rely on increases in property values.

- In respect of the second charge mortgage business, Insignia, where we were not only the majority shareholder but also the sole funding source, we decided in early 2009 that no further lending would be undertaken. We have since taken control of 100% of the business and we are managing the portfolio of loans as a closed operation.

- The mortgage broking business, which has fared badly as numbers of transactions in the housing market have shrunk to a fraction of those experienced historically, has been sold.

I should emphasise that, whilst we have placed the 'Old' Group businesses into run-off, they are still being managed vigorously and commercially. We expect to return these activities to profit, but that will not detract from our determination to exit these businesses. Over the long term, they simply do not fit the Back to Basics building society business model, with its traditional and modest appetite for risk.

Reinvigoration of the core business

I am pleased to report to the members that we have made significant progress in the reinvigoration of the Society to reposition ourselves as a leading independent regional building society. Let me share with you some of the actions already taken, or planned to be taken, in the short to medium term to create the 'New' West Bromwich Building Society.

Strengthening capital and funding

As the economic downturn deepened, the Regulator became increasingly focused upon not just the total level of capital held by building societies, but the quality of this capital. Whilst, in terms of total capital, the Society's position was acceptable, a large proportion, some £182.5m of Subordinated debt, was held as Tier 2 capital, which was considered, under emerging stress tests applied by the Regulator and Rating Agencies, to be inferior in nature to Core Tier 1 capital, as it did not share in any losses that the Society may incur.

Hence, on 12 June 2009, the Society, working with the Financial Services Authority, converted this Tier 2 capital into PPDS. Although this did not change the total level of capital held, it increased dramatically the quality of this capital and resulted in the Society having one of the strongest Core Tier 1 capital ratios in the sector. This ratio now stands at 11.8% (2008/9: 6.8%).

Following the Society's, and indeed the building society sector's, downgrading by the Rating Agencies and the resultant scarcity of wholesale funding opportunities, the Society was required to replace a very significant proportion of its wholesale funding. This was achieved by an aggressive and successful campaign to attract retail funds. It provided the opportunity, despite Bank Rate being reduced to 0.5%, to offer both new and existing members market leading savings products and pricing for virtually the whole of the financial year 2009/10.

Cost control

In the last 18 months we have taken the necessary steps to bring our costs into line with the requirements of our operating model and the economic and market conditions. Our cost reduction has been 26.0% and we have reduced head count from 1,018 in October 2008 to a current figure of circa 800. This action has been one of the key drivers which has enabled us to maintain market competitiveness for our savings members.

Identifying the right operating model

Essential to the Board's new strategy is the branch network. In March we announced a significant restructure of our branches, reflecting our desire to concentrate on the Society's core traditional operating area, primarily Birmingham and the Black Country with a small presence in mid-Wales. Whilst this meant the closure of a few branches that fell outside the operating area, it enabled the Board to focus on its plans to develop the remaining branches.

There has been very little investment over the last decade in the 35 remaining branches. It is now our intention to commence a major refurbishment and relocation programme to provide you, our members, with comfortable, efficient and friendly branch premises where we can provide the level of customer service our members would expect from a leading regional building society. This project will take two to three years to complete and will run in tandem with a further project to identify and open new branches in our core operating area where we believe we can attract new members to the Society.

We have also developed our non-branch channels significantly. During the year, our post and telephony operation processed some £2.0bn of new funds. We now wish to extend the ways in which members can access our products beyond branch, telephone and post. To this end we launched, shortly after the year end, our internet offering 'WeBSave'.

New brand

During the course of 2010/11 we will be introducing a new brand for your Society; a brand which is vibrant, refreshing and positions your Society as a leading provider of financial services in the local high streets of both Birmingham and the Black Country. Our branch refurbishment and relocation programme will embrace the new brand, as will all of our literature and corporate style.

New head office

Our current head office at 374 High Street, West Bromwich, is over 30 years old and is very dated in terms of working conditions, technology and health and safety requirements. As we move into a new era with the 'New' West Bromwich Building Society, the Board believes it is appropriate to minimise the considerable cost of maintaining the existing head office premises and, instead, find a new modern building that members can take pride in and which supports the local community. With this in mind, we have commenced negotiations with Sandwell Council, Advantage West Midlands and Stoford Developments and have agreed in principle to sign a lease for a new head office premises on the All Saints site in West Bromwich. This will be the start of an exciting new period for your Society and we intend to invite many of our local members to attend the opening of the new head office in early 2012.

Residential lending

During the last 18 months it has been necessary for the Society to restrict severely its activities in new residential lending. As our new strategy gathers pace we intend to put the building blocks in place to return to the mortgage market in late 2010 or early 2011.

Delivering value

As you will see from the Business Review on the pages that follow, we have delivered exceptional value to our members during the last year by being focused on our Back to Basics strategy. Despite the losses incurred from the non-core businesses, we have sought to ensure that those losses did not affect our ability to offer our members great value. This is reflected in the fact that on average, since 2008/9, the amount of interest we have paid to our savers relative to Bank Rate has increased by some 1.1%. As a result, during 2009/10 we attracted gross inflows of £2.9bn and our residential mortgage book is now funded 1.29 times by retail savings.

At the beginning of this year the Society entered into two significant new business partnerships to improve our offering to members. We linked up with AXA, the world's largest insurance company, as the West Brom's preferred provider for investment, protection and pension products. We also teamed up with RSA, who will act as our sole provider of buildings and contents insurance policies.

Member involvement

As a mutual organisation owned and run primarily for the benefit of members, it is incumbent on the Society to ascertain their views and feedback. There are two primary forums for gathering the views of our members: the Annual General Meeting (AGM) and our Members' Forums where members are able to speak directly to the Chief Executive and other senior management. In the past year, Forums were held in Birmingham, Solihull and Walsall and have provided an opportunity to reassure members at a time when many people are feeling a sense of financial unease from the recent economic turmoil.

The Society has an array of other means for gauging the opinions of members, such as customer surveys, a mystery shopper programme and customer research on specific topics. These also represent another expression of the Society's engagement with Treating Customers Fairly, a key policy of both the Board and the Financial Services Authority in protecting and promoting the interests of members.

Our people – serving our members

Our people have again shown their characteristic dedication and resilience in coping with the demands of another exacting year when the financial services world has been under continual pressure as a consequence of economic and market conditions.

We have continued to strengthen our Executive and management team and we believe we now have an extremely strong and capable team to drive the strategy and business forward.

Our staff recognition scheme – the Shine Awards – is testimony to the qualities, skill, knowledge and hard work that we have in abundance among our people at the West Brom. We received numerous nominations from customers about the outstanding service they received from our people, an observation echoed in the very encouraging findings from customer surveys and the mystery shopper programme.

In spite of the cost cutting exercises our people have embraced the changes made at the Society and are committed to the Back to Basics strategy and the 'New' West Bromwich Building Society.

Outlook – positive prospects

We have been living through one of the most precarious economic periods in living memory and any prospective recovery is still at a very early stage. The West Brom, as with many in the building society sector, has certainly felt the brunt of the recession, but the last financial year, as our results reveal, has seen the Society taking positive and decisive steps to ensure we are equipped to take advantage of improved market conditions as the recovery gains momentum.

I have outlined the way in which the West Brom has positioned itself to look ahead with a renewed focus on its traditional strengths as a leading independent building society with a strong regional identity. I believe this will establish the West Brom as a building society that is modern and forward-thinking and one that will never lose sight of the overriding priority which has guided the Society since it first came into being – the unwavering determination to serve and reward the support and loyalty of all our members and to be a safe and secure place for their savings.

Robert Sharpe
Chief Executive
26 May 2010

Board of Directors at 31 March 2010

Huw Davies BA, MBA, FCA

Huw joined the Board as a Non-Executive Director in 2006, and is currently Group Finance Director with Wates, one of the UK's largest construction services and development companies. He has previously been Head of Corporate Finance with major house-builder, Taylor Woodrow. Huw is a member of the Audit & Compliance and Nominations Committees. He is 53.

Ed Hucks BSc (Hons), MSc

Ed joined the Board in 2000 as a Non-Executive Director and is now Deputy Chairman and Senior Independent Director. Ed has impressive experience of the building society sector, as a result of his time as an Executive Director at National and Provincial Building Society, and at the Financial Ombudsman Service where he was a Non-Executive Director. Ed is Chairman of the Audit & Compliance Committee and a member of the Remuneration and Nominations Committees. He is 65 and will be retiring from the Board after the AGM.

Lesley James CBE, BA (Hons), MA, CCIPD, FRSA

Lesley was appointed to the Board as a Non-Executive Director in 2001. She has a background in human resources and was Director of Human Resources at Tesco and held roles at a senior level with SavaCentre, Sketchley and RHM Bakeries. Currently, Lesley is a Non-Executive Director of St. Modwen Properties PLC and the Anchor Housing Trust, which provides housing services for the retired. Lesley is Chairman of the Remuneration Committee and a member of the Nominations Committee. She is 61.

Mark Nicholls MA (Cantab), MBA

Appointed to the Board as Chairman in January 2010, Mark has considerable experience of the financial services world. This includes his time at SG Warburg Group plc and, later, as Managing Director of the private equity group of the Royal Bank of Scotland. Mark also has extensive experience of building societies, previously holding non-executive directorships with Portman and Nationwide. He is Protector of the National Lottery Fair Share Fund. Mark is the Chairman of the Nominations Committee. He is 61.

Martin Ritchley FCA, FCIB, Hon DBA (Coventry)

Martin was appointed to the Board as a Non-Executive Director in September 2009, and is a much-respected figure within the sector, having worked for over 35 years with Coventry Building Society. For 16 years prior to his retirement in 2006, Martin was Chief Executive at the Coventry. Martin is a Trustee of the ARC Addington Fund, a charity which helps to maintain the economic and social fabric of the farming community. Martin is a member of the Audit & Compliance and Group Risk Committees. He is 63.

Bharat Shah FCCA

Appointed to the Board as a Non-Executive Director in 2004, Bharat was the CEO of EAMER, Kodak Consumer Imaging and Vice President, Eastman Kodak. He was also a Vice President of Singer responsible for Europe, Africa, Middle East and Asia. He is the Non-Executive Chairman of the Sure Group and a Non-Executive Director of the Places for People Group. He has been the Deputy Chairman of the Audit Commission since September 2007. Bharat is a member of the Assets & Liabilities Committee. He is 56 and will be retiring from the Board after the AGM.

Robert Sharpe

Appointed to the Board in October 2008 as Chief Executive of the Society, Robert has extensive experience in the financial services industry, having worked at the Bank of America, Bank of Ireland and, more recently, as Chief Executive of Portman Building Society. Robert is Chairman of the Group Risk Committee and a member of the Assets & Liabilities Committee. He is 61.

Richard Sommers BA, ACIB

Appointed to the Board in October 2009 as a Non-Executive Director, Richard is also presently Treasurer of Lady Margaret Hall, Oxford University. He has a strong track record in retail and commercial banking, having held a series of senior positions with the Barclays Group, including Chief Financial Officer with Barclaycard US and Risk Director of Retail Financial Services. Richard is a member of the Group Risk Committee. He is 53.

Jonathan Westhoff BA (Hons) Fin Serv, FCMA, ACIB

Jonathan was appointed to the Board in May 2009 as Group Finance Director. He has widespread experience in the financial services sector after spending more than 27 years in banks and building societies, including 17 years with Barclays Bank and as Finance Director of two other large building societies, Portman and Newcastle. Jonathan is a member of the Group Risk Committee and Chairman of the Assets & Liabilities Committee. He is 45.

Financial Review

The Board considers that the results, which represent a significant improvement compared with the year to March 2009, are satisfactory. Against a backdrop of an unprecedented interest rate environment, the Society has sought to hold up the income of its saving members by increasing substantially the mutuality benefit, paid through maintaining competitive interest rates throughout the year, despite the adverse impact on profitability. In addition, the business operations that the Society has chosen to exit under its Back to Basics strategy, primarily commercial property lending and second charge mortgage lending, have continued to suffer from the severe economic downturn, albeit very much less so than in the previous year.

Both the capital and liquidity positions of the Society remained strong, particularly following the issue of £182.5m of PPDS in June 2009, which increased the Core Tier 1 ratio from 6.8% to 11.6%; this ratio has strengthened further to 11.8% during the year.

Performance overview

The Group loss before tax, on a reported and underlying basis, is set out in the table below:

Year to 31 March	2010 £m	2009 £m
Reported loss before tax on continuing operations	**(18.5)**	(48.8)
FSCS Levy	**(5.4)**	12.2
Curtailment benefit on closure of pension scheme	**–**	(8.0)
Restructuring costs	**4.6**	4.1
Net gains from fair value volatility	**(2.7)**	(10.6)
Underlying loss before tax on continuing operations	**(22.0)**	(51.1)

The Reported loss for the year before tax on continuing operations of £18.5m was significantly less than the £48.8m recorded in the year to March 2009. Year on year, the underlying loss was more than halved, to £22.0m.

Overview by business division

The Group is organised into four main business divisions:

- Retail; incorporating residential lending, savings, investments and protection;
- Commercial; primarily representing loans for commercial property investment;
- Property; a portfolio of residential properties for rent; and
- Mortgage broking (discontinued).

The profit/(loss) before tax contribution from each division is summarised below:

Year to 31 March	2010 £m	2009 £m
Retail	**3.5**	5.2
Commercial	**(23.3)**	(41.4)
Property	**0.2**	(12.6)
Intercompany adjustments	**1.1**	–
Profit before tax on continuing operations	**(18.5)**	(48.8)
Mortgage broking (discontinued operations)	**(5.8)**	–
Total Group loss before tax	**(24.3)**	(48.8)

Retail

The Group's Retail division represents the core building society activity.

The contribution from the Retail division has been affected by the low interest rate environment as the Bank of England Monetary Policy Committee (the MPC) reduced Bank Rate from 5% in September 2008 to just 0.5% in March 2009.

Whilst the vast majority of borrowers have benefited from this reduction in interest rates, we have also sought to protect the income being earned by our savers, and this has resulted in a significant reduction in the margin for the Retail division. The headline movements were:

- The average interest rate paid by residential mortgage borrowers down from 5.4% to 3.3%; and
- The average rate earned by savers, relative to Bank Rate, increased by 1.1%.

The credit performance of the Retail division remains strong, with arrears levels continuing below the market average and, in most categories of lending, having fallen steadily over the last 12 months. Just 1.55% of accounts were in arrears by 3 months or greater by the end of the year, compared with 1.73% for the year to March 2009.

In a market with general uncertainty in respect of the economic recovery, our financial planners have advised more customers this year than in any previous years and have seen an increase of 7% in the amount of money invested in capital protected products.

We have worked hard to keep down the costs of insurance cover for our members and, after negotiating a new arrangement with RSA, we were able to hold the costs for the majority of our customers on renewal. Through RSA we have also been able to offer a new and competitive product range both through our branches and, since the year end, on-line.

However, due to the overall slowdown in volumes in the lending market, non-interest income did reduce year on year by 48%.

Commercial

The Board concluded, at the end of 2008, that commercial lending was inconsistent with its Back to Basics strategy. The focus is now on managing out the risk inherent within the closed book, against a backdrop of a severe downturn in commercial property values and continuing failures on the high street. As a result, we have invested heavily in establishing an experienced work-out team for this division.

Whilst the severe market conditions have resulted in the Group having to provide for significant impairments against this portfolio, which in turn is a prime driver of the Group loss for the year, the reduction in the level of net impairment provisions year on year, down from £48.7m in 2008/9 to £15.7m, is pleasing and reflects the rigour with which the portfolio is managed. However, there will be no relaxation in the Group's determination to manage away these exposures.

Property

The Property division results reflect the profit arising from the Group's residential letting operation (West Bromwich Homes Limited) and the changes in the value of these properties. Whilst an operating loss of £1.2m was recorded for the year to 31 March 2010 (2008/9: £1.7m), this was a result of higher funding costs which were only in part offset by cost efficiencies introduced and improvements in the management of the portfolio. As each of these only impacted partway through the year, the benefit of these initiatives has yet to be reflected fully in the division's performance.

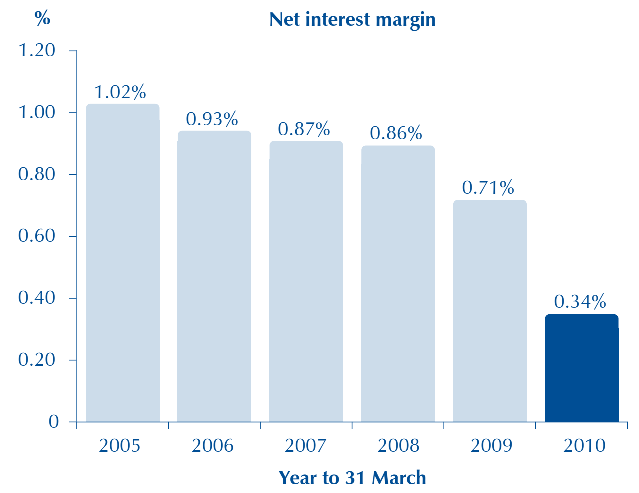
However, these actions, when combined with improvements in the housing market meant that, year on year, an overall loss of £12.6m in 2008/9, after the portfolio's value fell by some £10.9m, was turned into a profit of £0.2m.

Mortgage broking

A strategic review, which was concluded during the financial year, identified that the broking subsidiary, Mortgage Force, was not core to the Society's Back to Basics strategy and, consequently, the Board has now sold, subject to contractual conditions, this business. In addition to a small trading loss, of £0.4m, the exit of the business will require a write off of goodwill and intangibles of £5.4m. This has no impact on the Society's capital, as goodwill and intangible assets are deducted from capital resources when calculating capital adequacy.

Financial performance – Group

Net interest margin



The Net interest margin, effectively the difference between the interest received from those borrowing from the Group and the interest payable to investors with the Society, reduced to 0.34% (2008/9: 0.71%) resulting in net interest earnings falling to £29.7m (2008/9: £67.0m). This decline is a consequence of:

- the increased cost of retail savings as the Society has sought to protect savers from the unprecedented fall in interest rates. The rates being earned by our savers have increased on average by 1.1%, relative to Bank Rate;
- the lower returns available on the Society's liquidity portfolio, which is focused upon high quality investments such as gilts, cash, government guaranteed securities and treasury bills. As a consequence the yield on this portfolio has reduced; and
- increasing the duration of the Society's non-retail funding profile; at 31 March 2010, the average duration was 21 months compared with 13 months a year earlier.

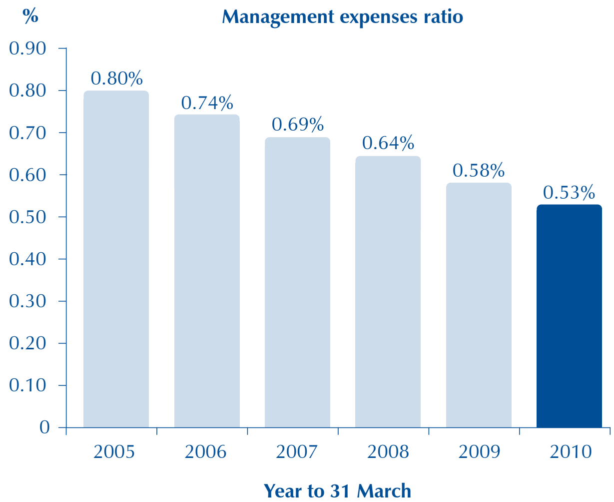
The Net interest margin is likely to remain subdued until Bank Rate increases.

Other income

Other income (excluding gains or losses on financial instruments), which represents income earned from the sale of insurance and investment products, together with fees earned on lending activity and rental income, decreased year on year to £10.4m from £15.2m.

The most significant impact on Other income, year on year, was the dramatic reduction in mortgage market volumes. This meant that income related to mortgage activity (fees, commission, protection and general insurance) reduced by £3.9m. Also, again reflecting the extreme market conditions, the Society received lower commission rates for investment sales, with income falling by around £0.8m.

Management expenses



The Management expenses ratio, a key measure of cost efficiency reflecting costs as a proportion of total assets managed, has reduced to 0.53% (2008/9: 0.58%). However, the underlying cost base, which excludes restructuring costs and gains from the cessation of the defined benefit pension scheme, reduced by 26.0%, resulting in an underlying Management expenses ratio of 0.49%.

Impairment provisions on loans and advances

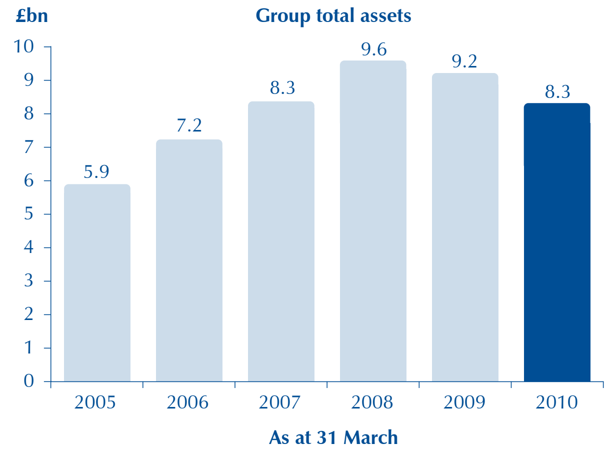
As at 31 March 2010 – Group	Commercial £m	Residential £m	Total £m
At 1 April 2009	50.6	31.6	82.2
Amounts written off	(7.9)	(10.9)	(18.8)
Discount unwind	–	–	–
Charge for the year	15.7	4.9	20.6
As at 31 March 2010	**58.4**	**25.6**	**84.0**

As at 31 March 2009 – Group	Commercial £m	Residential £m	Total £m
At 1 April 2008	2.4	22.4	24.8
Amounts written off	(0.5)	(6.9)	(7.4)
Discount unwind	–	(0.4)	(0.4)
Charge for the year	48.7	16.5	65.2
As at 31 March 2009	50.6	31.6	82.2

The charge for impairment losses on loans and advances was markedly lower than the previous year, down £44.6m to £20.6m. The focus on managing the risk within the commercial loan portfolio has been a key driver in this dramatic improvement. The underlying quality of our residential lending remains strong, with arrears, a lead indicator of potential impairment, improving year on year, in both prime residential and buy-to-let exposures.

Financial position

In the current environment, the Board deems it appropriate to conserve capital for the benefit of providing security to the Society's members and, accordingly, there is currently no reason to grow the balance sheet. With interest rates at an all time low, the need to provide savers with the best rates possible does mean that new lending remains uneconomic and is, therefore, not in the best interest of the Society's existing members. As a result of this strategy, Group total assets have reduced by 9.4% to £8.3bn.



Loans and advances to customers

Loans to customers primarily represent residential lending through the Society, West Bromwich Mortgage Company Limited and Insignia Finance Limited, and commercial property lending through West Bromwich Commercial Limited.

The Back to Basics strategy aims to rebalance, over time, the proportion of loans represented by traditional prime residential lending. Commercial property lending and residential second charge lending (Insignia) are in run-off following the decision to exit completely both of these sectors, but the maturity profile of the current exposures means that it may be another two to three years before a significant level of redemption is seen.

Residential

Retail residential mortgages represent prime advances made through the Society's branches and, historically, intermediary channels. This includes residential property acquired for letting (buy-to-let). Also included are mortgage portfolios acquired through the Society's subsidiary company, West Bromwich Mortgage Company Limited, although no such portfolios have been acquired since 2005.

At the end of the period, the residential lending portfolio was spilt; 36% prime owner occupied, 53% buy-to-let and only 11% acquired portfolios and other.

The low interest rate environment has clearly supported the ability of borrowers to maintain their repayments, despite the severity of the general economic downturn. Even so, the Group's residential arrears, at 1.55%, remains significantly below the sector average of 2.22%.

As at 31 March 2010 Group Arrears	Total Balances £m	3 months+ %
Prime	1,797.8	1.02
Buy-to-let	2,602.2	1.04
Acquired portfolios and other	523.1	5.16
Total	**4,923.1**	**1.55**

As at 31 March 2009 Group Arrears	Total Balances £m	3 months+ %
Prime	2,011.1	1.02
Buy-to-let	2,694.0	1.57
Acquired portfolios and other	585.4	4.67
Total	5,290.5	1.73

This year on year improvement is evident throughout the vast majority of the loan portfolio, however, it is particularly notable in relation to buy-to-let mortgages.

Commercial

Following an assessment of the relative risks associated with this type of lending, activity has been limited to the management of the run-off of the historic loan book. Consequently, balances secured on commercial property assets have reduced to £1,453m (2008/9: £1,537m), of which £367.9m is securitised (2008/9: £414.4m). In addition, loans fully secured on residential property portfolios managed by Commercial division have reduced to £124.5m (2008/9: £158.3m).

The Society is proactively managing the commercial loan portfolio and we believe that the overall impairment charge should have peaked during the 2008/9 financial year at £48.7m. This is reflected in the reduction in impairment charge for the year to 31 March 2010 to £15.7m, net of £7.9m of write-offs.

The sector split of commercial provisions is as follows:

As at 31 March	2010 £m	2009 £m
Healthcare & Leisure	**1.2**	4.1
Industrial & Warehouse	**1.2**	–
Office	**1.1**	0.8
Retail	**30.5**	27.0
Other	**10.2**	0.8
Collective	**14.2**	17.9
Total	**58.4**	50.6

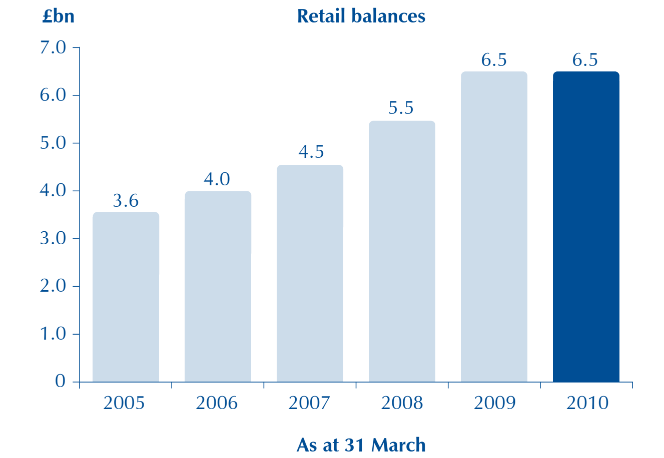
Although impairments have historically peaked one or two years after the low point of a recession, given the detailed account management of the portfolio and the significant charges over the last two years, the Society anticipates that the charge for the year 2010/11 will, once again, be lower than the current year charge.

Funding

The severe and sustained turbulence in the money markets has resulted in a shift in the sources of funding available to the building society sector. The West Brom has not been immune to this impact. Regulatory developments in liquidity requirements, combined with lower external ratings and competition for retail funding, have all played a part in this shift. However, the Society has responded well to these external pressures to ensure that it maintains a high level of good quality liquidity and a strong, low risk funding position.

Retail

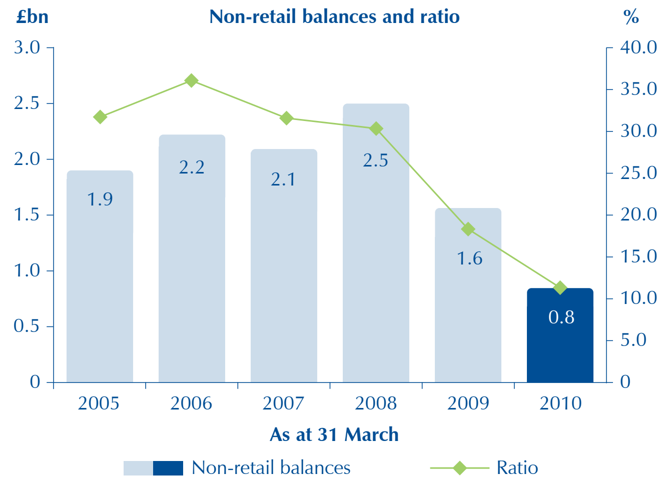
In line with its Back to Basics strategy, the Society has increased the proportion of its funding that comes from retail member deposits such that 89.0% (2008/9: 80.7%) of its funding is now obtained from this source. In a highly competitive market the Society was able to maintain total retail deposits at a record level of £6.5bn such that residential mortgage assets are now funded 1.29 times (2008/9: 1.20 times) by these deposits.



The main driver in retaining and attracting new retail customers is the Society's focus on providing members with a consistent and valuable return on their savings. The retail markets will remain the prime source of funding for the Society.

Non-retail

The reduction in the Society's reliance on the wholesale markets can be seen in the fall in its non-retail funding ratio from 19.3% as at 31 March 2009 to 11.0% at 31 March 2010.

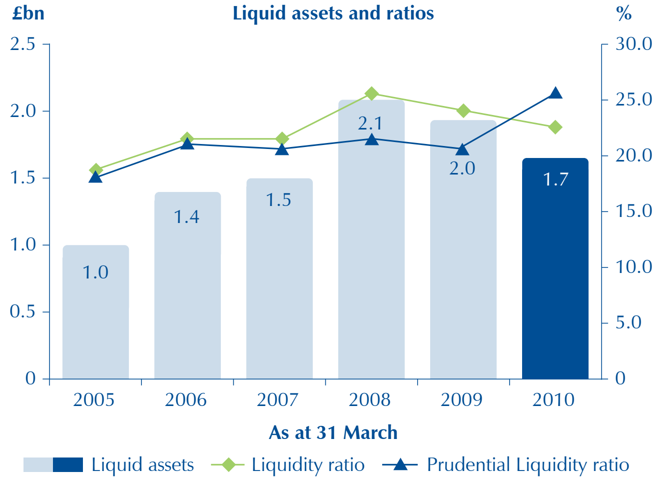


The table below analyses the change in the makeup of the Society's non-retail funding:

As at 31 March Non-retail funding sources	2010 £m	2009 £m
Repo and other secured agreements	**506.6**	470.2
Deposits	**236.9**	958.8
Certificates of deposit	**7.5**	75.0
Medium term notes	**56.6**	58.8
Total	**807.6**	1,562.8

During the year, management focused on extending the maturity duration of its non-retail funding liabilities. The average duration at the year end was 21 months compared with 13 months as at 31 March 2009.

Liquidity



The Group has a strong liquidity position which is supported by our loyal and stable customer base. This is reflected in its Liquidity ratio, a measure of the proportion of the total shares and borrowings that are held in the form of cash or highly liquid assets, of 22.5% (2008/9: 24.9%).

The focus of the Board remains on the quality of investments held in the Society's liquidity portfolio and hence driving up the Prudential Liquidity ratio to 25.5% (2008/9: 20.3%). As at 31 March 2010, 92.2% (2008/9: 89.3%) of the Group's treasury investment assets were rated single A or better. The Group continues to have no exposure in its liquidity portfolio to the emerging markets or any mortgage market other than the UK. The table below shows the ratings assigned against the Group's treasury investment portfolio:

As at 31 March Rating	2010 £m	2009 £m
AAA	**960.3**	1,459.5
AA+ to AA-	**510.2**	201.7
A+ to A-	**44.3**	136.6
Building Societies	**119.1**	207.0
Other	**8.2**	9.0
Total	**1,642.1**	2,013.8

The Society employs a rigorous credit assessment process and considers the risks of all assets before they are acquired and throughout the period they are held. Treasury assets are valued using quoted market prices or prices obtained from counterparties (see Note 31). The Society has continued to manage liquidity prudently in the light of market conditions and in anticipation of ongoing regulatory developments. No impairment charges were required against any treasury investment assets in the year.

Capital structure

Capital is held as the ultimate protection for depositors. The Board sets the internal level of capital with the aim of ensuring capital levels are always above minimum regulatory requirements.

The risk weighted assets are calculated by asset class under Basel II using the Standardised approach; this provides an estimate of credit, market and other risks associated with each asset and counterparty.

The following table shows the composition of regulatory capital and the capital ratios of the Group for the years ended 31 March 2010 and 31 March 2009 respectively. As at 31 March 2010, total regulatory capital stood at £518.5m (2008/9: £540.3m) with the Group's total solvency strengthening to 14.3% (2008/9: 14.1%) driven by the reduction in risk weighted assets.

As at 31 March	2010 Basel II Standardised	2009 Basel II Standardised
Regulatory capital	**£m**	**£m**
Tier 1		
General reserves	**258.5**	278.3
Permanent interest bearing shares (Note 1)	**74.9**	74.9
Profit participating deferred shares (Note 2)	**179.9**	–
Intangible assets (Note 3)	**(7.2)**	(11.1)
Deductions from Tier 1 capital (Note 4)	**(4.9)**	(5.9)
	501.2	336.2
Tier 2		
Revaluation reserve	**3.8**	4.6
Subordinated debt (Note 2)	**–**	184.3
Collective impairment allowance	**18.4**	21.0
Deductions from Tier 2 capital (Note 4)	**(4.9)**	(5.8)
	17.3	204.1
Total capital	**518.5**	540.3
Risk weighted assets – Pillar 1		
Retail mortgages	**1,935.3**	2,161.6
Commercial loans	**1,182.1**	1,172.9
Treasury	**182.6**	181.0
Other	**160.4**	165.5
Market risk	**35.9**	23.9
Operational risk	**120.6**	125.0
	3,616.9	3,829.9
Key capital ratios		
Core Tier 1 (%) (Note 5)	**11.8**	6.8
Tier 1 ratio (%) (Note 5)	**13.9**	8.8
Total capital (%) (Note 5)	**14.3**	14.1
Tier 2 to Tier 1 ratio (%)	**3.5**	60.7

Notes

(1) Permanent interest bearing shares and Subordinated debt include any fair value adjustments and adjustments for unamortised premiums and discounts.

(2) During the financial year the Society exchanged the full nominal value of its Subordinated debt for an equal value of Profit participating deferred shares (see Note 27 to the accounts).

(3) Intangible assets do not qualify as capital for regulatory purposes.

(4) Certain deductions from capital are required to be allocated, 50% to Tier 1 and 50% to Tier 2 capital.

(5) Calculated as relevant capital divided by risk weighted assets. Core Tier 1 relates to Tier 1 capital excluding Permanent interest bearing shares.

During the year the Society exchanged its entire Tier 2 Subordinated debt for an equal amount of PPDS, a new form of capital for building societies that qualifies as Core Tier 1 capital ('the Capital Exchange').

Following this Capital Exchange, the Group's Core Tier 1 ratio immediately increased from 6.8% to 11.6%, thereby demonstrating the resilience of the West Brom in the face of severe stress test scenarios. Since then the ratio has further strengthened to 11.8%. We believe this is one of the highest Core Tier 1 ratios in the sector. Further details of this transaction are shown in Note 27 of this Annual Report.

In addition to this Capital Exchange, we have strengthened further our capital base through a managed reduction of balance sheet exposures following the withdrawal from all lending other than prime residential mortgages. The detailed capital disclosures required under Basel II Pillar 3 are available on the Society's website.

Pension schemes

The Society operates a defined benefit and a defined contribution pension scheme. The total deficit of the defined benefit scheme at 31 March 2010 was £2.0m (2008/9: £1.6m). During the previous financial year, the Society announced the closure of the defined benefit scheme which realised a cessation gain of £8.0m in the Income Statement for the year ended 31 March 2009.

The Society will continue to monitor the deficit in the defined benefit scheme to manage the fund in a responsible manner, with the aim of eliminating the actuarial deficit in line with a plan agreed with the Trustee, within the next three to seven years. The Society made special contributions of £5.0m during the year (2008/9: £nil).

Risk Management and Control

Introduction

Effective management of risks and opportunities is essential to achieving the Society's corporate objectives.

The Board's approach to risk management includes the following steps:

- Identification of key risks;
- Assessment of the impact and likelihood of occurrence;
- Introduction of controls to limit the impact and/or reduce the likelihood;
- Monitoring the effectiveness of the controls; and
- Dealing effectively with risks which crystallise.

During the last financial year the Board has undertaken a thorough review of risk management arrangements and introduced a revised framework. The various components of this framework are described below.

Risk management framework

At the most fundamental level, the Society's activities are governed by its constitution, principles and values. Having established a Statement of Principles, the Directors agreed a set of statements, in May 2009, which describe the Board's risk appetite in terms of a number of key areas, including profitability, capital, liquidity, arrears, customer service, people and regulatory compliance (the Society's Risk Appetite Statements).

These Risk Appetite Statements then drive corporate planning activity and capital and liquidity planning as well as providing the basis for key risk measures.

The final element of the framework is the formal structure for managing risk across the Group. This is based on the '3 lines of defence' model which is illustrated below.

	Activity	Responsibility	Governance
1st	Business Operations	Line Management	Line Management Oversight
2nd	Policy Identify Assess Monitor	Control Functions	Management and Board Committees
3rd	Assurance	Internal Audit	Audit & Compliance Committee

Key risk categories

In order to identify the key risk categories most relevant to the Society, the Board considered an overall risk universe relating to firms in the financial services sector. This was distilled into nine material risk categories as shown in the table below.

Risk Category	Society Definition
Business Risk	The risk to the Society arising from changes in its business, including the risk that it may not be able to carry out its business plan and/or its desired strategy. This may be due to changes in the competitive environment or events which damage the operating economies of the Society (e.g. competitor activity or changes in regulation and/or taxation).
Credit Risk	The risk that material unexpected losses may arise as a result of borrowers, creditors or market counterparties failing to meet their obligations to repay.
Concentration Risk	The risk of losses arising due to the concentration of exposures which have a significant positive correlation (e.g. in terms of geography, industry sector, major counterparty etc), or are influenced by common external factors.
Liquidity Risk	The risk that the Group, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost.
Market Risk: Interest Rate Risk	The potential risk of movements in interest rates having an adverse impact upon planned future cash flows.
Market Risk: Other	The risk of potential losses or decrease in value of the balance sheet as a result of adverse market movements.
Operational Risk	The risk of loss and/or negative impact resulting from inadequate or failed internal processes, people and systems, or from external events.
Pension Liability Risk	The risk that there will be a shortfall in the value of the pension fund assets over and above the guaranteed liability to its employees under the defined benefit pension scheme. This may result from a number of sources including Market risk, Equity risk and/or mortality rates.
Residential Property Holding Risk	The risk of losses in the collective value of the Group's residential property portfolio following a general decrease in property prices both locally and nationally.

For each of these categories, key external and/or legacy related risks have been identified and assessed for impact and likelihood. This provides a 'top down' view of the main risks facing the Society. In addition, the Society's key processes have been identified and the main risks to those processes identified and assessed, giving a 'bottom up' view. The Group Risk Committee, established in 2009, meets quarterly, as a minimum, to review the combined view of the Group's risks.

For each risk and key process, the key mitigating controls have been identified and the effectiveness of the controls is monitored through a control risk self-assessment process. The self-assessment process itself is reviewed by the relevant control function, with assurance provided through the Internal Audit programme of reviews.

Principal risks and uncertainties

Set out in the table below are the key external and legacy risks which have been identified by the Group Risk Committee.

Risk Category	External/Legacy Risk	Controls and Activity
Business Risk	Continuation of ultra-low interest rates (leading to further strain on margins)	Business plans have modelled the impact of a range of interest rate scenarios. Income projections are reviewed regularly to identify mitigation actions.
Credit Risk	A sharp increase in Bank Rate (leading to increased arrears and losses)	Given the level of Base Rate Tracker mortgages, higher rates would improve margins. The Society would expand its credit management resource to manage any arrears impact. The Society's provisioning models take into account the impact of higher interest rates.
	Higher unemployment (leading to increased arrears and losses)	The Society's provisioning and stress testing models assume a range of unemployment levels. Should an increase occur, the Society would expand its credit management resource.
	Reduction in property prices (leading to a higher incidence of voluntary possessions)	The Society is committed to working with borrowers to avoid possession whenever possible. In the event that possessions were to increase the Society has provided prudently and regularly reviews its impairment provisions.
	'Double dip' recession (leading to further tenant failures)	The Society already has a well resourced and highly experienced team in place dealing with commercial property mortgages and, as has been the case throughout 2009/10, would work with borrowers to lessen the impact. The Society has set aside impairment provisions to limit the impact of losses.
Concentration Risk	Overexposure to non-prime residential lending (leading to losses if those exposures are affected disproportionately)	Known exposure to commercial mortgages is the subject of continuing intensive attention. The exposure to buy-to-let mortgages is acknowledged but, currently, these mortgages are performing well. If this were to change the Society would increase the resource available to handle any increased activity.
Liquidity Risk	Removal of Treasury backed support (requiring additional funding)	The Society's current funding plan takes account of the maturity of the Credit Guarantee Scheme.
	Intensification of competition for retail funding	The Society continues to attract new retail savers despite intense competition. Balance sheet growth plans ensure this risk is minimised.
Operational Risk	Insurance arrangements do not sufficiently cover an event (requiring the Society to pick up the cost)	The annual review of insurance arrangements is based on advice from brokers and an annual benchmarking exercise.
Pension Liability Risk	Increased longevity, higher (than anticipated) inflation, poor investment returns (requiring the Society to contribute more to the scheme)	The defined benefit scheme is closed to new members and existing members are no longer accruing service benefits. The Trustee takes extensive advice (actuary, investment advisers etc) to minimise the impact of the identified risks.
Residential Property Holding Risk	House price falls (leading to a reduction in book value of the residential letting portfolio)	The intention is to gradually dispose of the properties over time.

Day-to-day risk management and governance

Primary responsibility for risk management, including the design and operation of effective controls, rests with the management of each business function – the 'first line of defence'. Support and challenge is provided through specialist risk functions – Credit risk, Operational risk and Assets & Liabilities Management – the 'second line of defence'. These functions develop and review policies, monitoring and supporting compliance with those policies, and supporting the business functions to manage risk. Governance and oversight is provided through the Group Risk and Assets & Liabilities ('ALCo') Committees.

Independent assurance is provided by the Internal Audit function – the 'third line of defence', which has a direct reporting line into the Audit & Compliance Committee.

Credit risk

Credit risk refers to the risk that a customer or counterparty to a contract will not be able to meet their obligations as they fall due. For the purposes of the Group, this normally means the risk that a borrower will not repay their mortgage loan, or that a financial institution will not repay funds invested by the Society in that institution.

In the current constrained operating environment, the Society is engaged in only minimal lending activity, principally to existing borrowers. All such lending is in accordance with the Group's credit policy, which is consistent with the risk appetite established by the Board. Currently, no new non-conforming property lending (i.e. commercial, buy-to-let, sub-prime or self-certified) is being undertaken.

In 2008/9 the Group established a dedicated Credit Management Division (previously part of the Operations Division) to increase the skills and resource available to manage mortgage arrears. This has entailed a considerable investment in the team managing the legacy book.

The Group's exposure to residential and commercial credit risk is managed by a specialist Credit Risk department with a reporting line into the Group Finance Director. The Credit Risk department is responsible for setting the risk management policy and associated limits. It also provides regular reports to the Group Risk Committee, which is chaired by a Non-Executive Director and includes the Chief Executive, Group Finance Director and one other Non-Executive Director as members.

Additionally, Credit risk can occur within treasury transactions (used to meet liquidity requirements and those hedging instruments used for interest rate risk purposes). This type of Credit risk is managed by the Assets & Liabilities Management ('ALM') team. On a daily basis, ALM monitors exposures to counterparties and countries, and ensures the Group is operating within its Board approved limits. The Assets & Liabilities Committee ('ALCo') and the Board review the Treasury Policy and limits, with reports presented to ALCo on a monthly basis confirming compliance with such policy limits.

Throughout the last financial year, the Group has maintained a conservative approach to its liquidity management, investing for shortened periods with highly regarded financial institutions. The Group has also moved towards a position of holding a significant proportion of liquidity in the form of Government guaranteed stock, which is considered to be both highly liquid and secure. Treasury operates a strict control framework and exposures are monitored on a daily basis.

Market risk

Market risk relates to the possible changes in value of, or income arising from, the Group's assets and liabilities as a result of changes in interest/exchange rates or equities. Market risk exposures are managed through the Group Treasury department which is responsible for managing the Group's exposure to all aspects of Market risk within parameters set by the Board. ALCo reviews the Treasury Policy, recommending changes to the Board as appropriate, and ensures that regular reports on all aspects of Market risk (including interest rate risk and foreign currency risk) are assessed and reported to the Board. The principal Market risk within the Group relates to interest rate risk; which arises within the balance sheet as a result of the timing differences of the interest rate re-pricing between the Group's assets and liabilities. To mitigate this, the Treasury department uses balance sheet hedging (for example, matching 2 year fixed rate mortgages with 2 year fixed rate saving bonds) and derivative instruments. The use of derivatives is only permitted in accordance with the provisions of the Building Societies Act 1986, which places restrictions on their use.

The maximum level of interest rate risk is governed by the Board approved Treasury Policy in line with the Group's risk appetite.

In line with best practice and Basel guidelines the Group considers the impact of a +/- 2% parallel shift in the yield curve. However, in the day-to-day management of the Group the impact of alternate scenarios are also considered.

Interest rate sensitivity also arises from the potential for different interest rates to move in different ways, for example, Bank Rate mortgages funded by LIBOR-linked liabilities. The impact of these mismatches (basis risk) are monitored by ALM and reported to ALCo. Action is taken to keep any mismatch within a desired range, which could include changing our product mix or the use of derivatives.

The Group's main exposure to equities is through its defined benefit pension scheme. While the Group does attract funds through index-linked savings products, all exposures to equity indices are fully hedged. The Group has a negligible net exposure to exchange rates.

Liquidity risk

Liquidity risk refers to the risk that the Group may not be able to meet its financial obligations as they fall due, or is only able to do so by taking measures which involve an excessive cost. Mortgage lending is usually for terms of up to 25 years while savings accounts have a shorter duration, generally for no more than 5 years. This leads to a mismatch between assets and liabilities, known as 'maturity transformation'.

The Group has a low risk appetite in respect of Liquidity risk and has a liquidity policy to maintain sufficient high quality liquid resources to:

- cover cash flow imbalances;
- cover fluctuations in funding;
- retain full public confidence in the solvency of the Group; and
- be in a position to meet its financial obligations.

This is achieved through maintaining a prudent level of liquid assets, using a broad range of funding facilities and through controlled management of the growth of the business.

Wholesale funding remains scarce throughout the market and the Society has responded to this through a succession of initiatives to obtain retail funding. During the year, the Society has raised wholesale funds using HM Treasury's Credit Guarantee Scheme, which has provided £500m of stable funding until 2012. Inclusive of this funding, the Society's wholesale funding ratio remains extremely low, with negligible amounts of short-term refinancing risk.

The Group has adopted a prudent approach to liquidity management since the start of the 'credit crunch', in spite of the negative impact on the Group's margin. The following table illustrates the composition of the Group's current and historic liquidity portfolio:

Investment	2010	2009
Short term (up to 3 months)	**21%**	19%
Gilts/T.bills/Government Guaranteed Debt	**44%**	61%
Longer Term investments (over 3 months)	**21%**	8%
'AAA' UK Prime Residential Mortgage Backed Securities	**14%**	12%

The Group has a contingency funding plan, agreed at Board level and reviewed at least annually.

ALCo monitors Liquidity risk and also receives regular updates on the liquidity position, including the outputs from a wide range of stress tests. The scope and nature of the liquid assets held by the Group complies with applicable regulatory guidelines.

The development of the approach to liquidity management has positioned the Group to comply with the new FSA Liquidity standard due to come into effect during the financial year 2010/11. This includes the new Individual Liquidity Adequacy Assessment approach.

Operational risk

We have adopted a commonly used definition of Operational risk – the risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.

Each business function has a clearly articulated responsibility for identifying, monitoring and controlling its operational risks. The business function receives support and guidance from the Operational Risk team, which co-ordinates regular reviews with the function managers and collates the output for review by executive management and the Group Risk Committee.

The Risk Division also provides independent input and challenge to the business functions, both through the regular review of operational risks and day-to-day business initiatives.

Tax risk

The Group is subject to the tax laws in all countries in which it operates, but principally this risk is UK based. Tax risk is the risk associated with changes in tax law or in the interpretation of tax law when applied to business activities. It also includes the risk of changes in tax rates and the risk of failure to comply with procedures required by tax authorities.

Failure to manage tax risks could lead to additional tax charges and a corresponding reduction to profit after tax. It could also lead to financial penalties for failure to comply with required tax procedures or other aspects of tax law.

If, as a result of a tax risk materialising, the tax costs associated with particular transactions are greater than anticipated it could affect the value generated from those transactions. The Group takes a responsible approach to the management and control of its tax affairs and is cooperative in its dealings with the tax authorities.

Capital management

The Group conducts an annual Internal Capital Adequacy Assessment Process (ICAAP) covering all risks. This is used to assess the Group's capital adequacy and determine the levels of capital required going forward to support the current and future risks in the business. This analysis is collated into an Internal Capital Assessment (ICA) that is approved by the Board. The ICA incorporates expected future capital requirements from changes in business volumes, mix of assets and activities within the context of current and anticipated future risks, and multiple, stressed scenarios. The ICA is used by the FSA to set our capital requirements as Individual Capital Guidance (ICG). The detailed breakdown of the Group's capital position can be found on page 12.

Future developments and outlook

As already observed in the Chief Executive's Review, whilst the economy is showing signs of improvement, the future remains uncertain. At the time of writing, the outlook for the economic recovery is not clear and, accordingly, it may be that interest rates stay at very low levels for some considerable time.

This being the case, when combined with the Society's resolve to support members by offering the best rates possible, the timing of a significant recovery in the Net interest margin is not easily predicted. However, should the economy maintain its recovery, then corporate failures, principally on the high street, should decrease and, consequently, reduce the level of any further provisioning reported in respect of the commercial book.

The ongoing focus on exiting the run-off businesses should continue to improve the Society's balance sheet quality and capital position, enabling it to achieve the goal of repositioning the West Brom as a leading, independent regional building society.

Jonathan Westhoff
Group Finance Director
26 May 2010

Directors' Report

The Directors are pleased to present their Annual Report, together with the Audited Accounts, for the financial year ended 31 March 2010.

Business objectives

The main purpose of the Society and its subsidiaries (the Group) is to work together to meet the prime financial needs of our members. This entails provision of a diverse range of personal financial services, offering competitive pricing and excellent service. Underpinning this objective are the Society's core values, which are: to pursue sustainable success, treat everyone fairly, behave as a good corporate citizen, take personal responsibility, and pursue excellence in all things. During the year the Society has further embedded its Back to Basics strategy and this has resulted in the decision to close operations in its multi-tied financial services provider, Insync and the sale of Mortgage Force Limited.

Business review

The Group's business and future plans are referred to in the Chairman's Statement on page 2, the Chief Executive's Review on pages 3 to 5 and the Business Review on pages 7 to 17.

Profit and capital

The Group's loss before tax on continuing operations amounted to £18.5m (2008/9: £48.8m). The total loss after tax transferred to General reserves was £17.0m (2008/9: £39.3m).

The total Group reserves at 31 March 2010 were £260.2m (2008/9: £265.3m) after taking into account a Revaluation reserve of £3.8m (2008/9: £4.6m) and the Available for sale and Cash flow reserves of deficit £2.1m (2008/9: deficit £17.6m).

Gross capital at 31 March 2010 was £515.0m (2008/9: £530.2m) including £179.9m of Profit participating deferred shares (2008/9: £190.0m Subordinated debt) and £74.9m (2008/9: £74.9m) of Subscribed capital. For further details see page 90.

The main Group ratios were as follows: Gross capital ratio; 7.01% (2008/9: 6.54%), Free capital; 5.38% (2008/9: 5.05%) and Liquidity ratio; 22.47% (2008/9: 24.95%).

Key performance indicators (KPIs)

The Society measures its performance against its strategic aims by reference to a number of key performance indicators. These indicators are primarily financial in nature but also include a number of non-financial measures. The following table identifies and explains the key performance indicators that have been used by management for determining Group performance compared to the Corporate Plan. Where any of these measures are different from reported IFRS results, they should be seen as complementary to, rather than replacements for those results. Performance against financial KPIs is covered in the Business Review from page 7.

Measure	KPI		Calculation	Relevance to Society strategy
Capital	1	Core Tier 1 ratio	Proportion of risk weighted assets covered by Core Tier 1 capital of: General reserves, Subscribed capital, Profit participating deferred shares less intangible assets and other deductions.	Maintain a capital and liquidity position to reflect the risk appetite of the Society.
	2	Solvency ratio	Proportion of Risk weighted assets covered by Total capital of: Core Tier 1 capital plus Revaluation reserve, collective impairments allowance less certain deductions.	
Financial	3	Wholesale funding ratio	Wholesale funding as a percentage of shares and borrowings less non-recourse finance.	Maintain a focus on retail savings as the Society's core funding source.
	4	Lending limit	Proportion of Total assets not in the form of loans secured on residential properties.	Under its Back to Basics strategy, the Society will focus on prime residential mortgages.
	5	Prudential liquidity	Proportion of total Shares and borrowings that are held in the form of cash or highly liquid assets (incl Treasury Bills).	Maintain strong liquidity in order to ensure savers can access their funds whenever they so desire.
	6	Immediate cash	Proportion of liquid assets that are held in the form of cash or assets that can be converted to cash within 8 days.	Maintain strong liquidity in order to ensure savers can access their funds whenever they so desire.
	7	Underlying operating profit	Profit before impairment charges, investment property revaluation movements and exceptional items.	Restore the core Society and businesses in run-off to profit.
	8	Impairment charge	Total charge for impaired residential and commercial assets.	Maintain an intensive management of the Credit risk inherent in the balance sheet.
	9	Asset composition	Proportion of mortgage assets classified as Prime residential.	Under its Back to Basics strategy, the Society will focus on prime residential mortgages.
	10	Residential arrears	Residential Mortgage balances 1.5%+ in arrears/possession as a percentage of total book.	Maintain the quality of the Residential lending portfolio.
Customers/People	11	Customer satisfaction surveys	Customer satisfaction scores for each of the last three months.	Deliver an improvement in service and access levels through the reinvigoration of the core Society.

Risk management

As the Society operates in a very competitive environment, the management of risk and development of a suitable strategy are critical activities in achieving business success.

The Board and the Board Committees ensure that risk management and strategic direction are considered regularly, and that appropriate actions are implemented. These considerations are detailed in the Society's Internal Capital Adequacy Assessment Process (ICAAP) document which is part of the Basel II process.

The principal risks inherent to our business and details of how these risks are managed are set out in the Business Review (pages 13 to 17).

In addition to these principal risks there are, as a result of the current uncertain economic environment for banks and building societies, the ongoing actions under the FSA's supervisory review process, which include extensive stress testing exercises. The Directors are aware, in arriving at their judgements, that the Society will be subject, in the same way as others within the sector, to these ongoing tests of capital, and recognise the uncertainty inherent in the process as factors within each test change.

Financial risk management objectives and policies

The Society's objective is to minimise the impact of financial risk upon its performance. Financial risks faced by the Group include interest rate, credit, liquidity and currency risks. The Group manages these risks through a risk management framework, Board policies and its Treasury and Credit risk functions. Governance and oversight is provided through the Group Risk Committee and ALCo. Details of the Society's financial instruments, hedging activity and risk mitigation can be found in Notes 11 and 31 to the Accounts.

Mortgage arrears

At 31 March 2010 there were 211 (2008/9: 180) residential and commercial mortgage accounts where payments were 12 months or more in arrears based on current monthly repayments. The total amount outstanding on these accounts was £58.1m (2008/9: £30.0m), representing 0.91% (2008/9: 0.19%) of mortgage balances, and the amount of arrears was £3.6m (2008/9: £1.6m). Appropriate provisions were made for potential losses on mortgages in accordance with the provisioning policy set out in Note 1 to the Accounts.

Directors

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

John Bywater (to 31 December 2009)
Gary Cowdrill* (Group Finance Director – to 1 May 2009)
David Huw Davies
Edwin Hucks (Senior Independent Director and Deputy Chairman)
Lesley James CBE
Mark Nicholls (Chairman – from 1 January 2010)
Martin Ritchley (from 1 September 2009)
Bharat Shah
Robert Sharpe* (Chief Executive)
Roger Smith* (Group Commercial Director – to 30 April 2009)
Richard Sommers (from 1 October 2009)
Mark Stansfeld (to 28 October 2009)
Jonathan Westhoff* (Group Finance Director – from 5 May 2009)
Dr Brian Woods-Scawen (Chairman – to 31 December 2009)

* = Executive Directors

All Directors are members of the Society. None of the Directors have, at any time in the year or as at the year end, any beneficial interest in shares or debentures of any associated body of the Society.

Supplier payment policy

The Society's policy is to agree the terms of payment before trading with the supplier and to pay in accordance with its contractual and other legal obligations. At 31 March 2010, the creditor days figure was 22 days (2008/9: 21 days). This conforms with the Society's aim of paying creditors promptly.

Charitable donations

During the year the Society did not make any charitable donations. The Society did, however, raise significant sums through our community programme, affinity accounts and voluntary staff initiatives. These are outlined in the Corporate Responsibility Report (page 30).

No donations were made for political purposes. While encouraging any employees who wish to take part in community affairs, the Group does not support any employees in the pursuit of political activity.

Employees

The Group is an equal opportunities employer and gives proper consideration to all applications for employment regardless of race, creed, gender, sexual orientation, marital status, age, physical or mental disability with regard to vacancies that arise and to the applicant's own aptitude and abilities. If current staff members become disabled, every effort is made to enable them to maintain their present position or to receive relevant training.

The Group has systems that provide information to employees, permitting them to participate in the operation and development of the business. The Group consults with the West Bromwich Building Society Staff Union. Additionally, details of meetings, team briefings, circulars and information updates are placed on the Society's intranet to ensure that employees are aware of the Society's objectives and performance and conscious of the wider financial and commercial environment in which the Society functions.

Health and safety

The Society sets high standards to maintain the health and safety of all staff, customers and those affected by any of its operations. A comprehensive review has recently been completed which has resulted in the strengthening of the Society's policies and procedures.

The Society is committed to ensuring that all employees receive adequate training in health and safety to make them aware of their individual responsibilities to enable them to carry out their work tasks without injury or damage to the health of themselves or others affected by their work. All employees, on commencing employment with any business area, receive induction training which is reinforced through annual refresher training. Additional training is delivered when a need has been identified, such as Manager Training, Stress Awareness, Manual Handling, Fire Warden, First Aid etc.

The Society recognises the need to consult with its employees on health and safety issues and the rights of individuals and Trade Unions in respect of this. Accredited safety representatives will be afforded every opportunity to effect this consultation and to receive training as appropriate from their Trade Union. A Health and Safety Committee is in place with representatives from across the business which meets quarterly to review Health and Safety.

Health and safety issues are brought to the attention of all employees through business specific communication channels. Employees are similarly encouraged to raise issues through their line management.

During the reporting year no enforcement notices were issued against the organisation by any of the enforcing authorities and no proceedings were instigated against the Society for breaches of health and safety regulations within the reporting period.

Directors' responsibilities for preparing the Annual Accounts

The following statement, which should be read in conjunction with the statement of the Auditors' responsibilities on page 31, is made by the Directors to explain their responsibilities in relation to the preparation of the annual accounts, Annual Business Statement and Directors' Report.

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

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

The Act states that 'references to IAS 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 the most 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 International Accounting Standards; 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 containing, respectively, prescribed information relating to the business of the Society and the Group.

Directors' statement pursuant to the Disclosure and Transparency Rules

The Directors confirm that, to the best of each person's knowledge and belief:

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

Directors' responsibilities for accounting records and internal control

The Directors are responsible for ensuring that the Group:

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

The Directors have general responsibility for safeguarding the assets of the Group and for taking reasonable steps to prevent and detect fraud and other irregularities.

As well as through our branch network and contact centre, the Society can be contacted via our website, www.westbrom.co.uk. The maintenance and integrity of the Society website is the sole responsibility of the Directors. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' responsibilities in respect of going concern

In preparing the financial statements the Directors must satisfy themselves that it is reasonable for them to conclude it is appropriate to adopt the going concern basis. The Group meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business.

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive's Statement on page 3 to 5.

The financial position of the Group, its capital structure and risk management and control processes for managing exposure to Credit, Market, Liquidity and Operational risk are described in the Business Review on pages 7 to 17.

In addition, Note 31 to the financial statements includes further information on the Group's objectives, policies and processes for managing its exposure to liquidity, credit and interest rate risk, details of its financial instruments and hedging activities. The Group's forecasts and projections, taking account of possible changes in trading performance and funding retention, and including stress testing and scenario analysis, show that the Group will be able to operate at adequate levels of both liquidity and capital for the foreseeable future. Furthermore, the Group's capital is in excess of the FSA requirement.

After making enquiries the Directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future and that, therefore, it is appropriate to adopt the going concern basis in preparing the Annual Accounts.

Auditors

The auditors, KPMG Audit Plc, have expressed their willingness to continue in office. In accordance with Section 77 of the Building Societies Act 1986, a resolution for their re-appointment will be proposed at the Annual General Meeting.

Mark Nicholls
Chairman
26 May 2010

Directors' Report on Corporate Governance

The Board is committed to high standards of corporate governance and believe they are central to the West Brom's culture and values.

Corporate Governance – a brief history

The widely accepted articulation of good practice is the Combined Code on Corporate Governance. The first version of the Code was produced in 1992 by the Cadbury Committee which defined Corporate Governance as 'the system by which companies are directed and controlled'.

The current version of the Code was issued in June 2008. However, following the 2008/9 financial crisis and the Walker Review into the governance of banks and other financial institutions, the Financial Reporting Council (FRC) has recently (December 2009) consulted on revisions to the Code – now to be known as the UK Code on Corporate Governance.

The Walker Review identified a number of themes which, if implemented, should avoid the sorts of behaviours that contributed to the financial crisis.

The themes which are most relevant to building societies are:

- A greater emphasis on the 'comply or explain' (with the Code) approach;
- Boards must challenge the Executive more effectively;
- Boards must engage more in risk oversight and set up a Risk Committee; and
- There must be greater oversight of remuneration policies.

These themes have been welcomed by firms and regulators alike. The Financial Services Authority has already issued a Remuneration Code of Practice (see further comments in the Remuneration Report). As mentioned previously, the FRC is consulting on a revised version of the Code, which takes into account the Walker Review recommendations. The revised Code will come into force from the summer of 2010.

The remainder of this report explains how the Society met the current Code Principles during the last financial year. Where we are contemplating changes in anticipation of the revised Code those changes have been described.

The Code's Main Principles	Commentary
A1 The Board **"…an effective board … collectively responsible for the success of the Society."**	The principal functions of the Society's Board include: • Provide entrepreneurial leadership; • Set the Society's strategic aims and risk appetite; • Implement and maintain a framework of prudent and effective controls, which enable risk to be assessed and managed; • Ensure the necessary financial and human resources are in place for the Society to meet its objectives; and • Review management performance. The Board meets as often as is necessary to fulfil its responsibilities. Normally there are ten formal meetings in a financial year but the exceptional circumstances experienced in 2010 have required additional meetings. The details of Board Committee membership and the attendance records of individual Directors at the 14 formal meetings held in 2010 is shown in the table at the end of this Report. There are a number of matters reserved to the Board, which are set out in the Board Procedures Manual.
A2 Chairman and Chief Executive **"clear division of responsibilities"**	The positions of Chairman and Chief Executive are held by different people. The main responsibilities of the Chairman are set out in the Board Procedures Manual and include: • Establish and develop an effective Board, including succession planning and recruitment of Non-Executive Directors; • Lead the Board as a team; • Ensure that the Board has agreed clear values and a Statement of Principles; • Plan and manage the Board's business, including ensuring that appropriate committees are established with the right objectives and membership and that the Board has the right agenda and information; • Ensure that the Board has established key priorities.

The Code's Main Principles	Commentary
A2 Chairman and Chief Executive **"clear division of responsibilities"**	• Maintain and develop a productive and open relationship with the Chief Executive, to agree the Chief Executive's objectives and to carry out regular appraisals. The Chairman is responsible for leading the appointment process for the Chief Executive; • Carry out appraisals of the Non-Executive Directors; • Ensure there are appropriate arrangements for the evaluation and remuneration of senior executives; • Act as an accountability focus for the Society, including chairing the Annual General Meeting; • Represent the Society with the FSA and ensure that there is an open and trustworthy relationship with the Regulator; and • Ensure that the Board and its Committees periodically evaluate their own performance. The Board has satisfied itself that both at the time of his appointment, and currently, the Chairman is independent in character and judgement and meets the independence criteria set out in the Code. The Chief Executive is responsible for the day to day management of the Group and his objectives are set by the Board. His terms of employment are detailed in a service contract agreed by the Remuneration Committee.
A3 Board balance and independence **"a balance of executive and non-executive directors"**	The Board currently comprises seven Non-Executive Directors (including the Chairman) and two executive directors. During the year Ed Hucks (Deputy Chairman) undertook the role of Senior Independent Director. The Board has satisfied itself that all of the Non-Executive Directors are independent in character or judgement. However, in recognition of the fact that Lesley James has been a Director for more than nine years from the date of her first election (19 July 2001) she is standing for election at this year's AGM. Each of the Board Committee's terms of reference (which are available from the Group Secretary on request) make it clear that only Committee members are entitled to attend meetings, any other attendees are present only at the Committee's invitation.
Developments in 2010/11	The Board will review its composition in order to maintain sufficient Executive and Non-Executive Directors with the right skills and experience to run the Society. Ed Hucks and Bharat Shah will step down after the Society's AGM in July 2010. A process to recruit two new Non-Executive Directors has commenced. The composition of Board Committees will be reviewed.
A4 Appointments to the Board **"formal, rigorous and transparent procedure for the appointment of new directors"**	During the course of the last financial year, four appointments were made to the Board. In each case, the appointment process was led by the Nominations Committee. The members of this Committee are all Non-Executive Directors and it is chaired by the Society's Chairman. However, in the case of the appointment of the Society's new Chairman, the Committee was chaired by the Senior Independent Director and the previous Chairman was not involved in the selection process. Each of the four newly appointed Directors were required to satisfy the FSA's fitness and propriety test and have been registered as 'Approved Persons'. In each case the Directors attended a Significant Influence Function interview with the FSA. Each of the three Non-Executive Director appointments (including the Chairman's) is for a term of three years and is subject to election at this year's AGM. Their letters of appointment include the time commitment expected of them and their other significant commitments were considered by the Nominations Committee as part of the selection process. The terms of reference of the Nominations Committee are available on request from the Group Secretary. The Chairman (appointed 1 Jan 2010) confirmed that his other commitments would not interfere with his role.
Developments in 2010/11	The Board will review director and senior management succession plans.
A5 Information and professional development **"induction on joining … regularly update/refresh skills and knowledge … timely, quality information"**	Each of the three new Non-Executive Directors has benefited from a range of induction activities appropriate to their individual experience. These have included site visits, meetings with senior management and reports/information concerning the Group's operations. During the year, Directors have received awareness training on ICAAP, the ARROW process and wholesale funding. Board and Committee papers are issued to Directors in order to allow sufficient time for meeting preparation. Non-Executive Directors are encouraged to challenge constructively the Executive. Board and Committee Meeting minutes record the challenges and participation by individual Directors. The information provided to Directors has been subject to an ongoing review, resulting both in the upgrading and, in a number of cases, new suites of management information. The Board and its committees are serviced by the Group Secretary – a Board appointed role – who, through the Chairman, advises on governance matters and board procedures. The Board Procedures Manual documents the Group's governance arrangements.

The Code's Main Principles	Commentary
Developments in 2010/11	Establishment of a model Director Induction Programme, which can then be tailored to meet the needs of individual Directors. Introduction of a structured skills and knowledge refresh programme for Directors. Conclusion of the current review of management information provided to Directors.
A6 Performance Evaluation **"a formal and rigorous annual evaluation of its own performance"**	The last formal evaluation of Board, Committee and individual Director performance commenced in December 2008 and concluded in the early part of the 2009 financial year. The evaluations were initiated by a questionnaire and were reviewed by the Chairman and the output fed back to individual Directors. Evaluation of the outgoing Chairman was conducted by the Non-Executive Directors, led by the Vice-Chairman and Senior Independent Director. The conclusions were shared with the new Chairman.
Developments in 2010/11	A key activity for the new Chairman is to evaluate Board/Committee and individual Director performance, which may include an element of external facilitation.
A7 Re-election **"re-election at regular intervals … planned and progressive refreshing of the Board"**	All new Directors are required by the Society's Rules to stand for election at the first Annual General Meeting following their appointment to the Board. In addition, Directors must seek re-election at least every three years after being first elected. As a result, six of the Society's nine Directors will be standing for election or re-election at the 2010 AGM. The Board has seen significant planned changes in its composition over the last two years. Whilst the volume of changes will diminish in 2010/11, there will still be a planned replacement of retiring Non-Executive Directors.
Developments in 2010/11	The revised Code (UK Corporate Governance Code) is expected to lead to changes in the requirements for the re-election of Directors which, subject to those changes being consistent with the Society's Rules, are expected to be introduced from the AGM in 2011.
B1 Level and make-up of remuneration **B2 Procedure**	The Directors' Remuneration Report on pages 27 to 29 explains how the Society, through the Remuneration Committee and Board, approaches the remuneration of Directors and other executives. There has been a great deal of focus on remuneration in the financial services sector, including a number of recommendations in the Walker Review and the FSA's Remuneration Code (although the FSA has decided to apply its Rules and Guidance only to the very largest firms). The Directors' Remuneration Report describes how the Society has responded to the issues raised.
C1 Financial Reporting **"balanced and understandable assessment of the Society's position and prospects"**	The Directors' Report on pages 18 to 21 includes statements detailing the Directors' responsibilities. The Chief Executive's Review on pages 3 to 5 and the Business Review on pages 7 to 17, give an extensive report on the Society's performance, financial position and the key risks that will impact upon performance and risk management going forward.
C2 Internal Control **"maintain a sound system of internal control…"**	The Society's Board is responsible for the development of strategies relating to risk management and internal control. Operational responsibility rests with the Executive Directors and senior managers. The risk management systems and internal controls are designed to allow the Society to achieve its corporate objectives in a controlled manner and remain within defined risk appetite statements. These systems and controls are designed to manage rather than eliminate risk. The Board reviews the effectiveness of the risk management systems and internal controls in a number of ways, including: • Board review and approval of Risk Appetite Statements on at least a half-yearly basis, with monthly reporting of key indicators relating to those statements; • A formal committee structure, including an Audit & Compliance Committee (see below for more detail) and a Group Risk Committee – established in 2009. The minutes of the meetings of these Committees are reviewed by the full Board, the relevant Committee Chairman highlighting any key issues; • Regular reports and presentations to the Board by the Executive Directors and Group Secretary & Divisional Director Risk; and • Monthly Board report on key business performance. The Society's internal audit function, with a dual reporting line to the Chief Executive and Chair of Audit & Compliance Committee provides independent assurance regarding the adequacy and effectiveness of internal controls across all Group activities.

The Code's Main Principles	Commentary
Developments in 2010/11	During the next financial year, the role of the Society's Divisional Directors is expected to expand, including increased input to Board meetings (both reporting and presentations) and more interaction with Non-Executive Directors.
C3 Audit Committee and Auditors **"formal and transparent arrangements…"**	The Board has an Audit & Compliance Committee comprising three Non-Executive Directors, all of whom are considered independent according to the criteria contained in the Code. In Huw Davies (who is currently Group Finance Director of an external institution), the Board is satisfied that at least one member of the Committee has recent and relevant financial experience. The Chairman of the Audit & Compliance Committee receives additional fees in recognition of his added responsibilities. The terms of reference of the Committee are available from the Group Secretary on request. The Society has a policy on the engagement of external auditors to supply non-audit services, which is operated across the Group and in tandem with the external auditors' own internal policy on providing non-audit services. The Society has a well established Whistleblowing Policy to enable staff to raise concerns in confidence about possible improprieties in matters of financial reporting or other issues. This policy has taken account of the Public Interest Disclosure Act 1998. During the year, the Committee received a report summarising all of the reports made under this Policy. There have been five meetings of the Committee during the financial year 2009/10. Executive Directors and other members of senior management (by invitation only) attended the meetings. Those employees who regularly attend include the Chief Executive, Group Finance Director, Group Secretary and Divisional Director Risk, Head of Internal Audit and Head of Risk and Compliance. The Board receives regular reports on Committee meetings and also receives copies of the minutes of these meetings. During the last financial year, the Audit & Compliance Committee: • Validated the integrity of the Group's financial statements (including formal announcements relating to such statements); • Reviewed and approved significant financial reporting issues and accounting policies/issues; • Reviewed the Group's internal controls; • Monitored and reviewed the Group's Internal Audit and Compliance functions; and • Recommended the reappointment of the external auditor (following a review of the external auditor's independence and objectivity and the effectiveness of the audit process), the remuneration and terms of engagement.
D1 Dialogue with Stakeholders **"ensuring that a satisfactory dialogue takes place"**	The Society has members as opposed to shareholders. The overwhelming majority of the Society's almost 600,000 members are individuals who are also customers of the Society. Feedback from members and customers is invaluable in the operation and development of the Society and various means used for ascertaining feedback, including: • Regular Members' Forums held around the branch network; • Assessing enquiries from the Society's contact centre and website; • Analysing the nature and quantity of customer complaints; • Customer research on specific topics; and • Customer satisfaction surveys and mystery shopper programme.
D2 Constructive use of the AGM **"communication with members and encourage their participation"**	All members who are eligible to vote are sent a Summary Financial Statement and details of the Annual General Meeting (AGM). Proxy forms are also included in the AGM mailing to allow those members who do not attend the meeting to cast their vote. This year, for the first time, members will be able to submit their proxy form electronically. The Society uses independent scrutineers to count all proxy votes. All Board members are expected to be present at the AGM each year (except in the case of unavoidable absence). The Chairmen of the Audit & Compliance, Remuneration, Group Risk and Nominations Committees are available to answer questions at the AGM. The Notice of the AGM and related papers are sent at least 21 days before the AGM in accordance with the Building Societies Act 1986.

Attendance Records – Board and Board Committee Meetings

	Board	Assets & Liabilities	Audit & Compliance	Group Risk	Remuneration
Dr Brian Woods-Scawen CBE	*10 (11)				3 (3)
Mark Nicholls	*4 (4)				2 (2)
John Bywater	9 (9)				
Gary T Cowdrill	1 (1)	*1 (1)			
David Huw Davies	13 (14)		5 (5)		
Edwin Hucks	14 (14)		*5 (5)		2 (2)
Lesley James CBE	14 (14)				*5 (5)
Martin Ritchley	7 (7)		1 (2)	2 (2)	
Bharat C Shah	14 (14)	3 (5)	3 (3)		
Robert Sharpe	13 (14)	11 (12)		*2 (2)	
Roger D Smith		1 (1)			
Richard F Sommers	6 (6)			2 (2)	
Mark Stansfeld	7 (8)				2 (3)
Jonathan Westhoff	13 (13)	*11 (11)		2 (2)	

*indicates that the individual is the Chair of the Board/Board Committee.

Mark Nicholls
Chairman
26 May 2010

Directors' Remuneration Report

The purpose of this report is to inform members of the current policy for the remuneration of directors and executives, as established by the Remuneration Committee and the Board, taking into account the relevant recommendations contained in the Combined Code on Corporate Governance.

Main Code Principle: B.1 The Level and Make-up of Remuneration

Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive director's remuneration should be structured so as to link rewards to corporate and individual performance.

The Remuneration Committee compares pay and employment conditions for Executive Directors and executives both on the basis of positioning the Society relative to other competitors and by comparison to suitably challenging performance indicators (which are used as a basis for performance-related remuneration).

Performance-related remuneration is an essential part of the reward package for Executive Directors and other executives. The Society's remuneration arrangements are designed to align the interests of the members with the interests of the Directors and executives, and to provide a strong incentive to perform at the highest levels. All incentive schemes used by the Society are subject to challenging performance criteria reflecting the Society's objectives, combined with a number of personal objectives relevant to the participants. The objectives for Executive Directors and executives are set and reviewed by the Remuneration Committee. Any performance-related bonus awards are agreed by the full Board.

The main components of Executive Directors' remuneration and their contractual terms are described below:

Basic salary

The Remuneration Committee considers external data from independent national surveys and peer group building societies in assessing and setting basic salary levels for Executive Directors and executives. However, one of the best pay comparators is provided through the recruitment of new employees and, during the financial year ended 31 March 2010, the Society recruited a new Group Finance Director and a number of executives. The basic salaries paid to these new recruits are also an excellent way to benchmark the salaries of longer serving executives. The Committee is therefore satisfied that the Society is paying its most senior employees the appropriate rate for their roles.

At its meeting in March 2010 the Committee met to consider the annual review of staff salaries. The Committee recommended, and the Board subsequently agreed, that the general salary review should result in no increase in the basic salaries of Executive Directors and executives. Other employees were awarded a 2% increase effective from 1 April 2010.

Performance pay

Executive Directors and executives are eligible to receive performance-related pay based on the achievement of a number of Society and personal performance objectives.

At meetings in March and April 2010 the Committee considered the award of bonuses to employees (including executives) and Executive Directors. The Committee recognised the significant improvement in financial performance and the promising start made towards implementing the Back to Basics strategy. The Committee recommended, and the Board subsequently approved, bonus payments to all employees, linked to the achievement of a range of corporate and personal objectives.

Other benefits

Other Executive Director benefits are benchmarked against similar organisations. These benefits include car and fuel allowances or a cash allowance; medical insurance and health screening; housing allowance; a cash allowance instead of a pension and a lump sum of four times basic salary in the event of death in service. Neither of the current Executive Directors has ever been a member of the now closed Defined Benefit Pension Scheme.

Executive Director contractual terms

All new Executive Director appointments are made on the basis that the new Director will enter into a service contract terminable on 12 months' notice to be given by the Society and no less than 6 months' notice given by the Director. Both of the Society's Executive Directors have contracts on this basis. In certain circumstances (including a merger with a larger Society) the contractual terms allow for an enhanced severance payment of 2 years' remuneration.

Mr Sharpe signed his contract on 10 October 2008 and Mr Westhoff on 5 May 2009. Under the terms of his contract Mr Sharpe is permitted to act as a Non-Executive Director for other organisations and retain the fees paid to him. During the year Mr Sharpe received £147,500 in respect of other non-executive roles.

Non-Executive Directors

During the financial year, the Society appointed three new Non-Executive Directors, including a new Chairman. The opportunity was taken to review fees, particularly in the light of the increased time commitment expected of Non-Executive Directors. The fees for existing Non-Executive Directors were brought into line with the new fee levels from 1 April 2010. Non-Executive Directors do not have service contracts and are remunerated solely by fees, having no pension, benefits-in-kind or entitlement to a bonus.

Details of the Non-Executive and Executive Directors' emoluments are included in the tables overleaf.

Main Code Principle B.2: Procedure

There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

The Remuneration Committee, which is made up solely of Non-Executive Directors, has been established for a number of years. Throughout the last financial year the Committee was chaired by Lesley James, with Brian Woods-Scawen (until December 2009), Mark Nicholls (from January 2010), Mark Stansfeld (until October 2009) and Ed Hucks as additional members. The terms of reference for the Remuneration Committee are available on request from the Group Secretary.

The Committee has responsibility for recommending to the full Board the framework and outcomes for the remuneration of the Chairman, all Executive Directors and executives. The Committee is also responsible for ensuring that contractual terms on termination and any payments made are fair to the individual and to the Society.

At the Remuneration Committee's invitation, the Chief Executive, Group Finance Director, Group Secretary and Divisional Director Risk and Head of Human Resources attend all or part of the Remuneration Committee meetings.

The remuneration of Non-Executive Directors is reviewed by the Chief Executive and Chairman and any changes are submitted to the Society's full Board for consideration.

Developments in 2010/11

Early in 2010, the Committee considered the recently published FSA Remuneration Code and the Walker Review and agreed a number of enhanced governance arrangements. The key changes are described below:

- To make it a requirement that at least one member of the Committee should also be a member of the Society's Group Risk or Audit & Compliance Committee;
- To consider an annual report concerning risk/risk management;
- Introduce a stand-alone Remuneration Policy, reviewed annually, incorporating the Code requirements;
- No more than half of any variable remuneration for control function staff to be achievable through shared business objectives;
- To consider whether deferral of cash bonuses is appropriate and what the vesting period and proportion of deferral should be;
- Expand the Committee Terms of Reference to include annual approval of the Remuneration Policy;
- The Chair of Committee to be required to stand for re-election (at the following AGM) if the Remuneration Report is not supported by 75% or more of members voting at the AGM; and
- Expand the Remuneration Report to include details of any enhanced benefits triggered by specific events e.g. change of ownership.

The Board approved these changes at its meeting in February 2010.

Non-Executive Director Fees

Non-Executive Director	2009/10 Total Fees £000	2008/9 Total Fees £000
Mark Nicholls (appointed 1 January 2010)	**25**	–
Brian Woods-Scawen CBE (retired 31 December 2009)	**54**	72
John Bywater (retired 31 December 2009)	**32**	41
David Huw Davies	**35**	35
Edwin Hucks*	**53**	53
Lesley James CBE	**43**	43
Martin Ritchley (appointed 1 September 2009)	**29**	–
Bharat Shah	**43**	43
Richard Sommers (appointed 1 October 2009)	**25**	–
Mark Stansfeld (retired 28 October 2009)	**20**	35
Graham Wentzell (retired 31 July 2008)**	**–**	16
Total	**359**	338

* Mr Hucks also received £12,000 in respect of consultancy in relation to additional work during 2008/9 – overseeing a review of the Society's lending.

** Mr Wentzell also received £29,000 in 2008/9 and £11,000 in 2009/10 in relation to continuing support to the Board up to the 2009 AGM.

Executive Director Remuneration – 2009/10

Executive Director	Salary £000	Annual Bonus £000	Benefits in Lieu of Pension Contributions £000	Other Benefits £000	Sub Total £000	Increase in Accrued Pension £000	Total 2010 £000
Robert Sharpe*	390	150	98	22	660	–	**660**
Jonathan Westhoff* (Appointed 5 May 2009)	203	102	40	21	366	–	**366**
Roger D Smith** (Resigned 30 April 2009)	19	–	–	2	21	6	**27**
Gary T Cowdrill*** (Resigned 1 May 2009)	28	–	–	2	30	5	**35**
Total 2009/10	**640**	**252**	**138**	**47**	**1,077**	**11**	**1,088**

* The bonus paid to Robert Sharpe related to the period Oct 2008 - March 2010 and Jonathan Westhoff's to the period May 2009 - March 2010.

** Roger Smith resigned from the Society on 30 April 2009. In addition to the amounts shown above, £277,000 was paid to Mr Smith with respect to his resignation. The payment represents £212,000 notice pay, £49,000 severance pay, and £16,000 in respect of other benefits. Mr Smith received no bonus payment nor was his pension enhanced in any way.

*** Gary Cowdrill resigned from the Society on 1 May 2009. In addition to the amounts shown above, £321,000 was paid to Mr Cowdrill with respect to his resignation. The payment represents £212,000 notice pay, £94,000 severance pay, and £15,000 in respect of other benefits. Mr Cowdrill received no bonus payment nor was his pension enhanced in any way.

Executive Director Remuneration – 2008/9

Executive Director	Salary £000	Annual Bonus £000	Benefits in Lieu of Pension Contributions £000	Other Benefits £000	Sub Total £000	Increase in Accrued Pension £000	Total 2009 £000
Robert Sharpe* (Appointed 13 October 2008)	141	–	35	52	228	–	228
Stephen A Karle** (Resigned 10 October 2008)	145	–	–	15	160	6	166
Roger D Smith	212	–	–	29	241	9	250
Gary T Cowdrill	212	–	–	16	228	9	237
Total 2008/9	710	–	35	112	857	24	881

* Robert Sharpe was compensated for travel costs (incurred before his appointment) which he was required to cancel to fulfil his role.

** Stephen Karle resigned from the Society on 10 October 2008. In addition to the amounts shown above, £520,600 was paid to Mr Karle with respect to his resignation. The payment represents £274,000 notice pay, £78,000 severance pay, £68,000 pension, £82,000 bonus and £18,600 in respect of other benefits. Mr Karle received no enhancement to his pension terms.

Lesley James CBE
Chair, Remuneration Committee
26 May 2010

Corporate Responsibility

The Society is committed to creating and developing mutually supportive relationships with the various communities we serve. This commitment to our relevant stakeholders – members, staff, business partners and local communities – is underpinned by a belief in pursuing sustainable development, which offers an ethical framework for the Society's social and environmental responsibilities.

Community

Supporting the community has been a distinctive feature of the West Brom since its inception over 160 years ago and this remains an important part of the Society's regional identity. Such support encompasses a wide range of community and charitable causes, notably:

- Corporate support through managed, structured sponsorship and financial assistance programmes;
- Organising or participating in fund-raising activities; and
- Staff involvement in community projects with the Society's endorsement.

Several examples from the past year indicate the scope and scale of the Society's support for the community. These include:

- The established partnership with the Diocese of Lichfield (the Mercian Trust Partnership) has been a significant element in the Society's support for initiatives covering a spectrum of social and personal needs. This has incorporated issues relating to health, disability, old age, the development of children and young people, bereavement and poverty.
- The Society's nominated charity, which is selected by staff, offers a clear focus for their goodwill and generosity. For the past 18 months the Society's chosen charity has been the Midlands Air Ambulance. Through a number of fund-raising ventures, the Society raised nearly £25,000 for this vital charity.
- Helping children and young people has always formed a prominent part of the Society's community approach. Working with the likes of West Bromwich Albion, Walsall and Shrewsbury Town Football Clubs, the Society has funded programmes geared to giving educational and recreational opportunities for young people, particularly in disadvantaged communities.
- The Society's affinity accounts have again been greatly valued by organisations covering a variety of interests, such as sport and recreation in the case of Warwickshire County Cricket Club and Severn Valley Railway, and an alliance account with Birmingham Children's Hospital. £0.3m has been generated for these organisations in the year.
- In addition to supporting the Society's nominated charity, staff also contribute to the work of different organisations. For example, staff have taken part in projects in aid of homeless people as well as providing individual specialist advice for community-based bodies, such as 6 Towns Credit Union, Greets Green Partnership and the Sandwell Climate Change Partnership.

Environment

A policy of sustainable development implies a determination to limit any negative impact on the environment, which may occur in the attainment of business objectives. The Society has therefore reviewed its existing environmental footprint and is also making efforts to reduce unnecessary waste and energy. With this in mind, the Society is looking closely at such areas as recycling, paper use, postage, storage and archiving, energy, purchasing, recruitment and staff awareness and engagement on environmental issues.

This echoes the steps taken by the Society to minimise the extent of any environmental effect, including:

- The Society is represented on the Sandwell Climate Change Partnership, which comprises the local authority and businesses. The Partnership aims to tackle the challenges faced by the borough in relation to climate change;
- The Society's procurement policy assesses the environmental and ethical policies of potential suppliers so that they conform with the Society's stipulated criteria. Where practicable, the Society examines the supply chain and life cycle of products or services, including factory reports concerning items manufactured abroad. In view of the Society's attempts to improve the economic health of the local community, a preference is given to local business partners wherever feasible;
- Recycling is an ongoing element in the Society's operating culture and applies to many consumables, such as toner cartridges, paper cups and waste paper. Office furniture is also recycled through the award-winning Green Works charity; and
- Certain consumables, as with paper supplies, are sourced from sustainable forests with new consumables assessed for their environmental influence.

The Society does not knowingly deal with business partners that fail to comply properly with the safety, labour and other relevant laws in their respective countries. The Society opposes the exploitation of workers, and supports fair rewards and acceptable working conditions within the context of local conditions.

Independent Auditors' Report

Independent auditors' report to the members of West Bromwich Building Society

We have audited the Group and Society annual accounts of West Bromwich Building Society for the year ended 31 March 2010 which comprise the Group and Society Income Statements, the Group and Society Statements of Comprehensive Income, the Group and Society Statements of Financial Position, the Group and Society Statement of Changes in Members Interests, the Group and Society Cash Flow Statements and the related Notes. These annual accounts have been prepared under the accounting policies set out therein.

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

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report including the Directors' Report, the Annual Business Statement and the annual accounts in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on pages 20 to 21.

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

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

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

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

Basis of audit opinion

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

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

Opinion

In our opinion:

a) the annual accounts give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of affairs of the Group and of the Society as at 31 March 2010 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.

Richard Gabbertas (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
One Snowhill
Snow Hill Queensway
Birmingham, B4 6GH
26 May 2010

INCOME STATEMENTS

For the year ended 31 March 2010

	Notes	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Interest receivable and similar income	2	**250.3**	508.7	**239.6**	454.4
Interest expense and similar charges	3	**(220.6)**	(441.7)	**(214.1)**	(400.8)
Net interest receivable		**29.7**	67.0	**25.5**	53.6
Fees and commissions receivable		**6.7**	14.3	**5.0**	7.8
Fees and commissions payable		**–**	(3.0)	**–**	–
Other operating income	4	**6.4**	14.5	**1.9**	11.5
Total operating income		**42.8**	92.8	**32.4**	72.9
Administrative expenses – ongoing	5	**(38.9)**	(52.4)	**(33.0)**	(43.7)
Administrative expenses – restructuring	5	**(3.3)**	(4.1)	**(3.3)**	(4.1)
Administrative expenses – pension curtailment	5	**–**	8.0	**–**	8.0
Depreciation and amortisation	16,18	**(4.0)**	(5.6)	**(3.9)**	(5.1)
Operating (loss)/profit before impairments, provisions and revaluation gains or losses		**(3.4)**	38.7	**(7.8)**	28.0
Gains/(Losses) on investment properties	17	**1.4**	(10.9)	**–**	–
Impairment of investment	14(a)	**–**	–	**(6.8)**	–
Impairment losses on loans and advances	13	**(20.6)**	(65.2)	**(1.0)**	(1.3)
Provisions for liabilities – FSCS Levy	25	**5.4**	(12.2)	**5.4**	(12.2)
Provisions for liabilities – Other	25	**(1.3)**	0.8	**(1.3)**	0.8
(Loss)/Profit before tax		**(18.5)**	(48.8)	**(11.5)**	15.3
Taxation	8	**7.3**	9.5	**1.0**	(4.5)
(Loss)/Profit for the financial year from continuing operations		**(11.2)**	(39.3)	**(10.5)**	10.8
Discontinued operations					
Loss from discontinued operations	14(b)	**(5.8)**	–	**–**	–
(Loss)/Profit for the financial year		**(17.0)**	(39.3)	**(10.5)**	10.8

The 2009 results have been represented as a result of the disclosure of discontinued operations in the 2010 results and in respect of restructuring costs which have been shown on the face of the Income Statements.

The Notes on pages 39 to 89 form part of these Accounts.

STATEMENTS OF COMPREHENSIVE INCOME

For the year ended 31 March 2010

	Notes	Group 2010 £m	Group 2009 £m
Loss for the financial year		**(17.0)**	(39.3)
Other comprehensive income:			
Available for sale investments: valuation gain/(loss) taken to equity		**22.4**	(17.6)
Losses on revaluation of properties		**(1.2)**	(1.5)
Actuarial loss on retirement benefit obligations	30	**(6.8)**	(5.7)
Cash flow hedge (losses)/gains taken to equity		**(0.1)**	0.1
Tax on items taken directly to equity	29	**(4.5)**	5.3
Other comprehensive income for the year, net of tax		**9.8**	(19.4)
Total comprehensive income for the year		**(7.2)**	(58.7)

	Notes	Society 2010 £m	Society 2009 £m
(Loss)/Profit for the financial year		**(10.5)**	10.8
Other comprehensive income:			
Available for sale investments: valuation gain/(loss) taken to equity		**22.4**	(17.6)
Losses on revaluation of properties		**(1.2)**	(1.5)
Actuarial loss on retirement benefit obligations	30	**(6.8)**	(5.7)
Cash flow hedge (losses)/gains taken to equity		**(0.1)**	0.1
Tax on items taken directly to equity	29	**(4.5)**	5.3
Other comprehensive income for the year, net of tax		**9.8**	(19.4)
Total comprehensive income for the year		**(0.7)**	(8.6)

STATEMENTS OF FINANCIAL POSITION

at 31 March 2010

	Notes	**Group 2010 £m**	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
Assets					
Cash and balances with the Bank of England	9	**9.6**	8.5	**9.6**	8.5
Loans and advances to credit institutions		**192.9**	318.7	**108.4**	245.9
Investment securities: Available for sale	10	**1,449.2**	1,695.1	**2,630.5**	2,877.9
Derivative financial instruments	11	**78.4**	62.1	**96.0**	96.2
Loans and advances to customers	12	**6,437.0**	6,923.2	**2,351.7**	2,598.5
Investments	14(a)	**–**	–	**2,734.1**	2,905.8
Intangible assets	15,16	**7.2**	11.1	**6.6**	5.7
Investment properties	17	**116.0**	114.4	**–**	–
Property, plant and equipment	18	**14.6**	16.5	**14.5**	16.2
Current tax assets		**2.2**	6.9	**1.0**	–
Deferred tax assets	19	**20.1**	22.9	**4.6**	15.4
Trade and other receivables	20	**6.2**	16.1	**5.1**	11.0
		8,333.4	9,195.5	**7,962.1**	8,781.1
Held for sale	14(b)	**2.2**	–	**–**	–
Total assets		**8,335.6**	9,195.5	**7,962.1**	8,781.1
Liabilities					
Shares	21	**6,544.1**	6,541.3	**6,544.1**	6,541.3
Amounts due to credit institutions		**92.6**	461.5	**92.6**	461.5
Amounts due to other customers		**144.3**	497.3	**144.3**	497.3
Derivative financial instruments	11	**96.7**	125.3	**78.6**	116.1
Debt securities in issue	22	**911.3**	992.6	**570.7**	604.0
Current tax liabilities		**–**	–	**–**	5.8
Deferred tax liabilities	19	**6.9**	8.4	**1.4**	3.3
Trade and other payables	24	**16.2**	25.1	**13.0**	19.9
Provisions for liabilities	25	**6.0**	12.2	**6.0**	12.2
Retirement benefit obligations	30	**2.0**	1.6	**2.0**	1.6
Subordinated debt	23	**–**	190.0	**–**	190.0
		7,820.1	8,855.3	**7,452.7**	8,453.0
Held for sale	14(b)	**0.5**	–	**–**	–
Total liabilities		**7,820.6**	8,855.3	**7,452.7**	8,453.0
Equity					
Profit participating deferred shares	27	**179.9**	–	**179.9**	–
Subscribed capital	26	**74.9**	74.9	**74.9**	74.9
General reserves		**258.5**	278.3	**252.9**	266.2
Revaluation reserve		**3.8**	4.6	**3.8**	4.6
Available for sale reserve		**(2.3)**	(17.9)	**(2.3)**	(17.9)
Cashflow reserve		**0.2**	0.3	**0.2**	0.3
Total equity attributable to members		**515.0**	340.2	**509.4**	328.1
Total liabilities and equity		**8,335.6**	9,195.5	**7,962.1**	8,781.1

The Accounting policies and Notes on pages 39 to 89 form part of these accounts.

Approved by the Board of Directors on 26 May 2010 and signed on its behalf by:

M Nicholls
Chairman

R Sharpe
Chief Executive

J Westhoff
Group Finance Director

STATEMENTS OF CHANGES IN MEMBERS' INTEREST

for the year ended 31 March 2010

Group	**Profit participating deferred shares £m**	**Subscribed capital £m**	**General reserve £m**	**Revaluation reserve £m**	**Available for sale reserve £m**	**Cashflow reserve £m**	**Total £m**
Balance as at 1 April 2009	**–**	**74.9**	**278.3**	**4.6**	**(17.9)**	**0.3**	**340.2**
Issue of equity instrument	184.1	–	–	–	–	–	**184.1**
Loss for the financial year	(4.2)*	–	(12.8)	–	–	–	**(17.0)**
Other comprehensive income for the period							
Available for sale investments: valuation gain taken to equity	–	–	–	–	15.6	–	**15.6**
Losses on revaluation of properties	–	–	–	(0.8)	–	–	**(0.8)**
Actuarial loss on retirement benefit obligations	–	–	(4.9)	–	–	–	**(4.9)**
Cash flow hedge losses taken to equity	–	–	–	–	–	(0.1)	**(0.1)**
Total other comprehensive income (Note 29)	**–**	**–**	**(4.9)**	**(0.8)**	**15.6**	**(0.1)**	**9.8**
Total comprehensive income for the year	**(4.2)**	**–**	**(17.7)**	**(0.8)**	**15.6**	**(0.1)**	**(7.2)**
Interest on subscribed capital	–	–	(2.1)	–	–	–	**(2.1)**
Balance as at 31 March 2010	**179.9**	**74.9**	**258.5**	**3.8**	**(2.3)**	**0.2**	**515.0**

	Profit participating deferred shares £m	Subscribed capital £m	General reserve £m	Revaluation reserve £m	Available for sale reserve £m	Cashflow reserve £m	Total £m
Balance as at 1 April 2008 as previously stated	–	74.9	327.9	6.1	(5.3)	0.2	403.8
Prior year adjustment	–	–	(1.6)	–	–	–	(1.6)
Balance as at 1 April 2008 as restated	–	74.9	326.3	6.1	(5.3)	0.2	402.2
Loss for the financial year	–	–	(39.3)	–	–	–	(39.3)
Other comprehensive income for the period							
Available for sale investments: valuation loss taken to equity	–	–	–	–	(12.6)	–	(12.6)
Losses on revaluation of properties	–	–	–	(1.5)	–	–	(1.5)
Actuarial loss on retirement benefit obligations	–	–	(5.4)	–	–	–	(5.4)
Cash flow hedge gains taken to equity	–	–	–	–	–	0.1	0.1
Total other comprehensive income (Note 29)	–	–	(5.4)	(1.5)	(12.6)	0.1	(19.4)
Total comprehensive income for the year	–	–	(44.7)	(1.5)	(12.6)	0.1	(58.7)
Interest on subscribed capital	–	–	(3.3)	–	–	–	(3.3)
Balance as at 31 March 2009	–	74.9	278.3	4.6	(17.9)	0.3	340.2

* Under the terms of the Profit participating deferred shares ('PPDS'), 25% of the Group's annual post tax profits or (losses) are allocated against the PPDS reserve.

STATEMENTS OF CHANGES IN MEMBERS' INTEREST

for the year ended 31 March 2010

Society	**Profit participating deferred shares £m**	**Subscribed capital £m**	**General reserve £m**	**Revaluation reserve £m**	**Available for sale reserve £m**	**Cashflow reserve £m**	**Total £m**
Balance as at 1 April 2009	**–**	**74.9**	**266.2**	**4.6**	**(17.9)**	**0.3**	**328.1**
Issue of equity instrument	184.1	–	–	–	–	–	**184.1**
Loss for the financial year	(4.2)*	–	(6.3)	–	–	–	**(10.5)**
Other comprehensive income for the period							
Available for sale investments: valuation gain taken to equity	–	–	–	–	15.6	–	**15.6**
Losses on revaluation of properties	–	–	–	(0.8)	–	–	**(0.8)**
Actuarial loss on retirement benefit obligations	–	–	(4.9)	–	–	–	**(4.9)**
Cash flow hedge losses taken to equity	–	–	–	–	–	(0.1)	**(0.1)**
Total other comprehensive income	**–**	**–**	**(4.9)**	**(0.8)**	**15.6**	**(0.1)**	**9.8**
Total comprehensive income for the year	**(4.2)**	**–**	**(11.2)**	**(0.8)**	**15.6**	**(0.1)**	**(0.7)**
Interest on subscribed capital	–	–	(2.1)	–	–	–	**(2.1)**
Balance as at 31 March 2010	**179.9**	**74.9**	**252.9**	**3.8**	**(2.3)**	**0.2**	**509.4**

	Profit participating deferred shares £m	Subscribed capital £m	General reserve £m	Revaluation reserve £m	Available for sale reserve £m	Cashflow reserve £m	Total £m
Balance as at 1 April 2008 as previously stated	–	74.9	265.7	6.1	(5.3)	0.2	341.6
Prior year adjustment	–	–	(1.6)	–	–	–	(1.6)
Balance as at 1 April 2008 as restated	–	74.9	264.1	6.1	(5.3)	0.2	340.0
Profit for the financial year	–	–	10.8	–	–	–	10.8
Other comprehensive income for the period							
Available for sale investments: valuation loss taken to equity	–	–	–	–	(12.6)	–	(12.6)
Losses on revaluation of properties	–	–	–	(1.5)	–	–	(1.5)
Actuarial loss on retirement benefit obligations	–	–	(5.4)	–	–	–	(5.4)
Cash flow hedge gains taken to equity	–	–	–	–	–	0.1	0.1
Total other comprehensive income	–	–	(5.4)	(1.5)	(12.6)	0.1	(19.4)
Total comprehensive income for the year	–	–	5.4	(1.5)	(12.6)	0.1	(8.6)
Interest on subscribed capital	–	–	(3.3)	–	–	–	(3.3)
Balance as at 31 March 2009	–	74.9	266.2	4.6	(17.9)	0.3	328.1

* Under the terms of the Profit participating deferred shares ('PPDS'), 25% of the Group's annual post tax profits or (losses) are allocated against the PPDS reserve.

CASH FLOW STATEMENTS

For the year ended 31 March 2010

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Net cash (outflow)/inflow from operating activities (see overleaf)	**(335.8)**	449.7	**(568.9)**	458.5
Cash flows from investing activities				
Purchase of investment securities	**(5,545.5)**	(5,998.2)	**(5,544.0)**	(7,181.0)
Proceeds from disposal of investment securities	**5,476.6**	5,632.9	**5,476.6**	5,632.9
Purchase of property, plant and equipment and intangible assets	**(4.5)**	(2.9)	**(4.4)**	(2.8)
Proceeds from disposal of property, plant and equipment	**0.2**	0.1	**0.1**	–
Purchase of investment property	**(0.4)**	(1.4)	**–**	–
Proceeds from disposal of investment properties	**0.2**	0.2	**–**	–
Purchase of shares in subsidiary undertaking	**–**	–	**0.6**	–
New funding to subsidiaries	**–**	–	**(42.6)**	(686.5)
Repayment of funding from subsidiaries	**–**	–	**213.7**	1,366.9
Net cash flows from investing activities	**(73.4)**	(369.3)	**100.0**	(870.5)
Cash flows from financing activities				
Interest paid on subordinated liabilities	**(3.1)**	(12.0)	**(3.1)**	(12.0)
Dividend paid on subscribed capital	**(2.1)**	(4.6)	**(2.1)**	(4.6)
Repayment of mortgage backed loan notes	**(48.0)**	(476.9)	**–**	–
Net cash flows from financing activities	**(53.2)**	(493.5)	**(5.2)**	(16.6)
Net decrease in cash	**(462.4)**	(413.1)	**(474.1)**	(428.6)
Cash and cash equivalents at beginning of year	**1,230.6**	1,643.7	**1,157.8**	1,586.4
Cash and cash equivalents at end of year	**768.2**	1,230.6	**683.7**	1,157.8

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than 90 days to original maturity:

	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
Cash in hand	**3.1**	2.5	**3.1**	2.5
Loans and advances to credit institutions	**192.9**	318.7	**108.4**	245.9
Investment securities	**572.2**	909.4	**572.2**	909.4
	768.2	1,230.6	**683.7**	1,157.8

The Group is required to maintain balances with the Bank of England which, at 31 March 2010, amounted to £6.5 million (2008/9: £6.0 million). The movement in this balance is included within loans and advances to credit institutions.

CASH FLOW STATEMENTS (cont'd)

For the year ended 31 March 2010

Cash flows from operating activities	**Group 2010 £m**	Group 2009 £m	**Society 2010 £m**	Society 2009 £m
(Loss)/Profit on ordinary activities before tax from continuing activities	**(18.5)**	(48.8)	**(11.5)**	15.3
Loss on ordinary activities before tax from discontinued activities	**(5.8)**	–	**–**	–
Movement in prepayments and accrued income	**2.1**	(2.9)	**2.2**	(3.0)
Movement in accruals and deferred income	**(5.5)**	(0.4)	**(5.5)**	(1.7)
Impairment losses on loans and advances	**20.6**	65.2	**1.0**	1.3
Goodwill impairment	**4.9**	–	**–**	–
Depreciation and amortisation	**4.0**	5.6	**3.9**	5.1
Interest on subordinated liabilities	**3.1**	12.0	**3.1**	12.0
Disposal of fixed assets and investment properties	**–**	1.1	**–**	1.1
Revaluations of investment properties, land and buildings	**(1.4)**	10.9	**–**	–
Movement in provisions for liabilities	**(6.2)**	11.4	**(6.2)**	11.4
Movement in derivative financial instruments	**(44.9)**	75.9	**(37.3)**	30.3
Movement in fair value adjustments for hedged risk	**(5.1)**	(67.2)	**23.0**	(8.9)
Change in retirement benefit obligations	**(6.4)**	(9.2)	**(6.4)**	(9.2)
Cash flows from operating profits before changes in operating assets and liabilities	**(59.1)**	53.6	**(33.7)**	53.7
Movement in loans and advances to customers	**482.3**	371.7	**249.0**	346.8
Movement in shares	**(10.9)**	1,011.9	**(10.9)**	1,011.9
Movement in deposits and other borrowings	**(757.1)**	(990.6)	**(771.7)**	(975.4)
Movement in loans and advances to credit institutions	**–**	22.3	**–**	22.3
Movement in trade and other receivables	**2.0**	(8.8)	**3.2**	1.4
Movement in trade and other payables	**(1.9)**	(5.5)	**(8.6)**	(1.8)
Tax received/(paid)	**8.9**	(4.9)	**3.8**	(0.4)
Net cash (outflow)/inflow from operating activities	**(335.8)**	449.7	**(568.9)**	458.5

Notes to the Accounts

For the year ended 31 March 2010

1. ACCOUNTING POLICIES

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

Basis of preparation

The Annual Accounts of the Group and the Society have been prepared in accordance with International Financial Reporting Standards ('IFRS') and its interpretations as adopted by the EU and effective at 31 March 2010; and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 and the Building Societies Act 1986 applicable to societies reporting under IFRS.

The Annual Accounts have been prepared under the historical cost convention as modified by the revaluation of Available for sale assets, Derivatives, Investment properties, Property, Plant & Equipment and other financial assets at Fair value through the profit or loss.

The Annual Accounts are presented in pounds Sterling and, except where otherwise indicated, have been rounded to the nearest one hundred thousand.

Going concern

The Directors have prepared forecasts for the Group, including its capital position, for a period in excess of twelve months from the date of approval of these financial statements. The Directors have also considered the effect upon the Group's business, financial position, liquidity and capital of more pessimistic, but plausible, trends in its business using stress testing and scenario analysis techniques. The resultant forecasts and projections show that the Group will be able to operate at adequate levels of both liquidity and capital for the foreseeable future.

The Directors, therefore, consider that the Society and Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly they continue to adopt the going concern basis in preparing the financial statements.

Accounting developments

The following Accounting Standard amendments have been applied for the first time in 2009/10:

Development	Effective Date	Impact
IAS 1, 'Presentation of Financial Statements' (2007)	**1/4/2009 (Mandatory)**	This standard replaces the current IAS 1, Presentation of Financial Statements. IAS 1, which the Group has complied with, sets the overall framework for the presentation of financial statements, including guidelines on structure and minimum content requirements. The standard requires 3 new primary statements; Statement of Financial Position, Statement of Comprehensive Income and Statement of Changes in Members' Interest. Application of this standard has not changed the recognition, measurement or disclosure of specific transactions and other events required by other standards.
IAS 23, 'Borrowing Costs (Revised)'	**1/1/2009**	This revised standard relates to interest costs on qualifying assets that take a substantial time to get ready for intended use or sale. The option to recognise all borrowing costs immediately as an expense is eliminated, such costs must be capitalised. All other borrowing costs should be expensed as incurred. This revision has had no material impact on the Group.
Amendment to IFRS 7, 'Financial Instruments: Disclosures'	**1/1/2009**	The amendment requires enhanced disclosures about fair value measurements and liquidity risk. These enhanced disclosures are presented in Note 31 of these Annual Accounts.
IFRS 8, 'Operating Segments'	**1/1/2009**	This new standard replaces IAS 14, Segment Reporting. This standard requires operating segments to be identified on the basis of internal reports and components of the Group regularly reviewed by the chief operating decision maker to allocate resources to segments and to assess their performance. The Group's operating segments are described in Note 34.

The following standards and interpretations became effective in 2009/10, but were not relevant for the Group's operations:

- IFRS 2, 'Share-based payment – Vesting conditions and cancellations';
- IAS 32, 'Puttable financial instruments and obligations arising on liquidation';
- IFRIC 13, 'Customer loyalty programmes';
- IFRIC 16, 'Hedges of a net investment in a foreign operation'.

The following standards and interpretations have been issued and are mandatory for the Group's accounting periods beginning on or after 1 July 2009 or later periods and would be relevant to the Group:

Development	Impact
IFRS 3, 'Business combinations'	The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently remeasured through the Income Statement. There is a choice, on an acquisition-by-acquisition basis, to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed. The Group will apply IFRS 3 (revised) prospectively to all business combinations from 1 April 2010.
IAS 39, 'Financial instruments: Recognition and measurement – Eligible hedged items'	The amendment provides guidance for two situations. Firstly, on the designation of a one-sided risk in a hedged item, IAS 39 concludes that a purchased option designated in its entirety as the hedging instrument of a one-sided risk will not be perfectly effective. Secondly the designation of inflation as a hedged risk or portion is not permitted unless in particular situations. Neither will give rise to any changes to the Group's financial statements.
Improvements to IFRS: 'Improvements to IFRS' were issued in May 2008	The 'improvements' contain numerous amendments to IFRS that the IASB considers non-urgent but necessary. Application will result in accounting changes for presentation, recognition or measurement purposes, as well as terminology or editorial amendments related to a variety of individual standards. Most of the amendments are effective for annual periods beginning on or after 1 January 2009 and 1 January 2010 respectively, with earlier application permitted. No material changes to Accounting policies are expected as a result of these amendments.
IFRS 9, 'Financial instruments part 1: Classification and measurement' (not yet endorsed by the EU)	The standard replaces those parts of IAS 39 relating to the classification and measurement of financial assets. Whilst adoption of IFRS 9 is mandatory from 1 January 2013, dependent on its endorsement by the EU, earlier adoption is permitted. The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.
IAS 27, 'Consolidated and Separate Financial Statements' (2008)	The changes to this standard require the effects of all transactions with non-controlling interests to be recorded in equity if there has been no change in control. The changes also specify the accounting where control of an entity is lost. The amendment should not significantly impact the Group.

The Group did not early-adopt any of the above in the 2010 financial year.

1. ACCOUNTING POLICIES (cont'd)

Basis of consolidation
The Group financial statements consolidate the financial statements of the Society and its subsidiary undertakings.

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

The purchase method of accounting has been adopted, under which the results of subsidiary undertakings acquired or disposed of in a year are included in the Income Statement from the date of acquisition or up to the date of disposal. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the Income Statement.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Society, investments in subsidiary undertakings are carried at cost less any charges for impairment.

Securitisation transactions
The Group has entered into two securitisation transactions in which it sells mortgages to Special purpose entities ('SPEs'). In accordance with IAS 39, the Group continues to recognise securitised assets as loans and advances to customers. In subsequent periods, income from the securitised mortgages is recognised by the Group as disclosed below.

The equity of the SPEs created for these securitisations is not owned by the Group. However, to comply with the Building Societies Act 1986 (International Accounting Standards and Other Accounting Amendments) Order 2004 and Standing Interpretations Committee (SIC) 12, the SPEs are included as subsidiaries in the consolidated financial statements.

Assets held for sale and discontinued operations
When the group intends to dispose of, or classify as held for sale, a business component that represents a separate major line of business or geographical area of operations it classifies such operations as discontinued. The post tax profit or loss of the discontinued operations is shown as a single amount on the face of the Income Statement, separate from the other results of the group.

Assets classified as held for sale are measured at the lower of carrying value and fair value less costs to sell. Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when management are committed to the sale.

Segmental reporting
The Group adopted IFRS 8, 'Operating Segments', on 1 April 2009. IFRS 8 requires operating segments to be identified on the basis of internal reports and components of the Group regularly reviewed by the chief operating decision maker to allocate resources to segments and to assess their performance. In terms of the Group, the chief operating decision maker has been deemed to be the Board of Directors.

Each segment is determined according to the distinguishable operating component of the Group that is regularly reviewed by the Group's chief operating decision maker and for which discrete financial information is available.

Information regarding the results of each reportable segment is included in Note 34.

Interest income and expense
Interest income and expense are recognised in the Income Statement for all instruments measured at amortised cost or Available for sale using the effective interest method.

Interest income or expense on other financial instruments is recognised within Interest receivable / Interest payable. Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset to the carrying amount as reduced by any allowance for impairment.

Effective interest rate
The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability and 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. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fee and commission income and expense
Fees and commissions are generally recognised on an accruals basis when the service has been provided. Mortgage arrangement fees and other direct costs are deferred and recognised as an adjustment to the effective interest rate on the loan. Commissions and fees arising from negotiating or participating in the negotiation of a transaction with a third party are recognised on completion of the underlying transaction.

Investment properties
Investment properties are properties held for long-term rental yields and capital appreciation. Investment properties are carried in the Statement of Financial Position at fair value, representing open market value determined annually by a qualified internal valuer and at least every five years by an external valuer. Changes in fair values are recorded in the Income Statement in accordance with IAS 40 (revised 2003). Leasehold properties held for long-term rental yields are classified as investment properties and carried at fair value.

Financial instruments
In accordance with IAS 39, all financial assets and liabilities – which include derivative financial instruments – have to be recognised in the Statement of Financial Position and measured in accordance with their assigned category.

a) Financial assets
The Group allocates financial assets to the following IAS 39 categories: financial assets at Fair value through profit or loss; Loans and receivables; Held to maturity investments; and Available for sale financial assets. Management determines the classification of its financial instruments at initial recognition.

Financial assets at Fair value through profit or loss
This category comprises two sub-categories: financial assets classified as Held for trading, and financial assets designated by the Group as at Fair value through profit or loss upon initial recognition.

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and Interest rate risk arising from operational, financing and investment activities. In accordance with its treasury policy and the Building Societies Act 1986, the Group does not hold or issue derivative financial instruments for trading purposes.

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

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

– hedges of the fair value of recognised assets or liabilities or unrecognised firm commitments (fair value hedges); or

– hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedges).

Hedge accounting is used for derivatives designated in this way provided that certain criteria are met.

The Group documents, at the inception of any hedging transaction, the relationship between the hedging instrument and the hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

(a) Fair value hedges
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 a hedged item, for which the effective interest method is used, is amortised to profit or loss over the remaining expected life of the previously hedged item.

(b) Cash flow hedges
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised within the Statement of Comprehensive Income and the Cashflow hedge reserve. The gain or loss relating to the ineffective portion is recognised immediately in the Income Statement. Amounts accumulated in equity are recycled to the Income Statement in the periods in which the hedged item will affect profit or loss (for example, when the forecast mortgage completion that is hedged takes place). When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in other operating income within the Income Statement. If a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the Income Statement.

(c) Derivatives that do not qualify for hedge accounting
Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the Income Statement. Certain derivatives are embedded within other non-derivative financial instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivatives 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, it is then measured in accordance with the relevant IFRS standard.

The Group designates certain financial assets upon initial recognition as at Fair value through profit or loss (fair value option). This designation cannot subsequently be changed. According to IAS 39, the fair value option is only applied when the following conditions are met:

– the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise; or

– the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis; or

– the financial assets consists of debt host and an embedded derivatives that must be separated.

To reduce accounting mismatch, the fair value option is applied to certain loans and receivables that are hedged with credit derivatives or interest rate swaps but for which the hedge accounting conditions of IAS 39 are not fulfilled. The loans would have been otherwise accounted for at amortised cost, whereas the derivatives are measured at fair value through profit or loss.

Financial assets for which the fair value option is applied are recognised in the Notes to the accounts as 'Financial assets designated at fair value'. Fair value changes relating to financial assets designated at Fair value through profit or loss are recognised in 'Net gains on financial instruments designated at Fair value through profit or loss'.

Available for sale (AFS)
Available for sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices or that are not classified as loans and receivables, held to maturity investments or financial assets at Fair value through profit or loss. The Group's investment securities (e.g. certificates of deposit, gilts, etc) are classified as Available for sale assets.

Available for sale financial assets are initially recognised at fair value, which is the cash consideration including any directly attributable transaction costs, and measured subsequently at fair value with gains and losses being recognised as other comprehensive income within the consolidated Statement of Comprehensive Income, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognised, whereupon the cumulative gains and losses previously recognised in other comprehensive income are reclassified to the Income Statement as a reclassification adjustment.

Interest is calculated using the effective interest method, and foreign currency gains and losses on monetary assets classified as Available for sale are recognised in the consolidated Income Statement. Dividends on Available for sale equity instruments are recognised in the Income Statement in 'Dividend income' when the Group's right to receive payment is established.

The Group assesses at each year end date whether there is objective evidence that a financial asset has been impaired. If an Available for sale financial asset is determined to be impaired, the cumulative gain or loss previously recognised in the Statement of Comprehensive Income is recognised in the Income Statement. If in a subsequent period the fair value increases, the impairment loss is reversed with the amount of the reversal recognised in the Income Statement.

The fair values of Available for sale assets are based on quoted prices or, if these are not available, valuation techniques developed by the Group. These include, but are not limited to, the use of discounted cash flow models, option pricing models and recent arm's length transactions.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

– those that the Group intends to sell immediately or in the short term, which are classified as held for trading, and those that the entity upon initial recognition designates as at Fair value through profit or loss; or

– those that the Group upon initial recognition designates as Available for sale; or

– those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any directly attributable transaction costs – and measured subsequently at amortised cost using the effective interest rate method. Loans and receivables are reported in the Statement of Financial Position as loans and advances to credit institutions or customers or as investment securities. Interest on loans is included in the consolidated Income Statement and is reported as 'Interest and similar income'. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the loan and recognised in the Income Statement as 'Impairment losses on loans and advances'.

1. ACCOUNTING POLICIES (cont'd)

Held to maturity financial assets
Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity, other than:

– those that the Group upon initial recognition designates as at Fair value through profit or loss;

– those that the Group designates as Available for sale; and

– those that meet the definition of loans and receivables.

These are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method. Interest on held to maturity investments is included in the Income Statement and reported as 'Interest and similar income'. In the case of an impairment, the impairment loss is being reported as a deduction from the carrying value of the investment and recognised in the Income Statement as 'Net gains/(losses) on investment securities'.

b) Financial liabilities
The Group's holding in financial liabilities is in financial liabilities at Fair value through profit or loss, financial liabilities at amortised cost and hedging derivatives. Financial liabilities are derecognised when extinguished.

All financial liabilities including shares, deposits, debt securities in issue and subordinated liabilities held by the Group are recognised initially at fair value, being the Issue proceeds, net of premia, discounts and directly attributable transaction costs incurred.

Financial liabilities are subsequently measured at amortised cost using the effective interest method, except for those financial liabilities, for example derivative liabilities, which are measured at fair value through the Income Statement.

c) Financial instruments designated at Fair value through profit or loss
Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated by management. The Group may designate financial instruments at fair value when the designation;

– eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or recognising gains and losses on them, on different bases;

– the assets or liabilities are managed, evaluated and reported internally on a fair value basis; or

– the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

The fair value designation, once made, is irrevocable. Designation of financial assets and financial liabilities are recognised when the group enters into the contractual provisions of the arrangements with counterparties, which is generally trade date, and are normally derecognised when sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken directly to the Income Statement. Subsequently, the fair values are remeasured, and gains and loss from changes therein are recognised in 'Net income from financial instruments designated at fair value'. Note 28 sets out the amount of each class of financial asset or liability that has been designated at fair value through profit or loss.

d) Impairment of financial assets

Impairment of mortgage loans and advances
The Group assesses at each year end date whether there is objective evidence that a financial asset is impaired. Objective evidence of impairment can be defined as one or more events occurring after the initial recognition of the asset that have an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

The Group first assesses whether objective evidence of impairment exists for financial assets using the following criteria;

– deterioration in payment status';

– tenant failure;

– expected future increase in arrears due to change in loan status;

– breach of loan covenants; and

– any other information discovered during annual review suggesting that a loss is likely in the short to medium term.

If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment, and for which an impairment loss is or continues to be recognised, are not included in a collective assessment of impairment.

If there is objective evidence of an impairment of loans and receivables, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the Income Statement.

Impairment losses on debt instruments
At each year end date the Group assesses whether or not there is objective evidence that individual debt instruments are impaired. In determining whether there is any objective evidence of impairment the Group takes into account a number of factors including;

– significant financial difficulties of the issuer or obligor;

– any breach of contract or covenants;

– the granting of any concession or rearrangement of terms;

– the disappearance of an active market;

– any significant downgrade of ratings; and

– any significant reduction in market value.

In some cases a significant adverse change in one of the above factors will cause the Group to determine that there is objective evidence of impairment. In other cases it may not be possible to identify a single event that identifies impairment. The Group may additionally determine that there is impairment where there are a number of factors contributing to that view.

Where the Group determines that there is objective evidence of impairment or that trigger events exist at the year end date, then, in the case of Available for sale instruments, the cumulative loss that had been recognised directly in reserves is removed from reserves and recognised in the Income Statement. In the case of Held to maturity instruments an appropriate charge is made to the Income Statement.

If, in a subsequent period, the fair value of a debt instrument classified as Available for sale increases and the increase can be related to an event occurring after the impairment loss was recognised through the Income Statement, the impairment loss shall be reversed, with the amount of the reversal recognised through the Income Statement.

e) Derecognition of financial assets and liabilities

The Group's policy is to derecognise financial assets when the contractual right to the cash flows from the financial asset expires. The Group also derecognises financial assets that it transfers to another party provided the transfer of the asset also transfers the right to receive the cash flows of the financial asset and substantially all the risks and rewards of ownership.

The Group derecognises financial liabilities only when the obligation specified in the contract is discharged, cancelled or has expired.

f) Determination of fair value

The Group determines fair values by the three tier valuation hierarchy as defined within IAS 39 and Amendments to IFRS 7, Financial Instruments: Disclosures.

i) For financial instruments traded in active markets, the determination of fair values of financial assets and financial liabilities is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges (for example, FTSE, NYSE) and broker quotes from Bloomberg and Reuters.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indications that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

ii) For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs (for example, LIBOR yield curve, FX rates, volatilities and counterparty spreads) existing at the reporting dates.

The Group uses widely recognised valuation models for determining fair values of non-standardised financial instruments of lower complexity, such as options or interest rate and currency swaps. For these financial instruments, inputs into models are generally market observable.

iii) For more complex instruments, the Group uses internally developed models, which are usually based on valuation methods and techniques generally recognised as standard within the industry. Some of the inputs to these models may not be market observable and are therefore estimated based on assumptions. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's-length.

The impact on net profit of financial instrument valuations reflecting non-market observable inputs (level 3 valuations) is disclosed in Note 31.

Intangible assets

Goodwill

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

For the purpose of impairment testing, goodwill is allocated to each of the Group's applicable cash generating units. Each unit is tested at least annually and reviewed for impairment indicators at each reporting date, with a further impairment test performed if indicators deem necessary. The impairment test compares the carrying value of goodwill to the higher of its fair value less costs of sale and its value in use. The value in use calculations are carried out by discounting the future cash flows of the cash generating unit. Future cash flows are based upon approved profit budgets for the next five years (adjusted for non-cash items) and assumed growth thereafter for the next 10 years in line with the Bank of England's long term target for inflation. The Group estimates the discount rate based on current costs of capital adjusted for the risks inherent in each cash generating unit. A 15-year time horizon has been used to reflect that cash generating units are held for the long-term.

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

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

Computer software

Computer software which is not an integral part of the related hardware is recorded as an intangible asset. The identifiable and directly associated external and internal costs of acquiring and developing software are capitalised where the software is controlled by the Group, and where it is probable that future economic benefits that exceed its cost will flow from its use over more than one year. Intangible assets are held at amortised cost, amortisation is charged to the Income Statement on a straight line basis over the estimated useful life of 3-7 years; they are subject to regular impairment reviews. Costs associated with maintaining software are recognised as an expense when incurred.

Other acquired intangible assets

Other acquired intangible assets are capitalised if they can be separately identified from goodwill. Their useful lives are based on the period for which they are expected to generate economic benefits. If there are any signs of a decrease in value the asset will be subject to impairment testing. If there is no foreseeable limit on this period, their life is deemed to be indefinite and the asset tested at each reporting date for impairment.

These intangible assets are held at amortised cost, amortisation is charged to the Income Statement on a straight line basis over the estimated useful life of 20 years.

Property, plant and equipment

Land and buildings comprise mainly branches and offices. All property is stated at valuation less depreciation and plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. All gains on the revaluation of property, plant and equipment are recognised in the revaluation reserve when they arise.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the Income Statement during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method (unless otherwise stated) to allocate their cost less their residual values over their estimated useful lives, in the table below.

1. ACCOUNTING POLICIES (cont'd)

Asset class	Estimated useful life
Buildings	50 years
Short leasehold	Properties Annual instalments over the period of lease
Equipment, f&f and motor vehicles	
Office equipment	3 to 7 years
Computer equipment	3 to 7 years
Motor vehicles	25% per annum reducing balance
Refurbishments	5 to 10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each year end date. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the Income Statement.

Leases
The leases entered into by the Group are primarily operating leases. The total payments made under operating leases are charged to the Income Statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Foreign currency translation
Foreign currency transactions are translated into Sterling using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Income Statement.

Cash and cash equivalents
For the purposes of the cash flow statement, cash comprises cash in hand and loans and advances to credit institutions repayable on demand. Cash equivalents comprise highly liquid investments that are convertible into cash with an insignificant risk of changes in value, with original maturities of 90 days or less.

Taxation
Tax on the profits for the year comprises current tax and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity or items recognised in other comprehensive income, where it is recognised in the Statement of Comprehensive Income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted on the date of the Statement of Financial Position, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided in full, using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following differences: the initial recognition of goodwill, the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor income and expenditure, and differences relating to investments in subsidiary undertakings to the extent that it is probable they will not reverse in the foreseeable future.

Deferred tax is determined using tax rates (and laws) that have been enacted by the year end date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Provisions
Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Employee benefits
The Group provides a defined benefit scheme on behalf of directors and both a defined benefit scheme and a defined contribution scheme on behalf of staff. The defined benefit scheme is funded by contributions partly from the employees and partly from the Society at rates assessed by independent actuaries. These contributions are invested separately from the Group's assets. The Scheme assets are measured at market value at each year end date and the liabilities are measured using the projected unit valuation method, by qualified actuaries, discounted using a corporate bond rate. The resulting pension scheme surplus or deficit is recognised immediately in the Statement of Financial Position, net of deferred tax.

Actuarial gains and losses are recognised in full in the period in which they occur. As permitted by the revised standard, actuarial gains and losses are recognised outside profit or loss and presented in the Statement of Comprehensive Income.

Following the curtailment, any increase in the present value of the liabilities of the defined benefit scheme is expected to arise only from changes in actuarial assumptions surrounding the existing liabilities which would be charged to the Statement of Comprehensive Income. The expected return on the defined benefits scheme's assets and the increase in the scheme's liabilities, arising from the passage of time, are disclosed as a pension finance (charge)/income. Any resulting actuarial gains or losses, that is gains or losses arising from differences in the expected return on scheme assets compared to the actual return and changes in assumptions, or factors which affect those assumptions, used in measuring the scheme liabilities, are recognised immediately in the Statement of Comprehensive Income.

For defined contribution plans, the contributions are recognised as employee benefit expense in the Income Statement when they are due, in accordance with the rules of the scheme. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

Critical accounting estimates and judgements in applying Accounting policies
The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Pensions
The Group operates a defined benefit pension scheme. Significant judgements (on areas such as future interest and inflation rates and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme.

These judgements, which are based upon the Board receiving external advice from the scheme actuaries, are outlined in Note 30 to the Accounts.

Impairment losses on loans and advances
The creation of impairment provisions for a portfolio of mortgage loans is inherently uncertain and requires the exercise of a significant degree of judgement. Provisions are calculated using historic default and loss experience, but require judgement to be exercised in predicting economic conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time before impairments are identified (emergence period). The most critical estimate is of the level of house prices where a variance of 10% equates to £3.9 million of provision. Other sensitivities include the emergence period, where a variance of six months equates to £0.3 million, and the loss given default rate, where a 10% variance equates to £1.3 million of provision.

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

Effective interest rate
The calculation of an effective interest rate requires the Group to make assumptions around the expected lives of mortgages and the likely levels of early repayment fees (ERFs) to be received. Management regularly reviews these assumptions and compares with actual results.

Were the average lives of the mortgages to increase by 5%, the carrying value of mortgages would change by £2.4 million with a corresponding change to income.

Investment properties
The calculation of the fair value of investment properties involves certain judgments around how and when the property is to be sold. These are regularly reviewed by management to ensure they are in line with the future strategy of the Group.

If house prices were to change by 5%, the carrying value of the Investment properties would change by £5.8 million with a corresponding change to income.

Financial Services Compensation Scheme (FSCS)
Following FSA guidance, the Society provides for an estimate of the management expense levy payable for those years triggered by the reporting date. The amount provided by the Group is based upon the following factors;

– the FSCS' estimate of the total management expense levy;

– the Directors' estimate of the Group's share of qualifying deposits; and

– the Directors' estimate of future interest rates.

The impact of a 1% increase in the estimate of 12-month LIBOR rate would increase the provision by £1.3m and vice versa.

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

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

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

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

Deferred tax assets
A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

The recognition of the deferred tax asset is mainly dependent upon the projection of future taxable profits and future reversals of existing taxable temporary differences. Tax losses were incurred in the Society and a number of Group Companies in the last 2 years. Management has evaluated the factors contributing to the losses to determine whether the factors leading to the losses are temporary or indicative of a permanent decline in earnings. Based on its analysis, management has determined that the losses were primarily caused by increases in credit losses and contracting margin due to the current housing and credit market conditions, as well as continued weakening in the general economy, which has led to higher unemployment levels and, consequently, higher credit losses. Management's projections of future taxable income are based on business plans, future capital requirements and ongoing tax planning strategies. These projections include assumptions about the depth and severity of further house price depreciation, assumptions about the UK recession, including unemployment levels and their related impact on credit losses.

The assumptions surrounding future expected credit losses represent the most subjective areas of judgement in management's projections of future taxable income. Management's forecasts support the assumption that it is probable that the results of future operations will generate sufficient taxable income to utilise the deferred tax assets.

Securitisation transactions
In order to determine whether the Society controls a Special purpose entity ('SPE') or not, the Society has to make judgments about risks and rewards and assess the ability to make operational decisions for the SPE in question. In many instances, elements are present that, considered in isolation, indicate control or lack of control over an SPE, but when considered together make it difficult to reach a clear conclusion. When assessing whether the Group has to consolidate an SPE it evaluates a range of factors. The following are the prime factors that are considered and the applicable accounting treatment in each case:

– When the Group, in substance, controls the entity to which financial assets have been transferred, the entity is included in these consolidated financial statements and the transferred assets are recognised in the Group's Statement of Financial Position.

– When the Group transfers financial assets to an unconsolidated entity and it retains substantially all of the risk and rewards relating to the transferred assets, the transferred assets are recognised in the Group's Statement of Financial Position.

– When the Group transfers substantially all the risks and rewards relating to the transferred financial assets to an unconsolidated entity, the assets are derecognised from the Group's Statement of Financial Position.

– When the Group neither transfers nor retains substantially all the risks and rewards relating to a transferred financial asset and it retains control of the transferred asset, the Group continues to recognise the transferred financial asset to the extent of its continuing involvement in that transferred financial asset.

Details of the Group's securitisation activities are given in Note 12.

2. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
On loans fully secured on residential property	**174.3**	321.9	**95.6**	162.5
On other loans				
Connected undertakings	**–**	–	**116.8**	153.9
Loans fully secured on land	**63.2**	93.7	**–**	–
On investment securities	**21.8**	60.2	**39.0**	105.2
On other liquid assets	**2.6**	32.0	**2.0**	31.9
Net (expense)/income on financial instruments	**(11.6)**	0.9	**(13.8)**	0.9
Total interest income	**250.3**	508.7	**239.6**	454.4
Interest receivable includes:				
Income from fixed income securities	**19.4**	37.6	**19.4**	37.6

Included within interest income is £nil (2008/9: £0.4m) with respect to the unwind of the impairment provision discount. Included within interest receivable and similar income is interest accrued on impaired financial assets: Group £6.5m (2008/9: £9.7m) and Society £2.6m (2008/9: £4.0m). Included within interest income are £3.8m (2008/9: £1.6m) gains recycled from the Available for sale reserve arising on disposal of investment securities.

3. INTEREST EXPENSE AND SIMILAR CHARGES

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
On shares held by individuals	**191.7**	270.5	**191.7**	270.5
On subordinated debt	**3.1**	12.0	**3.1**	12.0
On deposits from banks and other deposits	**29.9**	154.6	**23.4**	113.7
Net (income)/expense on financial instruments	**(4.1)**	4.6	**(4.1)**	4.6
Total interest expense	**220.6**	441.7	**214.1**	400.8

4. OTHER OPERATING INCOME

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Other operating income comprises:				
Rent receivable	**3.9**	3.9	**0.1**	0.1
Pension fund cost (Note 30)	**(0.5)**	(0.2)	**(0.5)**	(0.2)
Net fair value gain on derivatives	**2.7**	10.6	**2.6**	11.6
Other	**0.3**	0.2	**(0.3)**	–
Total other operating income	**6.4**	14.5	**1.9**	11.5

5. ADMINISTRATIVE EXPENSES

	Group		Society	
	2010 £m	Re-presented 2009 £m	**2010 £m**	2009 £m
Staff costs				
Wages and salaries	**23.2**	31.2	**22.7**	28.6
Social security costs	**2.2**	2.8	**2.2**	2.5
Other pension costs/(income)	**1.2**	(5.3)	**1.2**	(5.4)
Rental charges payable under operating leases	**1.4**	0.9	**0.8**	0.8
Other administrative expenses	**14.2**	18.9	**9.4**	13.3
	42.2	48.5	**36.3**	39.8

Wages and salaries in 2010 includes £3.3m (2008/9: £4.1m) redundancy costs paid as part of the restructuring and rationalisation of the Group's cost base. Other pension costs/(income) in 2008/9 includes the gain on curtailment of the defined benefit pension scheme (see Note 30).

Other administrative expenses include:				
Remuneration of auditors and their associates				
Audit of these financial statements (excl VAT)	**0.1**	0.1	**0.1**	0.1
Audit of the subsidiary financial statements (excl VAT)	**0.1**	0.1	**–**	–
Advisory services in relation to analysis of credit risk (excl VAT)	**–**	0.5	**–**	0.5
All other services (excl VAT)	**–**	0.2	**–**	0.2

6. EMPLOYEE NUMBERS

	Group		Society	
	2010	2009	**2010**	2009
The average number of employees employed throughout the year was:				
Full time	**694**	816	**664**	756
Part time	**177**	172	**166**	169
	871	988	**830**	925
Building Society				
Central administration	**508**	594	**507**	594
Branches	**323**	331	**323**	331
Subsidiaries	**40**	63	**–**	–
	871	988	**830**	925

7. DIRECTORS' EMOLUMENTS

Total Directors' emoluments amounted to £2.045m (2008/9: £1.740m). Full details are given in the Directors' Remuneration Report on pages 27 to 29.

8. TAXATION

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
UK Corporation tax at 28%	**(0.9)**	(5.0)	**0.2**	2.9
Corporation tax – adjustment in respect of prior years	**(1.2)**	1.6	**(3.6)**	0.3
Total current tax	**(2.1)**	(3.4)	**(3.4)**	3.2
Deferred tax (Note 19)				
Current year	**(5.9)**	(6.1)	**(1.4)**	1.3
Adjustment in respect of prior periods	**0.7**	–	**3.8**	–
Tax on (loss)/profit on ordinary activities	**(7.3)**	(9.5)	**(1.0)**	4.5

UK corporation tax has been calculated at the applicable prevailing rate.

8. TAXATION (cont'd)

Further information about deferred tax is presented in Note 19. The tax on the Group's profit before tax differs from the theoretical amount that would arise using the standard rate of tax.

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
(Loss)/Profit before tax	**(24.3)**	(48.8)	**(11.5)**	15.3
(Loss)/Profit before tax multiplied by the standard rate of tax	**(6.8)**	(13.7)	**(3.2)**	4.3
Effects of:				
Expenses not deductible for tax purposes	**0.2**	0.4	**2.0**	–
Unrelieved losses	**–**	1.1	**–**	–
Non-taxable income	**(0.2)**	(0.1)	**–**	(0.1)
Adjustment in respect of prior years	**(0.5)**	1.6	**0.2**	0.3
Indexation of revaluation gain	**–**	1.2	**–**	–
Tax (credit)/expense	**(7.3)**	(9.5)	**(1.0)**	4.5

9. CASH AND BALANCES WITH THE BANK OF ENGLAND

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Cash in hand	**3.1**	2.5	**3.1**	2.5
Mandatory reserve deposits with central banks	**6.5**	6.0	**6.5**	6.0
	9.6	8.5	**9.6**	8.5

Mandatory reserve deposits are not available for use in the Group's day to day operations. Cash in hand and balances with central banks and mandatory reserve deposits are non-interest bearing.

10. INVESTMENT SECURITIES

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Investment securities: Available for sale;				
listed	**1,214.3**	1,529.1	**2,395.6**	1,529.0
unlisted	**234.9**	166.0	**234.9**	1,348.9
Total securities: Available for sale	**1,449.2**	1,695.1	**2,630.5**	2,877.9

Investment securities are stated at fair value in accordance with IAS39. The Group and Society did not make any material gains or losses from derecognition of Available for sale financial assets.

The movement in investment securities may be summarised as follows:

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
At 1 April	**1,695.1**	914.1	**2,877.9**	914.1
Additions	**5,208.3**	6,431.5	**5,208.3**	7,650.0
Disposals (sale and redemption)	**(5,476.6)**	(5,632.9)	**(5,478.1)**	(5,668.6)
Gains/(Losses) from changes in fair value	**22.4**	(17.6)	**22.4**	(17.6)
At 31 March	**1,449.2**	1,695.1	**2,630.5**	2,877.9

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

At 31 March 2010, £86.8m (2008/9: £412.5m) of investment securities were pledged as collateral under sale and repurchase agreements. All sale and repurchase transactions are conducted in line with market standard terms and conditions as defined in ISMA PSA Global Master Repurchase Agreements.

11. DERIVATIVE FINANCIAL INSTRUMENTS

A description of the derivative financial instruments used by the Group for hedging purposes is given in Note 31 'Financial Instruments'. The fair values at 31 March 2010 of derivative instruments held are set out below:

Group – 2010	**Notional principal amount £m**	**FAIR VALUES Assets £m**	**FAIR VALUES Liabilities £m**
Derivatives held for hedging			
Derivatives designated as fair value hedges	**2,806.4**	**34.3**	**(88.4)**
Derivatives designated as cashflow hedges	**40.8**	**13.1**	**–**
Other derivatives held for hedging	**417.6**	**31.0**	**(8.3)**
Total derivative assets/(liabilities) held for hedging	**3,264.8**	**78.4**	**(96.7)**

Society – 2010	**Notional principal amount £m**	**FAIR VALUES Assets £m**	**FAIR VALUES Liabilities £m**
Derivatives held for hedging			
Derivatives designated as fair value hedges	**2,189.5**	**34.3**	**(61.6)**
Derivatives designated as cashflow hedges	**40.8**	**13.1**	**–**
Other derivatives held for hedging	**998.3**	**48.6**	**(17.0)**
Total derivative assets/(liabilities) held for hedging	**3,228.6**	**96.0**	**(78.6)**

Group – 2009	Notional principal amount £m	FAIR VALUES Assets £m	FAIR VALUES Liabilities £m
Derivatives held for hedging			
Derivatives designated as fair value hedges	1,614.7	27.6	(113.1)
Derivatives designated as cashflow hedges	40.8	15.3	–
Other derivatives held for hedging	331.6	19.2	(12.2)
Total derivative assets/(liabilities) held for hedging	1,987.1	62.1	(125.3)

Society – 2009	Notional principal amount £m	FAIR VALUES Assets £m	FAIR VALUES Liabilities £m
Derivatives held for hedging			
Derivatives designated as fair value hedges	946.8	61.7	(114.7)
Derivatives designated as cashflow hedges	40.8	15.3	–
Other derivatives held for hedging	2,887.6	19.2	(1.4)
Total derivative assets/(liabilities) held for hedging	3,875.2	96.2	(116.1)

12. LOANS AND ADVANCES TO CUSTOMERS

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Loans and receivables				
Loans fully secured on residential property	**5,067.5**	5,468.3	**2,336.2**	2,583.3
Other loans				
Loans fully secured on land	**1,331.6**	1,388.9	**27.9**	30.5
Other loans	**0.2**	0.2	**–**	–
	6,399.3	6,857.4	**2,364.1**	2,613.8
At fair value through profit and loss				
Other loans				
Loans fully secured on land (Note 28)	**121.7**	148.0	**–**	–
	6,521.0	7,005.4	**2,364.1**	2,613.8
Less: impairment provisions	**(84.0)**	(82.2)	**(12.4)**	(15.3)
	6,437.0	6,923.2	**2,351.7**	2,598.5

The net profit on loans and advances which are designated as Fair value through profit and loss was £nil (2009: £nil).

Included within Loans and advances to customers are £367.9m (2008/9: £414.4m) of commercial mortgage balances that the Group has sold to bankruptcy remote special purpose entities ('SPEs'). The purchase price paid for these commercial mortgages is dependent upon their future performance within the SPEs. The SPEs have been funded by issuing Commercial Mortgage backed securities ('MBSs').

The Group has made subordinated loans to these SPEs to provide some level of credit enhancement to the MBSs. In future periods the Group will earn interest income on the subordinated loans, fees for managing the loans and will earn deferred consideration once the cashflows generated by the SPEs have been used to pay interest and capital to the holders of the MBSs. Since the Group maintains substantially all of the risks (key risk being an exposure to credit risk through the subordinated loan agreements) and rewards emanating from the commercial mortgages, they have been retained on the Group's Statement of Financial Position in accordance with IAS 39. A further £180.3m commercial and £974.9m residential mortgage balances have been sold to bankruptcy remote special purpose entities where the loan notes have been retained by the West Bromwich Building Society.

13. ALLOWANCE FOR LOSSES ON LOANS AND ADVANCES

	Loans fully secured on residential property		Loans fully secured on land		Total		
Group	**Individual £m**	**Collective £m**	**Individual £m**	**Collective £m**	**Individual £m**	**Collective £m**	**Total £m**
At 1 April 2009	29.4	3.1	31.8	17.9	61.2	21.0	**82.2**
Amounts written off	(11.2)	–	(7.6)	–	(18.8)	–	**(18.8)**
Charge/(Credit) for the year comprises:							
Provision/(release) for loan impairment	15.9	2.1	8.0	(4.7)	23.9	(2.6)	**21.3**
Adjustments to provisions resulting from recoveries	(0.7)	–	–	–	(0.7)	–	**(0.7)**
Charge/(Credit) for the year	15.2	2.1	8.0	(4.7)	23.2	(2.6)	**20.6**
As at 31 March 2010	**33.4**	**5.2**	**32.2**	**13.2**	**65.6**	**18.4**	**84.0**
Society							
At 1 April 2009	14.8	0.5	–	–	14.8	0.5	**15.3**
Amounts written off	(3.9)	–	–	–	(3.9)	–	**(3.9)**
Charge for the year comprises:							
Provision for loan impairment	1.1	0.1	–	–	1.1	0.1	**1.2**
Adjustments to provisions resulting from recoveries	(0.2)	–	–	–	(0.2)	–	**(0.2)**
Charge for the year	0.9	0.1	–	–	0.9	0.1	**1.0**
As at 31 March 2010	**11.8**	**0.6**	–	–	**11.8**	**0.6**	**12.4**

	Loans fully secured on residential property		Loans fully secured on land		Total		
Group	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m	Total £m
At 1 April 2008	20.8	1.6	1.0	1.4	21.8	3.0	24.8
Amounts written off	(6.9)	–	(0.5)	–	(7.4)	–	(7.4)
Discount unwind	(0.4)	–	–	–	(0.4)	–	(0.4)
Charge for the year comprises:							
Provision for loan impairment	16.7	1.5	31.3	16.5	48.0	18.0	66.0
Adjustments to provisions resulting from recoveries	(0.8)	–	–	–	(0.8)	–	(0.8)
Charge for the year	15.9	1.5	31.3	16.5	47.2	18.0	65.2
As at 31 March 2009	29.4	3.1	31.8	17.9	61.2	21.0	82.2
Society							
At 1 April 2008	15.6	0.5	–	–	15.6	0.5	16.1
Amounts written off	(1.7)	–	–	–	(1.7)	–	(1.7)
Discount unwind	(0.4)	–	–	–	(0.4)	–	(0.4)
Charge for the year comprises:							
Provision for loan impairment	2.1	–	–	–	2.1	–	2.1
Adjustments to provisions resulting from recoveries	(0.8)	–	–	–	(0.8)	–	(0.8)
Charge for the year	1.3	–	–	–	1.3	–	1.3
As at 31 March 2009	14.8	0.5	–	–	14.8	0.5	15.3

Included within Group loans fully secured on residential property are loans originated through the Commercial division. As at 31 March 2010, the provision against these loans totalled £13.0m (2008/9: £0.9m), with a charge for the year of £12.4m (2008/9: £0.9m). The total Group provision balance relating to the commercial division is thus £58.4m (2008/9: £50.6m), with a charge for the year of £15.7m (2008/9: £48.7m). The prior year figures have been represented to reflect the underlying security.

14. INVESTMENTS

a) Subsidiary undertakings

	Society	
	2010	2009
	£m	£m
Shares held in subsidiary undertakings	**0.6**	6.8
Loans to subsidiary undertakings	**2,733.5**	2,899.0
	2,734.1	2,905.8

During the year, the West Bromwich Building Society acquired the remaining shares of Insignia Finance Limited for a total consideration of £0.6m giving rise to goodwill of £0.6m (see Note 15).

During the year a decision to sell the Society's interest in the Mortgage Force Limited Subsidiary was taken by the Board. The carrying value of the investment in the subsidiary was impaired by £6.8m down to nil during the current financial year (see Note 14(b)).

Shares in subsidiary undertakings are held at cost less impairment. Investments in subsidiary undertakings are financial fixed assets. The net movement in loans to subsidiary undertakings during the year is as follows:

Society	**£m**
At 1 April 2009	2,899.0
Decrease in loans to subsidiaries	(165.5)
At 31 March 2010	**2,733.5**

All subsidiary loans are provided at open market rates.

The Society holds directly (unless otherwise stated) the following interests in key subsidiary undertakings, all of which are registered in England.

Name	Major activities	Class of shares held	Interest of Society
West Bromwich Mortgage Company Limited	Hold and dispose of debts secured on land and lend money on the security of land	Ordinary £1 shares	100%
West Bromwich Commercial Limited	Commercial lending	Ordinary £1 shares	100%
Mortgage Force Limited	Franchised mortgage broker	Ordinary £1 shares	100%
WBBS Computer Finance Limited	Leasing and licensing computer equipment	Ordinary £1 shares	100%
CL Mortgages Limited (1)	Hold and dispose of debts secured on land and lend money on the security of land	Ordinary £1 shares	100%
West Bromwich Homes Limited	Investment in property for rental	Ordinary £1 shares	100%
Insync Financial Planning Limited	Financial services product vendor	Ordinary £1 shares	100%
Insignia Finance Limited	Second charge lending	Ordinary £500 shares	100%
White Label Lending Limited (2)	Second charge lending	Ordinary £1 shares	100%

(1) The share capital of CL Mortgages is held by West Bromwich Mortgage Company Limited.

(2) The entire share capital of White Label Lending Limited is held by Insignia Finance Limited.

Securitisation entities

The results of the following securitisation entities are consolidated into the results of the Group under IAS 27 (Consolidated and separate financial statements):

Name	Country of incorporation	Principal activity
Sandwell Commercial Finance No 1 Plc	United Kingdom	Securitisation entity
Sandwell Finance Holdings Limited	United Kingdom	Holding company
Sandwell Commercial Finance No 2 Plc	United Kingdom	Securitisation entity
Hawthorn Hold Co Limited	United Kingdom	Holding company
Hawthorn Asset Co Limited	United Kingdom	Securitisation entity
Hawthorn Finance Limited	Jersey	Securitisation entity
Sandwell Commercial Finance No.3 Ltd	Jersey	Securitisation entity

The Society has no shareholdings in any of the companies listed above. Other than those stated above, all are incorporated in the United Kingdom and operate in Great Britain.

The assets and liabilities within Sandwell Finance No 1 Plc have been accounted for using the fair value option available under IAS 39.

14. INVESTMENTS (cont'd)

b) Disposal of subsidiary

During the year the Board decided to dispose of the Group's entire holding in Mortgage Force Limited and therefore all the assets and liabilities of the subsidiary company were classified as Held For Sale. Mortgage Force Limited was not a discontinued operation or classified as Held For Sale as at 31 March 2009 and the comparative Income Statement and Statement of Comprehensive Income have been re-presented to show the discontinued operation separately from the continuing operations.

An analysis of the contribution made by Mortgage Force to the Group is shown in the table below and the assets and liabilities are disclosed on the face of the Statement of Financial Position.

	2010 £m	2009 £m
Fees and commissions receivable	**2.4**	3.0
Fees and commissions payable	**(1.9)**	(1.7)
Total operating income	**0.5**	1.3
Administrative expenses	**(0.9)**	(1.3)
Depreciation and amortisation (Note 16)	**(0.5)**	–
Impairment of investments	**(4.9)**	
Loss before tax	**(5.8)**	–
Taxation	**–**	–
Loss for the year	**(5.8)**	–

Included in the Statement of Financial Position are assets of £2.2m and liabilities of £0.5m that are held for sale and relate to the Mortgage Force Limited discontinued subsidiary.

An analysis of the cash flows included within the Group Statement of Cash Flows made by Mortgage Force to the Group is shown in the table below:

	2010 £m	2009 £m
Net cash flows from operating activities	**(5.8)**	–
Net cash flows from investing activities	**0.3**	(0.7)
Net cash flows from discontinued activities	**(5.5)**	(0.7)

15. GOODWILL

	Group 2010 £m	Group 2009 £m
Cost		
At 1 April	7.3	7.3
Additions in the period	0.6	–
At period end	**7.9**	7.3
Aggregate impairment		
At 1 April	2.4	2.4
Impairment for the year	4.9	–
At period end	**7.3**	2.4
Net book value at 31 March	**0.6**	4.9

During the year, the Society purchased the remaining shares in Insignia Finance Limited for a total consideration of £0.6m giving rise to an equal amount of goodwill of £0.6m.

In accordance with IAS38 (Intangible Assets) the goodwill has been assessed as having an indefinite life. The Group carries out an impairment test in relation to goodwill on an annual basis. In assessing the recoverable amount of the goodwill the Group allocates the goodwill to the lowest cash generating unit (CGU) within the Group.

The recoverable amount of the Mortgage Force CGU has been measured at fair value less costs of sale, which, following the decision by the Board to discontinue activities through the Mortgage Force subsidiary, are nil. An impairment charge of £4.9 million has been recognised in the Income Statement which writes the goodwill down to nil as at 31 March 2010.

The recoverable amount of all other CGUs has been based upon the future earnings and based upon value in use calculations. The calculations use cash flow projections based upon the five year business plan approved by the Group Board. Further cash flows have then been included for the following 10 years (applying longer term growth rates of 3% (2008/9: 3%)), reflecting the long term nature of the businesses concerned. The long term growth rates are based upon management's expectations of long term growth in GDP over the forecast period. The pre-tax discount rate used in discounting projected cash flows has been 12.5% for 2010 (2008/9: 12.5%), reflecting management's required return from such CGU.

16. INTANGIBLE ASSETS

Group	Computer software 2010 £m	Brand name 2010 £m	Total 2010 £m	Computer software 2009 £m	Brand name 2009 £m	Total 2009 £m
Cost						
At beginning of year	13.1	0.6	13.7	18.4	0.6	19.0
Additions	2.6	–	2.6	2.1	–	2.1
Transfers	(4.2)	–	(4.2)	–	–	–
Disposals	(0.1)	–	(0.1)	(7.4)	–	(7.4)
Impairment	–	(0.6)	(0.6)	–	–	–
At end of year	**11.4**	**–**	**11.4**	13.1	0.6	13.7
Aggregate amortisation						
At beginning of year	7.4	0.1	7.5	12.3	0.1	12.4
Transfers	(4.1)	–	(4.1)	–	–	–
Charge for the year	1.6	–	1.6	2.5	–	2.5
Disposals	(0.1)	–	(0.1)	(7.4)	–	(7.4)
Impairment	–	(0.1)	(0.1)	–	–	–
At end of year	**4.8**	**–**	**4.8**	7.4	0.1	7.5
Net book value at end of year	**6.6**	–	**6.6**	5.7	0.5	6.2
Net book value at beginning of year	5.7	0.5	6.2	6.1	0.5	6.6

Society	Computer software 2010 £m	Total 2010 £m	Computer software 2009 £m	Total 2009 £m
Cost				
At beginning of year	13.0	13.0	11.4	11.4
Additions	2.6	2.6	2.1	2.1
Transfers	(4.2)	(4.2)	–	–
Disposals	–	–	(0.5)	(0.5)
At end of year	**11.4**	**11.4**	13.0	13.0
Aggregate amortisation				
At beginning of year	7.3	7.3	5.6	5.6
Transfers	(4.1)	(4.1)	–	–
Charge for the year	1.6	1.6	2.2	2.2
Disposals	–	–	(0.5)	(0.5)
At end of year	**4.8**	**4.8**	7.3	7.3
Net book value at end of year	**6.6**	**6.6**	5.7	5.7
Net book value at beginning of year	5.7	5.7	5.8	5.8

All amortisation charges in the year have been charged through 'Depreciation and amortisation'. During the year an exercise was undertaken to review the categorisation of the Intangible assets held by the Group, resulting in a transfer of cost and accumulated depreciation of £4.1m (Society: £4.1m) from Intangible assets to Property, plant and equipment.

17. INVESTMENT PROPERTIES

	Group	
	2010	2009
	£m	£m
Cost or valuation		
At 1 April	**114.4**	124.1
Additions – acquisitions	**0.4**	1.4
Disposals	**(0.2)**	(0.2)
Net gains/(losses) from fair value adjustments	**1.4**	(10.9)
At 31 March	**116.0**	114.4

A National firm of specialist residential valuers, Landmark Chartered Surveyors has carried out a valuation review of the residential investment properties held by West Bromwich Homes. This has taken the form of a physical 'drive by' inspection of a sample of approximately 10% of the total portfolio, and desktop appraisals of all remaining properties on an individual basis.

Landmark Chartered Surveyors confirm that based on their valuations of the individual properties, they are satisfied that the overall valuation of the portfolio, as at 31 March 2010, is a fair reflection of Market Value.

The valuation has been prepared in accordance with the RICS Valuation Standards Manual (known as the 'Red Book') in particular UK Practice Statement 1. Market Value is as defined in Practice Statement 3.2.

If the land and building was carried at cost, the carrying amount would have been £89.3m (2008/9: £89.1m).

The Group leases investment properties to non-commercial individuals for a contract period of up to 18 months. The future minimum lease receipts under non-cancellable operating leases that end within 12 months are £1.9m (2008/9: £1.6m). The Group has not recognised any contingent rent in the period (2008/9: £nil).

18. PROPERTY, PLANT AND EQUIPMENT

Group	**Freehold £m**	**Land and buildings Held for Sale £m**	**Short Leasehold £m**	**Equipment, Fixtures, Fittings and Vehicles £m**	**Total £m**
Cost or valuation					
At 1 April 2009	11.1	–	0.9	7.2	**19.2**
Additions	–	–	–	1.9	**1.9**
Transfers	(2.2)	1.8	0.1	4.4	**4.1**
Revaluation	(1.4)	–	–	–	**(1.4)**
Disposals	(0.1)	–	–	(0.3)	**(0.4)**
At 31 March 2010	**7.4**	**1.8**	**1.0**	**13.2**	**23.4**
Accumulated depreciation					
At 1 April 2009	–	–	0.8	1.9	**2.7**
Transfers	–	–	–	4.1	**4.1**
Charge for the year	0.2	–	0.1	2.1	**2.4**
Revaluation	(0.2)	–	–	–	**(0.2)**
Elimination on disposals	–	–	–	(0.2)	**(0.2)**
At 31 March 2010	**–**	**–**	**0.9**	**7.9**	**8.8**
Net Book value					
At 31 March 2010	**7.4**	**1.8**	**0.1**	**5.3**	**14.6**

Group	Freehold £m	Land and buildings Held for Sale £m	Short Leasehold £m	Equipment, Fixtures, Fittings and Vehicles £m	Total £m
Cost or valuation					
At 1 April 2008	15.6	–	1.0	10.0	26.6
Additions	–	–	–	0.4	0.4
Revaluation	(4.5)	–	–	–	(4.5)
Disposals	–	–	(0.1)	(3.2)	(3.3)
At 31 March 2009	11.1	–	0.9	7.2	19.2
Accumulated depreciation					
At 1 April 2008	1.9	–	0.7	2.5	5.1
Charge for the year	0.4	–	0.2	2.5	3.1
Revaluation	(2.3)	–	–	–	(2.3)
Elimination on disposals	–	–	(0.1)	(3.1)	(3.2)
At 31 March 2009	–	–	0.8	1.9	2.7
Net Book value					
At 31 March 2009	11.1	–	0.1	5.3	16.5

During the year, an exercise was undertaken to review the categorisation of the Property, plant and equipment held by the Group, resulting in a transfer of cost and accumulated depreciation of £4.1m from Intangible assets to Equipment, Fixtures, Fittings and Vehicles. As part of the restructuring of the Group, £0.3m accelerated depreciation has been charged.

18. PROPERTY, PLANT AND EQUIPMENT (cont'd)

Society	**Freehold £m**	**Land and buildings Held for Sale £m**	**Short Leasehold £m**	**Equipment, Fixtures, Fittings and Vehicles £m**	**Total £m**
Cost or valuation					
At 1 April 2009	11.1	–	0.9	6.7	**18.7**
Additions	–	–	–	1.9	**1.9**
Transfers	(2.2)	1.8	0.1	4.4	**4.1**
Revaluation	(1.4)	–	–	–	**(1.4)**
Disposals	(0.1)	–	–	(0.1)	**(0.2)**
At 31 March 2010	**7.4**	**1.8**	**1.0**	**12.9**	**23.1**
Accumulated depreciation					
At 1 April 2009	–	–	0.8	1.7	**2.5**
Transfers	–	–	–	4.1	**4.1**
Charge for the year	0.2	–	0.1	2.0	**2.3**
Revaluation	(0.2)	–	–	–	**(0.2)**
Elimination on disposals	–	–	–	(0.1)	**(0.1)**
At 31 March 2010	–	–	**0.9**	**7.7**	**8.6**
Net Book value					
At 31 March 2010	**7.4**	**1.8**	**0.1**	**5.2**	**14.5**

Society	Freehold £m	Land and buildings Held for Sale £m	Short Leasehold £m	Equipment, Fixtures, Fittings and Vehicles £m	Total £m
Cost or valuation					
At 1 April 2008	15.6	–	1.0	7.3	23.9
Additions	–	–	–	0.3	0.3
Revaluation	(4.5)	–	–	–	(4.5)
Disposals	–	–	(0.1)	(0.9)	(1.0)
At 31 March 2009	11.1	–	0.9	6.7	18.7
Accumulated depreciation					
At 1 April 2008	1.9	–	0.7	0.3	2.9
Charge for the year	0.4	–	0.2	2.3	2.9
Revaluation	(2.3)	–	–	–	(2.3)
Elimination on disposals	–	–	(0.1)	(0.9)	(1.0)
At 31 March 2009	–	–	0.8	1.7	2.5
Net Book value					
At 31 March 2009	11.1	–	0.1	5.0	16.2

The Group's freehold branch properties were revalued at 31 March 2010 by independent qualified valuers. The valuations were undertaken in accordance with the Appraisal and Valuation Standards issued by the Royal Institution of Chartered Surveyors in the United Kingdom by Colliers International, a firm of independent Chartered Surveyors on an open market basis.

These valuations have been incorporated into the financial statements and the resulting revaluation adjustments have been taken to the revaluation reserve. If the land and building was carried at cost, the carrying amount would have been £3.9m (2008/9: £4.0m).

During the year, an exercise was undertaken to review the categorisation of the Property, plant and equipment held by the Group, resulting in a transfer of cost and accumulated depreciation of £4.1m from Intangible assets to Equipment, Fixtures, Fittings and Vehicles. As part of the restructuring of the Group, £0.3m accelerated depreciation has been charged.

19. DEFERRED TAXES

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 28% (2008/9: 28%). The movement on the deferred tax account is as follows:

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
At 1 April	**14.5**	3.1	**12.1**	8.1
Income Statement credit/(charge)	**5.9**	6.1	**1.4**	(1.3)
Amount recognised directly in equity	**(6.5)**	5.3	**(6.5)**	5.3
Adjustments in respect of prior years	**(0.7)**	–	**(3.8)**	–
At 31 March	**13.2**	14.5	**3.2**	12.1

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

Deferred tax assets				
Pensions and other post retirement benefits	**0.5**	0.5	**0.4**	0.4
Accelerated tax depreciation	**0.4**	0.5	**0.3**	0.3
Available for sale assets	**–**	7.0	**–**	7.0
Carried forward tax losses	**13.9**	7.3	**–**	1.4
Other temporary differences	**5.3**	7.6	**3.9**	6.3
At 31 March	**20.1**	22.9	**4.6**	15.4
Deferred tax liabilities				
Property valuations	**(5.7)**	(6.0)	**(0.5)**	(0.9)
Other temporary differences	**(1.2)**	(2.4)	**(0.9)**	(2.4)
At 31 March	**(6.9)**	(8.4)	**(1.4)**	(3.3)

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

	2010 £m	2009 £m	**2010 £m**	2009 £m
Accelerated tax depreciation	**–**	(0.1)	**–**	(0.1)
Pensions and other post retirement benefits	**–**	(0.8)	**–**	(0.8)
Other provisions	**(1.6)**	0.3	**(1.0)**	0.7
Carried forward tax losses	**7.0**	4.9	**(1.4)**	(1.1)
Property valuations	**(0.2)**	1.8	**–**	–
	5.2	6.1	**(2.4)**	(1.3)

Deferred tax assets are recognised in respect of the carry-forward of tax losses only to the extent that realisation of the related tax benefit is probable against future taxable profits over the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes related to the same fiscal authority.

The deferred tax assets and liabilities closing balances have been calculated at 28% in accordance with IAS 12.

20. TRADE AND OTHER RECEIVABLES

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Prepayments and accrued income	**2.9**	5.0	**2.8**	5.0
Other	**3.3**	11.1	**2.3**	6.0
	6.2	16.1	**5.1**	11.0

21. SHARES

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Held by individuals	**6,542.7**	6,539.9	**6,542.7**	6,539.9
Other shares	**1.4**	1.4	**1.4**	1.4
	6,544.1	6,541.3	**6,544.1**	6,541.3

22. DEBT SECURITIES IN ISSUE

	Group	
	2010 £m	2009 £m
EURO medium term notes	**53.6**	55.8
GBP medium term notes	**3.0**	3.0
Certificates of deposit	**7.5**	75.0
Other debt securities	**506.6**	470.2
Non-recourse finance on securitised advances	**340.6**	388.6
	911.3	992.6

	Society	
	2010 £m	2009 £m
EURO medium term notes	**53.6**	55.8
GBP medium term notes	**3.0**	3.0
Certificates of deposit	**7.5**	75.0
Other debt securities	**506.6**	470.2
	570.7	604.0

The Non-recourse finance comprises mortgage backed floating rate notes ('the Notes') secured over a portfolio of mortgage loans secured by first charges over residential and commercial properties in the United Kingdom (see Note 12). Prior to redemption of the Notes on the final interest payment date, the Notes will be subject to mandatory and/or optional redemption in certain circumstances, on each interest payment date. For details of assets held at Fair value through profit and loss see Note 28.

23. SUBORDINATED DEBT

	Group & Society	
	2010 £m	2009 £m
Subordinated notes		
Floating rate subordinated loan 2013	–	5.3
Fixed rate notes due 2013	–	7.9
Fixed rate notes due 2013	–	7.7
Fixed rate notes due 2019	–	10.2
Fixed rate notes due 2036	–	10.7
Fixed rate notes due 2034	–	5.6
Fixed rate notes due 2035	–	5.6
Fixed rate notes due 2031	–	16.0
Fixed rate notes due 2031	–	8.0
Floating rate subordinated loan 2014	–	10.2
Fixed rate notes due 2025	–	25.6
Fixed rate notes due 2017	–	51.3
Fixed rate notes due 2017	–	25.9
	–	190.0

All notes are denominated in Sterling.

On 21 July 2009, in consultation with the FSA, the Society completed the exchange of £182.5m of the Society's Tier 2 subordinated debt for an equal amount of Profit participating deferred shares (PPDS), a new form of capital for building societies, that counts as Core Tier 1 capital (the Capital Exchange). At the year ended 31 March 2009 Subordinated debt totalled £190.0m. See Note 27 for further details.

24. TRADE AND OTHER PAYABLES

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Accruals	**9.0**	10.1	**7.7**	8.8
Other creditors	**5.0**	8.4	**2.8**	4.2
Income tax	**2.2**	6.6	**2.2**	6.6
Amounts due to subsidiary undertakings	–	–	**0.3**	0.3
	16.2	25.1	**13.0**	19.9

25. PROVISIONS FOR LIABILITIES

	2010			2009			
	FSCS £m	**Onerous contracts £m**	**Total £m**	FSCS £m	Onerous contracts £m	Regulatory £m	Total £m
Group and Society							
At 1 April	**12.2**	–	**12.2**	–	–	0.8	0.8
Utilised in the year	**(2.1)**	–	**(2.1)**	–	–	–	–
(Release)/Charge for the year	**(5.4)**	**1.3**	**(4.1)**	12.2	–	(0.8)	11.4
At period end	**4.7**	**1.3**	**6.0**	12.2	–	–	12.2

25. PROVISIONS FOR LIABILITIES (cont'd)

Regulatory
Provisions have been made in respect of various potential customer compensation claims. The main area of potential claim is endowment policies sold as repayment vehicles for mortgage borrowings. Against a background of falling investment returns, claims were received from some members who claimed that they did not appreciate the risk that these policies may not be sufficient to repay the mortgage. Claims were investigated on an individual basis and, in some cases, compensation payments made. In the previous year there had been a significant reduction in these claims and the provision was fully released.

Financial Services Compensation Scheme ('FSCS')
In common with all regulated UK deposit takers, the Society pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it. The FSCS levy consists of two parts – a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it. We understand that the FSCS has met, or will meet, the claims by way of loans received from HM Treasury. The terms of these loans are interest only for the first three years, and the FSCS will seek to recover the interest cost, together with ongoing management expenses, through levies on member firms over this period. Subsequently, should there be insufficient funds from the realisation of the failed banks' assets to fully extinguish the FSCS' loans from HM Treasury, this may result in the FSCS raising a compensation levy on member firms.

The Society recognised, in the prior year's results, a provision for FSCS management expenses and levies of £12.2m, covering the scheme years 2009/10 and 2010/11. This amount was calculated on the basis of the Society's current share of protected deposits taking into account the FSA's estimate of total management expense levies for the scheme years 2008/9 and 2009/10 and assuming that levies for subsequent years are at similar levels. During the course of the year there has been further clarification from the Financial Services Authority on amounts to be provided. This clarification confirms that accrual should only be made for liabilities incurred as a result of market participation up to the date of the Statement of Financial Position and that future market participation should not be taken into account. As a result there has been a release of provision of £5.4m. The provision does not include any estimate for management expense levies for future scheme years or for compensation levies which may arise.

Onerous contracts
The provision for onerous contracts established during the year to 31 March 2010 covers the loss anticipated in connection with future lease expenses from non-cancellable lease commitments in branches that the Society has, as part of its branch restructure, decided are no longer required.

26. SUBSCRIBED CAPITAL

	Group and Society	
	2010 £m	2009 £m
Permanent interest bearing shares	**74.9**	74.9

In a winding up or dissolution of the Society the claims of the holders of PIBS would rank behind all other creditors of the Society, other than holders of the PPDS with which the PIBS rate pari-passu, and the claims of members holding shares as to principal and interest. The holders of PIBS are not entitled to any share in any final surplus upon winding up or final dissolution of the Society.

As a result of the Capital Exchange in Note 27 and a desire to achieve yield equivalence between the holders of PPDS and the PIBS, the Society has implemented the following policy in relation to the interest payments on the Society's existing PIBS. With respect to future interest payments, as a condition of the PPDS, the Society has undertaken to pay an amount to holders which, when annualised, represents the lower of: 6.15% of the outstanding principal amount of the PIBS and the dividend yield attributable to the PPDS with respect to the prior financial year ending 31 March, such payment at the discretion of the Society.

27. PROFIT PARTICIPATING DEFERRED SHARES

	Group and Society	
	2010 £m	2009 £m
Profit participating deferred shares	**179.9**	–

On 21 July 2009, in consultation with the FSA, the Society exchanged £182.5m of the Society's Tier 2 subordinated debt for an equal amount of Profit participating deferred shares (PPDS), a new form of capital for building societies, that counts as Core Tier 1 capital (the Capital Exchange). At year end 31 March 2009 subordinated debt totalled £190.0m.

Following the Capital Exchange, which received FSA approval, some 82% of the Society's capital became Core Tier 1, so enabling the Society to demonstrate resilience in the face of severe stress-test scenarios. On a pro-forma basis, the Society's Core Tier 1 ratio increased from 6.8% to 11.6%, amongst, we believe, the highest in the sector.

The PPDS holders are entitled to receive a distribution, at the discretion of the Society, of up to 25% of the Society's post-tax profits in the future (calculated prior to payment of the PPDS dividend).

The carrying value of the issued PPDS equated to the book value of the subordinated debt as at the date of transfer. The book value consisted £182.5m of nominal plus £3.8m cumulative fair value adjustments. £2.2m of issue costs were capitalised as part of this transaction and transferred to the PPDS reserve. There was no gain or loss recognised in the Income Statement as a result of this Exchange.

28. FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial assets and liabilities are valued at Fair value through profit or loss when this results in more relevant information because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or liabilities on different bases or recognising the gains and losses on them on different bases. The 'Fair Value Option' is used by the Group where financial assets or liabilities would otherwise be measured at amortised cost, the associated derivatives used to economically hedge the risk are held at fair value, and it is not practical to apply hedge accounting. The table below shows the carrying value of financial assets and liabilities that upon initial recognition, or at 1 April 2005 on the adoption of IAS 39, were valued at Fair value through profit or loss, and the net gains or losses on these instruments.

	2010 £m	2009 £m
Financial assets at Fair value through profit or loss:		
Loans fully secured on land:		
Carrying value at 31 March	**121.7**	148.0
Net (losses)/gains in the year (included in 'Interest expense and similar charges')	**(3.9)**	12.5
Financial liabilities at Fair value through profit or loss:		
Non-recourse finance on securitised advances:		
Carrying value at 31 March	**117.3**	137.2
Non-recourse finance on securitised advances	**–**	–
Derivative financial instruments		
Carrying value at 31 March	**(6.9)**	(10.8)
Net gains/(losses) in the year (included in 'Interest expense and similar charges')	**3.9**	(12.2)

29. TAX EFFECTS RELATING TO EACH COMPONENT OF OTHER COMPREHENSIVE INCOME

Group	**Before tax amount 2010 £m**	**Taxation 2010 £m**	**Net of tax amount 2010 £m**	Before tax amount 2009 £m	Taxation 2009 £m	Net of tax amount 2009 £m
Available for sale financial assets	**22.4**	**(6.8)**	**15.6**	(17.6)	5.0	(12.6)
Cash flow hedges	**(0.1)**	**–**	**(0.1)**	0.1	–	0.1
Actuarial loss on retirement benefit obligations	**(6.8)**	**1.9**	**(4.9)**	(5.7)	0.3	(5.4)
Revaluation reserve	**(1.2)**	**0.4**	**(0.8)**	(1.5)	–	(1.5)
Other comprehensive income	**14.3**	**(4.5)**	**9.8**	(24.7)	5.3	(19.4)

Society	**Before tax amount 2010 £m**	**Taxation 2010 £m**	**Net of tax amount 2010 £m**	Before tax amount 2009 £m	Taxation 2009 £m	Net of tax amount 2009 £m
Available for sale financial assets	**22.4**	**(6.8)**	**15.6**	(17.6)	5.0	(12.6)
Cash flow hedges	**(0.1)**	**–**	**(0.1)**	0.1	–	0.1
Actuarial loss on retirement benefit obligations	**(6.8)**	**1.9**	**(4.9)**	(5.7)	0.3	(5.4)
Revaluation reserve	**(1.2)**	**0.4**	**(0.8)**	(1.5)	–	(1.5)
Other comprehensive income	**14.3**	**(4.5)**	**9.8**	(24.7)	5.3	(19.4)

30. RETIREMENT BENEFIT OBLIGATIONS

Amounts recognised in the Statement of Financial Position	Group and Society				
	2010 **£m**	2009 £m	2008 £m	2007 £m	2006 £m
Defined benefit pension scheme	**2.0**	1.6	5.1	4.5	4.9

Defined Benefit Plans

The Society closed its defined benefit scheme ('the Scheme') to new members in 2002. With effect from 1 August 2009, the scheme was closed to future accruals for all members, at which date all previously active members became entitled to deferred pensions in the Scheme. The assets of the Scheme are held in a separate trustee administered fund. In addition, the Society has some unregistered arrangements in place in respect of former directors. The financial effect of these arrangements is included in this Note.

The last formal actuarial valuation of the scheme carried out by the appointed actuary, was as at 31 March 2007. This valuation has been updated to the accounting date by an independent qualified actuary in accordance with IAS19. The expected rate of return as at 31 March 2010 was 6.2% pa (2008/9: 6.0% pa) net of an allowance of 0.3% pa (2008/9: 0.5% pa) for expenses. This rate is derived by taking the weighted average of the long term expected rate of return that is expected on each of the asset classes that the Scheme will invest in, based on the allocation to each asset class as at 31 March 2010.

The estimated amount of Society contributions expected to be paid to the Scheme during 2010/11 is £1.3m (2009/10: £7.3m actual).

The key assumptions used by the actuary in the updated calculation were:

	2010	2009	2008	2007	2006
Rate of increase in salaries	–	–	5.50%	4.20%	4.00%
Pension increases in payment (5% LPI)	**3.60%**	3.20%	3.40%	3.00%	2.80%
Pension increases in payment (2.5% LPI)	**2.40%**	2.30%	2.30%	2.20%	2.10%
Discount rate	**5.60%**	7.00%	6.30%	5.30%	5.00%
Expected return on assets	**6.20%**	6.00%	6.50%	6.90%	6.30%
Life expectancy of male aged 65 at year end date	**22.8**	22.7	22.6	21.8	21.8
Life expectancy of female aged 65 at year end date	**24.8**	24.6	24.5	24.7	24.7
Life expectancy of male aged 65 in 2030	**24.7**	24.3	–	–	–
Life expectancy of female aged 65 in 2030	**25.8**	25.6	–	–	–

As at 31 March 2010, the post retirement mortality is assumed to be in line with 95% of the 'PNA00' mortality tables allowing for future improvements according to the medium cohort projection scale with a minimum improvement rate of 1.0% p.a. for males and 0.5% p.a. for females.

30. RETIREMENT BENEFIT OBLIGATIONS (cont'd)

The amounts recognised in the Statement of Financial Position are determined as follows:

	Group and Society				
	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Present value of funded obligations	**70.7**	49.1	63.0	62.1	57.1
Present value of unfunded obligations	**0.8**	0.6	0.6	0.7	1.7
	71.5	49.7	63.6	62.8	58.8
Fair value of scheme assets	**(69.5)**	(48.1)	(58.5)	(58.3)	(53.9)
Liability in the Statement of Financial Position	**2.0**	1.6	5.1	4.5	4.9

The amounts recognised in the income statement are as follows:

	Group and Society			
	Projected 2011 £m	**Actual 2010 £m**	Actual 2009 £m	Actual 2008 £m
Current service costs	*–*	**0.4**	2.1	1.6
Interest cost	*3.9*	**3.4**	4.0	3.4
Expected return on plan assets	*(4.3)*	**(2.9)**	(3.8)	(4.1)
Past service cost	*–*	**–**	0.2	0.1
Gains on curtailment and settlements	*–*	**–**	(8.0)	–
Total cost	*(0.4)*	**0.9**	(5.5)	1.0

Current and past service costs and gains on curtailments and settlements are shown in administrative expenses whilst interest cost and expected return are within 'Other operating income'. The curtailment gain arising in the prior year reflects primarily the impact of the Society's decision to close the Scheme to future benefit accrual. The actual return on Scheme assets was a profit of £16.0m (2008/9: loss of £11.9m).

Change in benefit obligations

	Group and Society		
	2010 £m	2009 £m	2008 £m
Benefit obligations at beginning of year	**49.7**	63.6	62.8
Current service cost	**0.4**	2.1	1.6
Interest cost	**3.4**	4.0	3.4
Employee contributions	–	–	0.7
Actuarial losses/(gains)	**19.9**	(10.0)	(3.5)
Benefits paid	**(1.9)**	(2.2)	(1.5)
Past service costs	–	0.2	0.1
Curtailments and settlements	–	(8.0)	–
Benefit obligations at the end of the year	**71.5**	49.7	63.6

Change in scheme assets

	Group and Society		
	2010 £m	2009 £m	2008 £m
Fair value of scheme assets at beginning of year	**48.1**	58.5	58.3
Expected return on scheme assets	**2.9**	3.8	4.1
Actuarial gains/(losses)	**13.1**	(15.7)	(6.3)
Contribution by employer	**7.3**	3.7	3.2
Employee contributions	–	–	0.7
Benefits paid	**(1.9)**	(2.2)	(1.5)
Fair value of scheme assets at end of year	**69.5**	48.1	58.5

The amount recognised outside profit or loss in the Statement of Comprehensive Income (SOCI) for 2009/10 is an actuarial loss of £6.8m (2008/09: loss of £5.7m). The cumulative amount recognised outside profit and loss at 31 March 2010 is an actuarial loss of £18.9m.

30. RETIREMENT BENEFIT OBLIGATIONS (cont'd)

History of experience gains and losses

	Group and Society				
	2010	2009	2008	2007	2006
Experience gains and (losses) on scheme assets:					
amount (£m)	**13.1**	(15.7)	(6.3)	(1.2)	7.8
percentage of scheme assets	**19%**	(33%)	(11%)	(2%)	14%
Experience gains and (losses) on scheme liabilities:					
amount (£m)	**0.5**	–	(0.7)	(4.3)	–
percentage of scheme liabilities	**1%**	–	(1%)	(7%)	–

Scheme assets and liabilities

The assets in the Scheme and their expected rates of return at 31 March were:

	Long-term rate of return expected 2010 %	**Value 2010 £m**	Long-term rate of return expected 2009 %	Value 2009 £m	Long-term rate of return expected 2008 %	Value 2008 £m
Equities	**7.8%**	**35.6**	8.0%	24.7	7.7%	33.9
Corporate bonds	**5.4%**	**4.9**	5.5%	1.9	–	–
Gilts	**4.3%**	**20.7**	4.2%	15.6	4.5%	18.9
Tactical asset allocation	**7.2%**	**3.0**	9.8%	1.3	10.0%	1.9
Fund of hedge fund	–	–	–	–	6.2%	2.1
Diversified growth fund	**7.5%**	**4.7**	–	–	–	–
Active currency	–	–	9.8%	1.1	12.0%	1.5
Cash and other assets	**1.0%**	**0.6**	4.2%	3.5	4.5%	0.2
	6.2%	**69.5**	6.0%	48.1	6.5%	58.5

Provisional asset information at bid value was supplied by the investment managers as at 31 March 2010. The unaudited value of the invested assets at this date is £69.5m (2008/9: £48.1m).

	£m
Black Rock Advisors UK Limited (Equity portfolio)	**35.6**
Black Rock Advisors UK Limited (Bond portfolio)	**25.6**
Black Rock Advisors UK Limited (Tactical Asset Allocation portfolio)	**3.0**
Ruffers Diversified Growth Fund	**4.7**
Total invested assets	**68.9**
Cash and net current assets	**0.6**
Total assets	**69.5**

Stakeholder Scheme

The total cost for the year of the stakeholder plan was £0.7m (2008/9: £0.3m) and at the end of the year there were no outstanding contributions.

For the period through to 31 July 2009 staff could continue to contribute between 2% and 9% with the Society contributing on a sliding scale between 2% and 7%. From 1 August 2009 staff have been able to contribute between 2% and 10% with the Society providing matched funding.

31. FINANCIAL INSTRUMENTS

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity of another entity. The Group is a retailer of financial instruments, mainly in the form of mortgages and savings. The Group uses wholesale financial instruments to invest liquid asset balances and raise wholesale funding, and to manage the risks arising from its operations.

As a result of these activities, the Group is exposed to a variety of risks, the most significant of which are credit risk, liquidity risk and market risk (principally interest rate, foreign currency and equity risk).

Credit risk
Credit risk can be described as the risk of the customers or counterparties being unable to meet their financial obligations to the Group as they become due. The most significant credit risk arises in respect of loans to retail and commercial mortgage customers.

The Group Risk Committee is responsible for the management of the level of credit risk that has been established by the Board and for approving lending policy and setting limits on credit exposures, which are monitored and reviewed on a monthly basis. The minutes of this committee are presented to the Board. This committee is supported by two Executive sub-committees; the Group Credit Policy and Commercial Loans Risk Committees and their role in the credit risk framework is outlined below:

– The Group Credit Policy Committee is responsible for the monitoring of the Group's credit exposures and approving changes to the credit scoring systems that are utilised. In addition, the committee reviews the type and quality of approved residential and commercial mortgages business and appraises actual arrears and repossession levels against trends and industry averages. The minutes of this committee are presented to the Group Risk Committee.

– The Commercial Loans Risk Committee (CLRC) approves large residential and commercial loans at levels mandated by the Board. Details of all loans approved by the committee are provided to the Board.

The Group adopts a responsible approach to lending and ensures that the servicing of the loan meets the customer's ability to repay.

The maximum credit risk exposure is the book value as shown in the book and fair value table on page 84. The Group's most significant exposures to credit risk are loans secured on UK residential properties and loans secured on UK land.

Residential assets

	Group		Society	
Concentration by loan type	**2010 £m**	2009 £m	**2010 £m**	2009 £m
Prime owner occupied	**2,151.8**	2,354.0	**1,608.3**	1,829.8
Buy-to-Let	**2,720.7**	2,818.5	**707.8**	734.5
Other	**50.6**	118.0	**–**	3.9
Gross balances	**4,923.1**	5,290.5	**2,316.1**	2,568.2
Impairment provisions	**(25.6)**	(31.6)	**(12.4)**	(15.3)
Fair value adjustments	**20.1**	19.5	**14.1**	15.1
	4,917.6	5,278.4	**2,317.8**	2,568.0

The table below shows analysis of the indexed loan to value distribution of the residential loan portfolio at the year end date:

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
>95%	**931.4**	1,781.2	**213.8**	468.5
90% - 95%	**562.2**	552.3	**168.1**	230.9
85% - 90%	**545.0**	457.0	**185.2**	192.7
75% - 85%	**928.1**	639.4	**399.6**	326.5
50% - 75%	**1,123.2**	1,021.0	**676.1**	676.4
<50%	**833.2**	839.6	**673.3**	673.2
	4,923.1	5,290.5	**2,316.1**	2,568.2

The Group's average indexed loan to value is 63.7% (2009: 67.1%).

31. FINANCIAL INSTRUMENTS (cont'd)

The table below provides further information on the Group's residential loans and advances to customers by payment due status as at 31 March 2010.

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Loans neither past due or impaired	**4,685.2**	5,007.5	**2,210.8**	2,453.4
Past due but not impaired				
Past due up to 3 months	**83.8**	71.4	**41.2**	34.9
Past due 3 to 6 months	**13.2**	17.0	**8.8**	10.1
Past due 6 to 12 months	**6.5**	5.7	**3.5**	3.0
Past due over 12 months	**1.9**	1.7	**1.1**	1.2
Impaired				
Past due up to 3 months	**43.6**	52.5	**14.6**	15.0
Past due 3 to 6 months	**27.5**	42.4	**7.5**	12.9
Past due 6 to 12 months	**16.3**	37.8	**6.0**	12.1
Past due over 12 months	**31.5**	27.1	**18.0**	15.6
Possessions	**13.6**	27.4	**4.6**	10.0
	4,923.1	5,290.5	**2,316.1**	2,568.2

£30m (2008/9: £8m) of loans that would be past due or impaired have had their terms renegotiated.

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

Fair value of collateral held	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Not impaired	**8,209.4**	8,891.5	**4,732.2**	5,354.8
Impaired	**132.4**	206.7	**49.8**	89.1
Possessions	**14.3**	25.9	**4.8**	10.5
	8,356.1	9,124.1	**4,786.8**	5,454.4

Commercial assets

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Concentration by loan type				
Loans secured on commercial property	**1,364.0**	1,435.5	**24.5**	24.5
Loans to housing associations	**0.1**	5.1	**–**	–
Loans secured on residential property	**124.4**	153.2	**6.0**	6.0
Gross balances	**1,488.5**	1,593.8	**30.5**	30.5
Impairment provisions	**(58.4)**	(50.6)	**–**	–
Fair value adjustments	**89.3**	101.6	**3.4**	–
	1,519.4	1,644.8	**33.9**	30.5

31. FINANCIAL INSTRUMENTS (cont'd)

Loans secured on commercial property are further split down into the following:

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Healthcare & Leisure	**251.8**	250.7	**–**	–
Industrial & Warehouse	**94.8**	103.7	**1.2**	1.2
Office	**248.7**	253.8	**11.3**	11.3
Retail	**750.1**	806.5	**12.0**	12.0
Other	**18.6**	20.8	**–**	–
	1,364.0	1,435.5	**24.5**	24.5

The Group's average unindexed loan to value at the year end date is 97.3% (2008/9: 75.8%). £19.1m (2008/9: £4.9m) of loans that would be past due or impaired have had their terms renegotiated.

Included within commercial loans are £367.9m (2008/9: £414.4m) of commercial mortgage balances that the Group has sold to bankruptcy remote Special purpose entities ('SPEs'). Since the Group maintains substantially all of the risks and rewards emanating from the commercial mortgages subject to first loss limitations, they are included in the Group's Statement of Financial Position in accordance with IAS 39.

The table below provides further information on the Group's Commercial assets by payment due status as at 31 March 2010.

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Loans neither past due or impaired	**1,170.9**	1,338.6	**30.5**	30.5
Not past due but impaired	**71.4**	89.5	**–**	–
Past due but not impaired				
Past due up to 3 months	**64.6**	51.8	**–**	–
Past due 3 to 6 months	**0.1**	4.7	**–**	–
Past due 6 to 12 months	**2.9**	36.2	**–**	–
Past due over 12 months	**3.3**	–	**–**	–
Impaired				
Past due up to 3 months	**77.1**	58.7	**–**	–
Past due 3 to 6 months	**43.7**	8.0	**–**	–
Past due 6 to 12 months	**2.0**	4.5	**–**	–
Past due over 12 months	**47.5**	0.7	**–**	–
Possessions	**5.0**	1.1	**–**	–
	1,488.5	1,593.8	**30.5**	30.5

The collateral held consists of properties, land or other guarantees or cash held within the above categories. The use of such collateral is in line with terms that are usual and customary to standard lending activities.

Value of collateral held - Group	2010		2009	
	Indexed £m	**Unindexed £m**	Indexed £m	Unindexed £m
Not impaired	**1,542.5**	**1,685.4**	1,542.6	2,056.2
Impaired	**116.0**	**120.3**	112.2	192.8
Possessions	**4.6**	**4.4**	–	–
	1,663.1	**1,810.1**	1,654.8	2,249.0

31. FINANCIAL INSTRUMENTS (cont'd)

Value of collateral held – Society	2010		2009	
	Indexed £m	**Unindexed £m**	Indexed £m	Unindexed £m
Not impaired	**53.2**	**67.3**	54.2	67.3
Impaired	**–**	**–**	–	–
Possessions	**–**	**–**	–	–
	53.2	**67.3**	54.2	67.3

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

The Group determines that treasury assets are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment. In making this judgment, the Group evaluates among other factors, the normal volatility in valuation, evidence or deterioration in the financial health of the investee, industry and sector performance and operational and financing cash flows. As at 31 March 2010 none of the Group's treasury portfolio exposure was either past due or impaired.

As at 31 March 2010, 92.2% (2008/9: 89.3%) of the Group's treasury investment assets were rated single A or better. The Group continues to have no exposure of any kind to the emerging markets or any mortgage market other than the UK. The tables below show the relative concentrations of the Group's treasury investment portfolio:

	Group		Society	
	2010 £m	2009 £m	**2010 £m**	2009 £m
Concentration by credit grading				
AAA	**960.3**	1,459.5	**960.3**	1,387.1
AA+ to AA-	**510.2**	201.7	**425.7**	201.2
A+ to A-	**44.3**	136.6	**44.3**	136.6
Building Societies	**119.1**	207.0	**119.1**	207.0
Other	**8.2**	9.0	**1,189.5**	1,191.9
	1,642.1	2,013.8	**2,738.9**	3,123.8
Concentration by sector				
Financial institutions	**673.5**	959.0	**589.0**	886.2
Local authorities	**8.2**	9.0	**8.2**	9.0
Asset backed securities	**227.9**	208.9	**1,409.2**	1,391.8
Sovereign	**732.5**	836.9	**732.5**	836.8
	1,642.1	2,013.8	**2,738.9**	3,123.8
Concentration by region				
UK	**1,510.8**	1,850.3	**2,607.6**	2,960.3
Europe (excluding UK)	**55.9**	104.2	**55.9**	104.2
North America	**10.0**	29.8	**10.0**	29.8
Australasia	**65.4**	29.5	**65.4**	29.5
	1,642.1	2,013.8	**2,738.9**	3,123.8

31. FINANCIAL INSTRUMENTS (cont'd)

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 rates, equity prices or other market prices. 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 Board. This policy sets out the nature of risk which may be taken and aggregate risk limits. At each meeting the Assets and Liabilities Committee ('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 by using appropriate hedging instruments or by taking advantage of natural hedges arising or existing within the Group's businesses. Market risk is managed within a clearly defined framework of policy limits and it 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, basis risk analysis, scenario analysis, net interest income and market value sensitivity analysis.

Interest rate risk
Interest rate risk arises from the mortgage, savings and other financial services products that we offer. The varying interest rate features and maturities on these products and the need to raise wholesale funds to fund these products create interest rate risk exposures. These primarily arise from the imperfect matching of interest rates between different financial instruments and the timing differences on the repricing of assets and liabilities.
This risk is managed on a continuous basis, within limits set by the Board, through the use of appropriate financial instruments, including derivatives.

The Group monitors risk using a Risk Management System and operates within limits set down by the Board following recommendations from ALCo. The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest bearing liabilities as they mature are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates and exchange rates.

The primary interest rate risk metric employed by the Group incorporates market value and net interest income methodologies. The Group's exposure to interest rate risk is stress tested against limits by determining the effect of the Group's current net notional value of assets and liabilities for a 1% and +/- 2% parallel shift in the yield curve combined with high and low extremities from 100 random rate scenarios. The results are reviewed monthly by ALCo. The scale of interest risk is controlled by the establishment of an operational range and an absolute limit structure which controls the scale of risk. The Group also operates a gap limit, and the Group's gap positions are reported monthly to the FSA.

The levels of Group pre-tax interest rate risk exposures, to a 2% parallel shift, through the reporting period were as follows:

	As at 31 March 10 £m	Average 2010 £m	High 2010 £m	Low 2010 £m
Market Value	**(0.2)**	(1.7)	4.4	(8.9)
Net interest income	**0.7**	0.8	3.9	(2.6)

The table overleaf provides a summary of the interest rate repricing profile of the Group's assets and liabilities as at 31 March 2010. 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.

31. FINANCIAL INSTRUMENTS (cont'd)

As at 31 March 2010

Group	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	Non-interest bearing £m	Total £m
Assets							
Liquid assets	1,091.3	3.1	185.1	271.0	101.1	0.1	**1,651.7**
Derivative financial instruments	–	–	–	–	–	78.4	**78.4**
Loans fully secured on residential property, land and other loans	4,539.2	39.8	381.4	808.7	667.9	–	**6,437.0**
Property, plant and equipment and intangible fixed assets	–	–	–	–	–	137.8	**137.8**
Trade and other receivables	–	–	–	–	–	28.5	**28.5**
Held for sale	–	–	–	–	–	2.2	**2.2**
Total assets	**5,630.5**	**42.9**	**566.5**	**1,079.7**	**769.0**	**247.0**	**8,335.6**
Liabilities							
Shares	3,701.7	857.8	465.8	1,517.8	1.0	–	**6,544.1**
Amounts owed to credit institutions, other customers and debt securities in issue	622.4	9.6	5.1	511.1	–	–	**1,148.2**
Derivative financial instruments	–	–	–	–	–	96.7	**96.7**
Trade and other payables	–	–	–	–	–	31.1	**31.1**
Profit participating deferred shares	–	–	–	–	–	179.9	**179.9**
Subscribed capital	–	–	–	–	–	74.9	**74.9**
Other reserves	–	–	–	–	–	260.2	**260.2**
Held for sale	–	–	–	–	–	0.5	**0.5**
Total liabilities	**4,324.1**	**867.4**	**470.9**	**2,028.9**	**1.0**	**643.3**	**8,335.6**
Effect of derivative items	(1,537.5)	554.6	82.8	1,108.3	(208.2)	–	**–**
Interest rate sensitivity gap	(231.1)	(269.9)	178.4	159.1	559.8	(396.3)	**–**
Cumulative interest rate sensitivity gap	(231.1)	(501.0)	(322.6)	(163.5)	396.3	–	**–**

31. FINANCIAL INSTRUMENTS (cont'd)

As at 31 March 2010

Society	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	Non-interest bearing £m	Total £m
Assets							
Liquid assets	2,188.2	3.1	185.1	271.0	101.1	–	**2,748.5**
Derivative financial instruments	–	–	–	–	–	96.0	**96.0**
Loans fully secured on residential property, land and other loans	1,752.6	13.5	59.3	291.8	234.5	–	**2,351.7**
Investments	–	–	–	–	–	2,734.1	**2,734.1**
Property, plant and equipment and intangible fixed assets	–	–	–	–	–	21.1	**21.1**
Trade and other receivables	–	–	–	–	–	10.7	**10.7**
Total assets	**3,940.8**	**16.6**	**244.4**	**562.8**	**335.6**	**2,861.9**	**7,962.1**
Liabilities							
Shares	3,701.7	857.8	465.8	1,517.8	1.0	–	**6,544.1**
Amounts owed to credit institutions, other customers and debt securities in issue	281.8	9.6	5.1	511.1	–	–	**807.6**
Derivative financial instruments	–	–	–	–	–	78.6	**78.6**
Trade and other payables	–	–	–	–	–	22.4	**22.4**
Profit participating deferred shares	–	–	–	–	–	179.9	**179.9**
Subscribed capital	–	–	–	–	–	74.9	**74.9**
Reserves	–	–	–	–	–	254.6	**254.6**
Total liabilities	**3,983.5**	**867.4**	**470.9**	**2,028.9**	**1.0**	**610.4**	**7,962.1**
Effect of derivative items	(1,401.9)	554.6	55.0	1,065.4	(273.1)	–	**–**
Interest rate sensitivity gap	(1,444.6)	(296.2)	(171.5)	(400.7)	61.5	2,251.5	**–**
Cumulative interest rate sensitivity gap	(1,444.6)	(1,740.8)	(1,912.3)	(2,313.0)	(2,251.5)	–	**–**

Liquid assets include cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment securities. Trade and other receivables include other loans, Trade and other receivables, prepayments and accrued income. Trade and other payables include Trade and other payables, accruals and deferred income, provisions for liabilities.

31. FINANCIAL INSTRUMENTS (cont'd)

As at 31 March 2009

Group	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	Non-interest bearing £m	Total £m
Assets							
Liquid assets	1,629.3	32.9	2.1	284.6	54.3	19.1	2,022.3
Derivative financial instruments	–	–	–	–	–	62.1	62.1
Loans fully secured on residential property, land and other loans	4,214.8	182.2	671.0	1,217.6	637.6	–	6,923.2
Property, plant and equipment and intangible fixed assets	–	–	–	–	–	142.0	142.0
Trade and other receivables	–	–	–	–	–	45.9	45.9
Total assets	5,844.1	215.1	673.1	1,502.2	691.9	269.1	9,195.5
Liabilities							
Shares	4,322.3	717.7	809.1	531.9	1.3	159.0	6,541.3
Amounts owed to credit institutions, other customers and debt securities in issue	1,742.2	119.7	73.5	15.2	0.8	–	1,951.4
Derivative financial instruments	–	–	–	–	–	125.3	125.3
Trade and other payables	–	–	–	–	–	47.3	47.3
Subordinated debt	5.2	–	10.3	104.2	70.3	–	190.0
Subscribed capital	–	–	–	–	74.9	–	74.9
Reserves	–	–	–	–	–	265.3	265.3
Total liabilities	6,069.7	837.4	892.9	651.3	147.3	596.9	9,195.5
Effect of derivative items	842.0	(13.0)	(44.0)	(482.0)	(303.0)	–	–
Interest rate sensitivity gap	616.4	(635.3)	(263.8)	368.9	241.6	(327.8)	–
Cumulative interest rate sensitivity gap	616.4	(18.9)	(282.7)	86.2	327.8	–	–

31. FINANCIAL INSTRUMENTS (cont'd)

As at 31 March 2009

Society	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	Non-interest bearing £m	Total £m
Assets							
Liquid assets	2,739.3	32.9	2.1	284.6	54.3	19.1	3,132.3
Derivative financial instruments	–	–	–	–	–	96.2	96.2
Loans fully secured on residential property, land and other loans	102.9	124.5	222.7	391.5	1,756.9	–	2,598.5
Investments	–	–	–	–	2,905.8	–	2,905.8
Property, plant and equipment and intangible fixed assets	–	–	–	–	–	21.9	21.9
Trade and other receivables	–	–	–	–	–	26.4	26.4
Total assets	2,842.2	157.4	224.8	676.1	4,717.0	163.6	8,781.1
Liabilities							
Shares	4,322.3	717.7	809.1	531.9	1.3	159.0	6,541.3
Amounts owed to credit institutions, other customers and debt securities in issue	1,353.6	119.7	73.5	15.2	0.8	–	1,562.8
Derivative financial instruments	–	–	–	–	–	116.1	116.1
Trade and other payables	–	–	–	–	–	42.8	42.8
Subordinated debt	5.2	-	10.3	104.2	70.3	–	190.0
Subscribed capital	–	–	–	–	74.9	–	74.9
Reserves	–	–	–	–	–	253.2	253.2
Total liabilities	5,681.1	837.4	892.9	651.3	147.3	571.1	8,781.1
Effect of derivative items	(294.0)	–	2.0	213.0	79.0	–	–
Interest rate sensitivity gap	(3,132.9)	(680.0)	(666.1)	237.8	4,648.7	(407.5)	–
Cumulative interest rate sensitivity gap	(3,132.9)	(3,812.9)	(4,479.0)	(4,241.2)	407.5	–	–

Liquid assets include cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment securities. Trade and other receivables include other loans, Trade and other receivables, prepayments and accrued income. Trade and other payables include Trade and other payables, accruals and deferred income, provisions for liabilities.

31. FINANCIAL INSTRUMENTS (cont'd)

Liquidity Risk

The Board recognises that a structural maturity mismatch exists within the Group's Statement of Financial Position. This is caused by the fundamental purpose of the Group's business: providing its members with long term mortgage advances funded, primarily, by contractually short term retail share accounts. This structural mismatch is the dominant contributor to the Group's liquidity risk.

Liquidity risk is the risk that the Group is not able to meet its financial obligations as they fall due, or can only do so at excessive cost. The Group has a low liquidity risk appetite; its policy is to maintain sufficient liquidity to cover potential cash flow imbalances and fluctuations in funding to retain 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 diverse retail and wholesale funding facilities and through management control of the growth of the business. The Group maintains a contingency funding plan and actively manages its funding operations to minimise liquidity risk. This resulted in actions to reduce the Group exposure to wholesale funding in anticipation of the experienced credit rating downgrades.

It is Group policy to ensure that at all times sufficient liquid assets are available to meet the Group's obligations including the withdrawal of customer deposits, the drawdown of customer facilities and growth in the Statement of Financial Position. The development and implementation of liquidity policy is the responsibility of ALCo. The day-to-day management of liquidity is the responsibility of Group Treasury. Two key measures used by Treasury to manage the Groups overall exposure to liquidity risk are Prudential Liquidity, which was 25.5% at 31 March 2010 (2008/9: 20.3%) and immediate cash, which was 15.06% at 31 March 2010 (2008/9: 13.74%). See pages 13 to 17 of the Business Review for further details.

The table below analyses the Group's liabilities across maturity periods that reflect the residual duration from the year end date to the contractual maturity date. The actual repayment profile of loans and advances is likely to be significantly different to that shown in the analysis.

As at 31 March 2010 Group	**Repayable on demand £m**	**Less than 3 months £m**	**3 months to 12 months £m**	**1 to 5 years £m**	**Over 5 years £m**	**No specific maturity £m**	**Total £m**
Assets							
Cash and balances with the Bank of England	–	–	–	–	–	9.6	**9.6**
Loans and advances to credit institutions	94.5	98.4	–	–	–	–	**192.9**
Investment securities: Available for sale	–	572.2	236.9	504.0	136.1	–	**1,449.2**
Derivative financial instruments	–	2.3	10.0	40.5	25.6	–	**78.4**
Loans and advances to customers	–	49.6	291.2	1,291.2	4,805.0	–	**6,437.0**
Intangible assets	–	–	–	–	–	7.2	**7.2**
Investment properties	–	–	–	–	–	116.0	**116.0**
Property, plant and equipment	–	–	–	–	–	14.6	**14.6**
Current tax assets	–	–	–	–	–	2.2	**2.2**
Deferred tax assets	–	–	–	–	–	20.1	**20.1**
Trade and other receivables	–	–	–	–	–	6.2	**6.2**
Held for sale	–	–	–	–	–	2.2	**2.2**
	94.5	**722.5**	**538.1**	**1,835.7**	**4,966.7**	**178.1**	**8,335.6**
Liabilities							
Shares	2,970.1	985.4	1,052.4	1,535.2	1.0	–	**6,544.1**
Amounts due to credit institutions	–	92.6	–	–	–	–	**92.6**
Amounts due to other customers	–	133.2	11.1	–	–	–	**144.3**
Derivative financial instruments	–	0.1	2.6	21.0	73.0	–	**96.7**
Debt securities in issue	–	7.5	–	517.4	386.4	–	**911.3**
Deferred tax liabilities	–	–	–	–	–	6.9	**6.9**
Trade and other payables	–	–	–	–	–	16.2	**16.2**
Provisions for liabilities	–	–	–	–	–	6.0	**6.0**
Held for sale	–	–	–	–	–	0.5	**0.5**
Profit participating deferred shares	–	–	–	–	–	179.9	**179.9**
Retirement benefit obligations	–	–	–	–	–	2.0	**2.0**
Subscribed capital	–	–	–	–	–	74.9	**74.9**
General reserves	–	–	–	–	–	258.5	**258.5**
Revaluation reserve	–	–	–	–	–	3.8	**3.8**
Available for sale reserve	–	–	–	–	–	(2.3)	**(2.3)**
Cashflow reserve	–	–	–	–	–	0.2	**0.2**
	2,970.1	**1,218.8**	**1,066.1**	**2,073.6**	**460.4**	**546.6**	**8,335.6**

31. FINANCIAL INSTRUMENTS (cont'd)

As at 31 March 2010 Society	Repayable on demand £m	Less than 3 months £m	3 months to 12 months £m	1 to 5 years £m	Over 5 years £m	No specific maturity £m	Total £m
Assets							
Cash and balances with the Bank of England	–	–	–	–	–	9.6	**9.6**
Loans and advances to credit institutions	–	108.4	–	–	–	–	**108.4**
Investment securities: Available for sale	–	572.2	236.9	504.0	1,317.4	–	**2,630.5**
Derivative financial instruments	–	2.3	11.3	44.6	37.8	–	**96.0**
Loans and advances to customers	–	5.8	11.2	167.1	2,167.6	–	**2,351.7**
Intangible assets	–	–	–	–	–	6.6	**6.6**
Investments	–	–	–	–	–	2,734.1	**2,734.1**
Property, plant and equipment	–	–	–	–	–	14.5	**14.5**
Current tax assets	–	–	–	–	–	1.0	**1.0**
Deferred tax assets	–	–	–	–	–	4.6	**4.6**
Trade and other receivables	–	–	–	–	–	5.1	**5.1**
	–	**688.7**	**259.4**	**715.7**	**3,522.8**	**2,775.5**	**7,962.1**
Liabilities							
Shares	2,970.1	985.4	1,052.4	1,535.2	1.0	–	**6,544.1**
Amounts due to credit institutions	–	92.6	–	–	–	–	**92.6**
Amounts due to other customers	–	133.2	11.1	–	–	–	**144.3**
Derivative financial instruments	–	–	2.1	15.4	61.1	–	**78.6**
Debt securities in issue	–	7.5	–	523.0	40.2	–	**570.7**
Deferred tax liabilities	–	–	–	–	–	1.4	**1.4**
Trade and other payables	–	–	–	–	–	13.0	**13.0**
Provisions for liabilities	–	–	–	–	–	6.0	**6.0**
Profit participating deferred shares	–	–	–	–	–	179.9	**179.9**
Retirement benefit obligations	–	–	–	–	–	2.0	**2.0**
Subscribed capital	–	–	–	–	–	74.9	**74.9**
General reserves	–	–	–	–	–	252.9	**252.9**
Revaluation reserve	–	–	–	–	–	3.8	**3.8**
Available for sale reserve	–	–	–	–	–	(2.3)	**(2.3)**
Cashflow reserve	–	–	–	–	–	0.2	**0.2**
	2,970.1	**1,218.7**	**1,065.6**	**2,073.6**	**102.3**	**531.8**	**7,962.1**

31. FINANCIAL INSTRUMENTS (cont'd)

As at 31 March 2009 Group	Repayable on demand £m	Less than 3 months £m	3 months to 12 months £m	1 to 5 years £m	Over 5 years £m	No specific maturity £m	Total £m
Assets							
Cash and balances with the Bank of England	–	–	–	–	–	8.5	8.5
Loans and advances to credit institutions	119.0	199.7	–	–	–	–	318.7
Investment securities: Available for sale	–	909.4	36.3	667.0	82.4	–	1,695.1
Derivative financial instruments	–	0.5	0.6	47.3	13.7	–	62.1
Loans and advances to customers	–	13.7	67.3	741.9	6,100.3	–	6,923.2
Intangible assets	–	–	–	–	–	11.1	11.1
Investments	–	–	–	–	–	114.4	114.4
Property, plant and equipment	–	–	–	–	–	16.5	16.5
Current tax assets	–	–	–	–	–	6.9	6.9
Deferred tax assets	–	–	–	–	–	22.9	22.9
Trade and other receivables	–	–	–	–	–	16.1	16.1
	119.0	1,123.3	104.2	1,456.2	6,196.4	196.4	9,195.5
Liabilities							
Shares	3,714.3	721.3	1,559.1	545.3	1.3	–	6,541.3
Amounts due to credit institutions	–	459.5	2.0	–	–	–	461.5
Amounts due to other customers	–	315.6	177.5	4.2	–	–	497.3
Derivative financial instruments	–	0.2	3.3	65.0	56.8	–	125.3
Debt securities in issue	–	116.4	38.1	536.0	302.1	–	992.6
Deferred tax liabilities	–	–	–	–	–	8.4	8.4
Trade and other payables	–	–	–	–	–	25.1	25.1
Provisions for liabilities	–	–	–	–	–	12.2	12.2
Profit participating deferred shares	–	–	–	116.1	73.9	–	190.0
Retirement benefit obligations	–	–	–	–	–	1.6	1.6
Subscribed capital	–	–	–	–	74.9	–	74.9
General reserves	–	–	–	–	–	278.3	278.3
Revaluation reserve	–	–	–	–	–	4.6	4.6
Available for sale reserve	–	–	–	–	–	(17.9)	(17.9)
Cashflow reserve	–	–	–	–	–	0.3	0.3
	3,714.3	1,613.0	1,780.0	1,266.6	509.0	312.6	9,195.5

31. FINANCIAL INSTRUMENTS (cont'd)

As at 31 March 2009 Society	Repayable on demand £m	Less than 3 months £m	3 months to 12 months £m	1 to 5 years £m	Over 5 years £m	No specific maturity £m	Total £m
Assets:							
Cash and balances with the Bank of England	–	–	–	–	–	8.5	8.5
Loans and advances to credit institutions	119.0	126.9	–	–	–	–	245.9
Investment securities: Available for sale	–	909.4	36.3	1,849.8	82.4	–	2,877.9
Derivative financial instruments	–	0.5	0.7	41.1	53.9	–	96.2
Loans and advances to customers	–	0.7	1.1	82.6	2,514.1	–	2,598.5
Intangible assets	–	–	–	–	–	5.7	5.7
Investments	–	–	–	–	–	2,905.8	2,905.8
Property, plant and equipment	–	–	–	–	–	16.2	16.2
Deferred tax assets	–	–	–	–	–	15.4	15.4
Trade and other receivables	–	–	–	–	–	11.0	11.0
	119.0	1,037.5	38.1	1,973.5	2,650.4	2,962.6	8,781.1
Liabilities:							
Shares	3,714.3	721.3	1,559.1	545.3	1.3	–	6,541.3
Amounts due to credit institutions	–	459.5	2.0	–	–	–	461.5
Amounts due to other customers	–	315.6	177.5	4.2	–	–	497.3
Derivative financial instruments	–	-	1.9	43.6	70.6	–	116.1
Debt securities in issue	–	114.5	13.7	444.6	31.2	–	604.0
Current tax assets	–	–	–	–	–	5.8	5.8
Deferred tax liabilities	–	–	–	–	–	3.3	3.3
Trade and other payables	–	–	–	–	–	19.9	19.9
Provisions for liabilities	–	–	–	–	–	12.2	12.2
Subordinated debt	–	–	–	116.1	73.9	–	190.0
Retirement benefit obligations	–	–	–	–	–	1.6	1.6
Subscribed capital	–	–	–	–	74.9	–	74.9
General reserves	–	–	–	–	–	266.2	266.2
Revaluation reserve	–	–	–	–	–	4.6	4.6
Available for sale reserve	–	–	–	–	–	(17.9)	(17.9)
Cashflow reserve	–	–	–	–	–	0.3	0.3
	3,714.3	1,610.9	1,754.2	1,153.8	251.9	296.0	8,781.1

The subscribed capital consists of PIBS which have no specified maturity date but for this analysis it is assumed that they will be repaid by the Society at the first issuer call date which is 5 April 2021.

31. FINANCIAL INSTRUMENTS (cont'd)

The significant development of liquidity stress testing and forecast models carried out in 2009 has continued in 2010 due to economic and market conditions. A wide range of scenarios are considered in incorporating mild and severe stresses, credit downgrades and a total closure of the wholesale market. An analysis of the liquidity portfolio of the Group is set out in the table below:

	2010		2009	
	£m	**%**	£m	%
Cash in hand and balances with the Bank of England	**9.6**	**0.6**	8.5	0.4
Cash with banks and building societies	**192.9**	**11.7**	318.7	15.8
Gilts	**134.6**	**8.1**	67.0	3.3
Certificates of deposit	**230.4**	**14.0**	166.0	8.2
Local authority investments	**8.2**	**0.5**	8.6	0.4
Fixed rate bonds	**672.9**	**40.7**	1,033.0	51.1
Floating rate notes	**174.9**	**10.6**	211.6	10.5
Residential mortgage backed securities	**228.2**	**13.8**	208.9	10.3
Total	**1,651.7**	**100.0**	2,022.3	100.0

During the year the liquidity balances have decreased from £2,022.3m at 31 March 2009 to £1,651.7m at 31 March 2010, expressed as a proportion of our combined shares and deposits liabilities this represents a decrease from 24.95% to 22.47%.

The following table is an analysis of the Group's gross contractual cash flows payable under financial liabilities

At 31 March 2010 – Group	**0 - 3 months £m**	**3 - 12 months £m**	**1 - 5 years £m**	**Over 5 years £m**	**Total £m**
Liabilities					
Shares	3,951.1	1,052.0	1,540.1	1.0	**6,544.2**
Amounts owed to credit institutions, customers and debt securities	178.2	11.1	522.9	40.2	**752.4**
Derivative financial instruments	0.1	2.6	21.0	73.0	**96.7**
Total liabilities	**4,129.4**	**1,065.7**	**2,084.0**	**114.2**	**7,393.3**

At 31 March 2009	0 - 3 months £m	3 - 12 months £m	1 - 5 years £m	Over 5 years £m	Total £m
Liabilities					
Shares	4,510.2	1,602.0	601.7	1.3	6,715.2
Amounts owed to credit institutions, customers and debt securities	793.4	212.1	624.7	286.6	1,916.8
Derivative financial instruments	2.8	6.5	29.7	31.1	70.1
Subordinated liabilities	1.0	9.9	152.8	125.9	289.6
Total liabilities	5,307.4	1,830.5	1,408.9	444.9	8,991.7

For each material class of financial liability a maturity analysis is provided in pages 76 to 79.

31. FINANCIAL INSTRUMENTS (cont'd)

At 31 March 2010 – Society	**0 - 3 months £m**	**3 - 12 months £m**	**1 - 5 years £m**	**Over 5 years £m**	**Total £m**
Liabilities					
Shares	3,951.1	1,052.0	1,540.1	1.0	**6,544.2**
Amounts owed to credit institutions, customers and debt securities	178.2	11.1	522.9	40.2	**752.4**
Derivative financial instruments	3.9	10.7	26.4	37.6	**78.6**
Total liabilities	**4,133.2**	**1,073.8**	**2,089.4**	**78.8**	**7,375.2**

At 31 March 2009 Society	0 - 3 months £m	3 - 12 months £m	1 - 5 years £m	Over 5 years £m	Total £m
Liabilities					
Shares	4,510.2	1,602.0	601.7	1.3	6,715.2
Amounts owed to credit institutions, customers and debt securities	793.4	212.1	624.7	286.6	1,916.8
Derivative financial instruments	0.3	(1.0)	5.4	4.2	8.9
Subordinated liabilities	1.0	9.9	152.8	125.9	289.6
Total liabilities	5,304.9	1,823.0	1,384.6	418.0	8,930.5

Foreign currency risk
Foreign exchange risk arises as a result of activities undertaken by the Group when raising and investing funds in currencies other than sterling, which is done in order to manage wholesale funding costs and the returns on liquid assets and to provide diversity in funding and investment markets. The Group's only foreign currency exposure at 31 March 2010 was £53.6m (2008/9: £55.8m) consisting of fully hedged Euro Medium term notes.

Equity risk
Equity Risk arises from index linked savings products which the Group offers and is managed through the use of derivative contracts. The Group's only exposure to equity risk at 31 March 2010 was £335.6m (2008/9: £278.8m) of fully hedged savings products.

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

The Group uses derivatives to reduce market risk in its daily activities and are not used in trading activity or for speculative purposes. The nature of these instruments means that the nominal value of these transactions is not included in the Statement of Financial Position. The interest payments, receipts and changes in fair value of effective hedges are recognised in the interest margin. Fair values are recorded in the Statement of Financial Position.

Types of derivatives
The principal derivatives used by the Group are interest rate swaps, cross currency interest rate swaps and index linked swaps that are used to hedge Group Statement of Financial Position exposures.

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

Activity	**Risk**	**Managed by**
Management of the investment of reserves and other non-interest bearing liabilities	Sensitivity to changes in interest rates	Matching against fixed rate assets
Fixed rate mortgage lending and other assets	Sensitivity to rises in interest rates	Pay fixed rate interest rate swaps and swaptions, matching against fixed rate receipts
Fixed rate savings products and funding	Sensitivity to falls in interest rates	Receive fixed rate interest rate swaps and swaptions, matching against fixed rate liabilities
Investments, funding or products denominated in foreign currencies	Sensitivity to changes in interest rates and currency exchange rates	Cross currency interest rate \ basis swaps
Equity linked investment products	Sensitivity to changes in equity indices	Equity linked swaps and options
Cap, collared or floored products	Sensitivity to changes in interest rates	Matching against appropriate cap, collar or floor derivatives or suitable assets or liabilities

31. FINANCIAL INSTRUMENTS (cont'd)

Classification of financial assets and financial liabilities

The following tables summarise the classification of carrying amounts of the Group's primary financial assets and liabilities as at 31 March 2010 and 31 March 2009:

As at 31 March 2010 – Group	**Amortised Cost £m**	**Available for sale £m**	**Fair value through profit or loss £m**	**Total £m**
Assets				
Cash and balances with the Bank of England	9.6	–	–	**9.6**
Loans and advances to credit institutions	192.9	–	–	**192.9**
Investment securities: Available for sale	–	1,449.2	–	**1,449.2**
Derivative financial instruments	–	–	78.4	**78.4**
Loans and advances to customers	6,315.3	–	121.7	**6,437.0**
Total financial assets	**6,517.8**	**1,449.2**	**200.1**	**8,167.1**
Other non-financial assets				**168.5**
Total assets				**8,335.6**
Liabilities				
Shares	6,544.1	–	–	**6,544.1**
Amounts due to credit institutions	92.6	–	–	**92.6**
Amounts due to other customers	144.3	–	–	**144.3**
Derivative financial instruments	–	–	96.7	**96.7**
Debt securities in issue	740.4	–	170.9	**911.3**
Total financial liabilities	**7,521.4**	**–**	**267.6**	**7,789.0**
Other non-financial assets				**31.6**
Total liabilities				**7,820.6**

As at 31 March 2009 – Group	Amortised Cost £m	Available for sale £m	Fair value through profit or loss £m	Total £m
Assets				
Cash and balances with the Bank of England	8.5	–	–	8.5
Loans and advances to credit institutions	318.7	–	–	318.7
Investment securities: Available for sale	–	1,695.1	–	1,695.1
Derivative financial instruments	–	–	62.1	62.1
Loans and advances to customers	6,775.2	–	148.0	6,923.2
Total financial assets	7,102.4	1,695.1	210.1	9,007.6
Other non-financial assets				187.9
Total assets				9,195.5
Liabilities				
Shares	6,541.3	–	–	6,541.3
Amounts due to credit institutions	461.5	–	–	461.5
Amounts due to other customers	497.3	–	–	497.3
Derivative financial instruments	–	–	125.3	125.3
Debt securities in issue	799.6	–	193.0	992.6
Subordinated debt	190.0	–	–	190.0
Total financial liabilities	8,489.7	–	318.3	8,808.0
Other non-financial assets				47.3
Total liabilities				8,855.3

The financial assets and liabilities designated as at Fair value through profit and loss consist of derivative financial instruments and instruments that were designated as such upon initial recognition to avoid an accounting mismatch. No items held at fair value through profit and loss were classified as held for trading. As discussed in Note 1, Accounting policies and Note 28, these are economically hedged where it is not practical to apply hedge accounting.

31. FINANCIAL INSTRUMENTS (cont'd)

Classification of financial assets and financial liabilities (cont'd)

The following tables summarise the classification of carrying amounts of the Society's primary financial assets and liabilities as at 31 March 2010 and 31 March 2009:

As at 31 March 2010 – Society	**Amortised Cost £m**	**Available for sale £m**	**Fair value through profit or loss £m**	**Total £m**
Assets				
Cash and balances with the Bank of England	9.6	–	–	**9.6**
Loans and advances to credit institutions	108.4	–	–	**108.4**
Investment securities: Available for sale	–	2,630.5	–	**2,630.5**
Derivative financial instruments	–	–	96.0	**96.0**
Loans and advances to customers	2,351.7	–	–	**2,351.7**
Investments	2,734.1	–	–	**2,734.1**
Total financial assets	**5,203.8**	**2,630.5**	**96.0**	**7,930.3**
Other non-financial assets				**31.8**
Total assets				**7,962.1**
Liabilities				
Shares	6,544.1	–	–	**6,544.1**
Amounts due to credit institutions	92.6	–	–	**92.6**
Amounts due to other customers	144.3	–	–	**144.3**
Derivative financial instruments	–	–	78.6	**78.6**
Debt securities in issue	517.1	–	53.6	**570.7**
Total financial liabilities	**7,298.1**	**–**	**132.2**	**7,430.3**
Other non-financial assets				**22.4**
Total liabilities				**7,452.7**

As at 31 March 2009 – Society	Amortised Cost £m	Available for sale £m	Fair value through profit or loss £m	Total £m
Assets				
Cash and balances with the Bank of England	8.5	–	–	8.5
Loans and advances to credit institutions	245.9	–	–	245.9
Investment securities: Available for sale	–	2,877.9	–	2,877.9
Derivative financial instruments	–	–	96.2	96.2
Loans and advances to customers	2,598.5	–	–	2,598.5
Investments	2,905.8	–	–	2,905.8
Total financial assets	5,758.7	2,877.9	96.2	8,732.8
Other non-financial assets				48.3
Total assets				8,781.1
Liabilities				
Shares	6,541.3	–	–	6,541.3
Amounts due to credit institutions	461.5	–	–	461.5
Amounts due to other customers	497.3	–	–	497.3
Derivative financial instruments	–	–	116.1	116.1
Debt securities in issue	548.2	–	55.8	604.0
Subordinated debt	190.0	–	–	190.0
Total financial liabilities	8,238.3	–	171.9	8,410.2
Other non-financial assets				42.8
Total liabilities				8,453.0

The financial assets and liabilities designated as at Fair value through profit and loss consist of derivative financial instruments and instruments that were designated as such upon initial recognition to avoid an accounting mismatch. No items held at fair value through profit and loss were classified as held for trading. As discussed in Note 1, Accounting policies and Note 28, these are economically hedged where it is not practical to apply hedge accounting.

31. FINANCIAL INSTRUMENTS (cont'd)

Fair values of financial assets and financial liabilities

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Group Statement of Financial Position:

	Group		Society	
	Carrying Value 2010 £m	**Fair value 2010 £m**	**Carrying Value 2010 £m**	**Fair value 2010 £m**
Financial assets				
Cash and balances with Bank of England	**9.6**	9.6	**9.6**	9.6
Investment securities: Available for sale	**1,449.2**	1,449.2	**2,630.5**	2,630.5
Loans and advances to credit institutions	**192.9**	192.9	**108.4**	108.4
Loans and advances to customers	**6,436.8**	6,543.4	**2,351.7**	2,482.6
Financial liabilities				
Shares	**6,544.1**	6,544.1	**6,544.1**	6,544.1
Amounts due to credit institutions	**92.6**	92.6	**92.6**	92.6
Amounts due to other customers	**144.3**	144.3	**144.3**	144.3
Debt securities in issue	**911.3**	912.5	**570.7**	571.9

	Group		Society	
	Carrying Value 2009 £m	Fair value 2009 £m	Carrying Value 2009 £m	Fair value 2009 £m
Financial assets				
Cash and balances with Bank of England	8.5	8.5	8.5	8.5
Investment securities: Available for sale	1,695.1	1,695.1	2,877.9	2,877.9
Loans and advances to credit institutions	318.7	318.7	245.9	245.9
Loans and advances to customers	6,923.2	6,981.3	2,598.5	2617.1
Financial liabilities				
Shares	6,541.3	6,541.3	6,541.3	6,541.3
Amounts due to credit institutions	461.5	461.5	461.5	461.5
Amounts due to other customers	497.3	497.3	497.3	497.3
Debt securities in issue	992.6	993.4	604.0	604.8
Subordinated debt	190.0	222.7	190.0	222.7

a) Loans and advances to customers
Loans and advances are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

b) Deposits and borrowings
The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand.
The estimated fair value of fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

c) Debt securities in issue
The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

The fair values have been calculated on a product basis and as such do not necessarily represent the value that could have been obtained for a portfolio if it were sold at 31 March 2010.

31. FINANCIAL INSTRUMENTS (cont'd)

Fair value measurement

The following table summarises the fair value measurement basis used for assets and liabilities held on the Statement of Financial Position at fair value:

2010 – Group	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets				
Investment securities: Available for sale	1,449.2	–	–	**1,449.2**
Loans and advances to customers	–	121.7	–	**121.7**
Derivative financial instruments	–	78.4	–	**78.4**
	1,449.2	200.1	–	**1,649.3**
Financial liabilities				
Debt securities in issue	–	121.7	–	**121.7**
Derivative financial instruments	–	96.7	–	**96.7**
	–	218.4	–	**218.4**
2010 – Society				
Financial assets				
Investment securities: Available for sale	2,630.5	–	–	**2,630.5**
Derivative financial instruments	–	96.0	–	**96.0**
	2,630.5	96.0	–	**2,726.5**
Financial liabilities				
Debt securities in issue	–	53.6	–	**53.6**
Derivative financial instruments	–	78.6	–	**78.6**
	–	132.2	–	**132.2**

2009 – Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Investment securities: Available for sale	1,695.1	–	–	1,695.1
Loans and advances to customers	–	148.0	–	148.0
Derivative financial instruments	–	62.1	–	62.1
	1,695.1	210.1	–	1,905.2
Financial liabilities				
Debt securities in issue	–	193.0	–	193.0
Derivative financial instruments	–	125.3	–	125.3
	–	318.3	–	318.3
2009 – Society				
Financial Assets				
Investment securities: Available for sale	2,877.9	–	–	2,877.9
Derivative financial instruments	–	96.2	–	96.2
	2,877.9	96.2	–	2,974.1
Financial Liabilities				
Debt securities in issue	–	55.8	–	55.8
Derivative financial instruments	–	116.1	–	116.1
	–	171.9	–	171.9

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as price) or indirectly (i.e. derived from prices).

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

These definitions have been taken from the March 2009 amendment to IFRS 7 'Improving Disclosures about Financial Instruments'.

32. FINANCIAL COMMITMENTS

	Group		Society	
	2010 **£m**	2009 £m	**2010** **£m**	2009 £m
a) Capital commitments				
Capital expenditure contracted but not yet provided for in the accounts	**0.2**	0.4	**0.2**	0.4

	Group		Society	
	2010 **£m**	2009 £m	**2010** **£m**	2009 £m
b) Leasing commitments				
The total commitments under non-cancellable leases are as follows:				
Amounts falling due:				
Within one year	**0.8**	0.1	**0.6**	0.1
Within two to five years inclusive	**1.7**	0.7	**1.5**	0.4
Over five years	**1.1**	2.9	**1.1**	3.2
	3.6	3.7	**3.2**	3.7

	Group		Society	
	2010 **£m**	2009 £m	**2010** **£m**	2009 £m
c) Loan commitments				
Undrawn loan facilities	**–**	2.7	**–**	1.8

33. RELATED PARTY TRANSACTIONS

i) Subsidiary, parent and ultimate controlling party

The subsidiaries of the Society (the ultimate controlling party) are detailed in Note 14 of these accounts.

ii) Key management personnel

The Board considers key management personnel to comprise Executive and Non-Executive Directors. Details of Directors' remuneration are disclosed in Note 7.

iii) Transactions with key management personnel, and their close family members

Key management personnel, which comprises Executive and Non-Executive Directors, and their close family members have undertaken the following transactions with the West Bromwich Building Society and Group.

	No of key management personnel 2010	Amount in respect of key management personnel and their close family members 2010 £'000	No of key management personnel 2009	Amount in respect of key management personnel and their close family members 2009 £'000
Mortgage balances	**2**	**251**	4	752
Interest	**4**	**10**	4	45

Mortgages are granted to key management personnel and members of their close family at normal commercial terms and no specific provisions are held against them. Included within the 2010 figures above is a £150k (2009: £176k) mortgage balance relating to a close family member who is not classified as a connected person under the Building Society Act 1986.

A register is maintained by the Society containing details of loans and transactions and arrangements made between the Society or its subsidiary undertakings and Directors of the Society or persons connected with Directors of the Society. The register will be available for inspection by members at the Annual General Meeting and during normal office hours at the Society's Principal Office (374 High Street, West Bromwich) during the period 15 days prior to the Meeting.

iv) Contributions to pension Schemes

During the year the Group and Society paid contributions of £7.3m (2008/9: £3.1m) and £7.3m (2008/9: £3.1m) respectively to defined benefit pension schemes, which are classified as related parties.

v) Transactions with group companies

	2010		2009	
	Interest paid to WBBS £m	**Admin fee paid to Society £m**	Interest paid to WBBS £m	Admin fee paid to Society £m
West Bromwich Mortgage Company Limited	**48.7**	**–**	89.1	–
West Bromwich Commercial Limited	**62.8**	**–**	57.9	–
WBBS Computer Finance Limited	**–**	**(0.4)**	–	(0.4)
West Bromwich Homes Limited	**4.7**	**0.1**	5.3	0.1
Insignia Finance Limited	**1.4**	**–**	1.6	–
	117.6	**(0.3)**	153.9	(0.3)

At the year end the following balances were outstanding with Group companies:

	2010		2009	
	Loans owed by Subsidiaries £m	**Loans owed to Subsidiaries £m**	Loans owed by Subsidiaries £m	Loans owed to Subsidiaries £m
West Bromwich Mortgage Company Limited	**1,589.8**	**–**	1,712.5	–
West Bromwich Commercial Limited	**999.7**	**–**	1,035.5	–
Mortgage Force Limited	**2.5**	**–**	2.2	–
Governangle Limited – dormant	**–**	**0.2**	–	0.2
Governafter Limited – dormant	**–**	**0.1**	–	0.1
Insync Financial Planning Limited	**0.2**	**–**	1.3	–
West Bromwich Homes Limited	**92.6**	**–**	91.6	–
Insignia Finance Limited	**48.7**		55.9	
	2,733.5	**0.3**	2,899.0	0.3

Transactions and balances between Group companies are on normal commercial terms and conditions.

34. BUSINESS SEGMENTS

In the financial year 2010, segment reporting by the Group was prepared for the first time in accordance with IFRS 8, 'Operating segments'. Segment information for 2009 that is reported as comparative information for 2010 has been restated to conform to the requirements of IFRS 8. Following the management approach of IFRS 8, operating segments are reported in accordance with the internal reporting provided to the Group Board (the chief operating decision-maker), which is responsible for allocating resources to the reportable segments and assesses its performance. All operating segments used by the Group meet the definition of a reportable segment under IFRS 8.

The Group has four main business divisions:

- Retail; incorporating residential lending, savings, investment and protection;
- Commercial; primarily representing loans for commercial property investment;
- Property; a portfolio of residential properties for rent; and
- Mortgage broking (discontinued).

Central group operations have been included in Retail and comprise risk management, funding, treasury services, human resources and the provision of computer services, none of which constitute a separately reportable segment or business activity from head office. As the Group's segment operations are all financial with a majority of revenues deriving from interest and the Group Board relies primarily on net interest revenue to assess the performance of the segment, the total interest income and expense for all reportable segments is presented on a net basis. There were no changes in the reportable segments during the year.

Transactions between the business segments are carried out at arm's length. The revenue from external parties reported to the Group Board is measured in a manner consistent with that in the consolidated Income Statement.

Funds are ordinarily allocated between segments, resulting in funding cost transfers disclosed in inter-segment net interest income. Interest charged for these funds is based on the Group's cost of funding. Central administrative costs are also allocated between segments and are disclosed in intersegment admin expenses. There are no other material items of income or expense between the business segments.

The Group's management reporting is based on a measure of operating profit comprising net interest income, loan impairment charges, net fee and commission income, other income, depreciation and administrative expenses. This measurement basis excludes the effects of non-recurring expenditure from the operating segments such as restructuring costs, legal expenses and goodwill impairments when the impairment is the result of an isolated, non-recurring event.

As the Group Executive Board reviews operating profit, the results of discontinued operations are not included in the measure of operating profit.

The information provided about each segment is based on the internal reports about segment income or expense, assets and other information, which are regularly reviewed by the Group Board. Segment assets and liabilities comprise operating assets and liabilities, being the majority of the Statement of Financial Position, but exclude items such as taxation.

Income Statements – March 2010	**Retail £m**	**Commercial £m**	**Property £m**	**Consol adj £m**	**Continuing operations £m**	**Discontinued operations (Mortgage broking) £m**	**Total Group £m**
Interest receivable and similar income	253.5	63.5	–	(66.7)	250.3	–	**250.3**
Interest payable and similar charges	(214.1)	(69.3)	(4.7)	67.5	(220.6)	–	**(220.6)**
Net interest receivable/(payable)	**39.4**	**(5.8)**	**(4.7)**	**0.8**	**29.7**	**–**	**29.7**
Fees & commissions receivable/(payable)	7.3	0.3	–	(0.9)	6.7	2.4	**9.1**
Fees and commissions payable	–	–	–	–	–	(1.9)	**(1.9)**
Other operating income/(expense)	2.5	0.8	5.1	(0.6)	7.8	–	**7.8**
Total operating income/(expense)	**49.2**	**(4.7)**	**0.4**	**(0.7)**	**44.2**	**0.5**	**44.7**
Administrative expenses - ongoing	(37.6)	(2.9)	(0.2)	1.8	(38.9)	(0.9)	**(39.8)**
Administrative expenses - restructuring	(3.3)	–	–	–	(3.3)	–	**(3.3)**
Depreciation and amortisation	(4.0)	–	–	–	(4.0)	(0.5)	**(4.5)**
Impairment of investments	–	–	–	–	–	(4.9)	**(4.9)**
Operating profit/(loss) before provisions	**4.3**	**(7.6)**	**0.2**	**1.1**	**(2.0)**	**(5.8)**	**(7.8)**
Impairment losses on loans and advances	(4.9)	(15.7)	–	–	(20.6)	–	**(20.6)**
Provisions for contingent liabilities and commitments	4.1	–	–	–	4.1	–	**4.1**
Profit/(Loss) on ordinary activities before tax	**3.5**	**(23.3)**	**0.2**	**1.1**	**(18.5)**	**(5.8)**	**(24.3)**
Taxation	–	6.3	0.5	0.5	7.3	–	**7.3**
Profit/(Loss) for the year	**3.5**	**(17.0)**	**0.7**	**1.6**	**(11.2)**	**(5.8)**	**(17.0)**

Statements of Financial Position - March 2010	**Retail £m**	**Commercial £m**	**Property £m**	**Consol adj £m**	**Continuing operations £m**	**Discontinued operations (Mortgage broking) £m**	**Total Group £m**
Total assets	**7,965.8**	**1,541.9**	**118.9**	**(1,287.2)**	**8,339.4**	**(3.8)**	**8,335.6**
Total liabilities	**7,443.6**	**1,559.3**	**97.2**	**(1,282.5)**	**7,817.6**	**3.0**	**7,820.6**
Capital expenditure	**4.5**	**–**	**0.4**	**–**	**4.9**	**–**	**4.9**

34. BUSINESS SEGMENTS (cont'd)

Income Statements – March 2009 (re-presented)	Retail £m	Commercial £m	Property £m	Consol adj £m	Continuing operations £m	Discontinued operations (Mortgage broking) £m	Total Group £m
Interest receivable and similar income	480.9	104.5	–	(76.7)	508.7	–	508.7
Interest expense and similar charges	(417.7)	(95.6)	(5.2)	76.8	(441.7)	–	(441.7)
Net interest receivable/(payable)	63.2	8.9	(5.2)	0.1	67.0	–	67.0
Fees and commissions receivable/(payable)	14.0	0.3	–	–	14.3	3.0	17.3
Fees and commissions payable	(3.0)	–	–	–	(3.0)	(1.7)	(4.7)
Other operating income/(expense)	11.3	0.8	(7.1)	(1.4)	3.6	–	3.6
Total operating income/(expense)	85.5	10.0	(12.3)	(1.3)	81.9	1.3	83.2
Administrative expenses – ongoing	(50.7)	(2.7)	(0.3)	1.3	(52.4)	(1.3)	(53.7)
Administrative expenses – restructuring	(4.1)	–	–	–	(4.1)	–	(4.1)
Administrative expenses – pension curtailment	8.0	–	–	–	8.0	–	8.0
Depreciation and amortisation	(5.6)	–	–	–	(5.6)	–	(5.6)
Operating profit/(loss) before provisions	33.1	7.3	(12.6)	–	27.8	–	27.8
Impairment losses on loans and advances	(16.5)	(48.7)	–	–	(65.2)	–	(65.2)
Provisions for liabilities and commitments	(11.4)	–	–	–	(11.4)	–	(11.4)
Profit/(Loss) before tax	5.2	(41.4)	(12.6)	–	(48.8)	–	(48.8)
Taxation	(3.8)	11.6	2.2	(0.5)	9.5	–	9.5
Profit/(Loss) for the year	1.4	(29.8)	(10.4)	(0.5)	(39.3)	–	(39.3)

Statements of Financial Position – March 2009	Retail £m	Commercial £m	Property £m	Consol adj £m	Continuing operations £m	Discontinued operations (Mortgage Broking) £m	Total Group £m
Total assets	8,796.9	1,599.7	118.1	(1,321.5)	9,193.2	2.3	9,195.5
Total liabilities	8,544.4	1,597.7	96.2	(1,310.9)	8,927.4	2.8	8,930.2
Capital expenditure	2.5	–	1.4	–	3.9	–	3.9

Annual Business Statement

at 31 March 2010

1. Statutory percentages

	2010 %	Statutory Limit %
Lending limit	**19.4**	25.0
Funding limit	**11.0**	50.0

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

The Lending limit measures the proportion of business assets not in the form of loans secured on residential property. Business assets are the total assets of the Group plus provisions for bad and doubtful debts less liquid assets, non-recourse finance, investment properties, intangible assets and property, plant and equipment as shown in the Group Accounts.

The Funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals excluding non-recourse finance. The statutory limits are as laid down under the Building Societies Act 1986 as amended by the Building Societies Act 1997 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

2. Other percentages

As a percentage of shares and borrowings:	2010 %	2009 %
Gross capital	**7.01**	6.54
Free capital	**5.38**	5.05
Liquid assets	**22.47**	24.95
Loss for the financial year as a percentage of mean total assets	**(0.19)**	(0.42)
Management expenses as a percentage of mean total assets	**0.53**	0.58

The above percentages have been prepared from the Group's 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 excluding non-recourse finance, in each case including accrued interest.

– 'Gross capital' represents the aggregate of General reserves, Available for sale reserve, Revaluation reserve, Cashflow reserve, Subscribed capital, Subordinated liabilities and Profit participating deferred shares.

– 'Free capital' represents the aggregate of gross capital and collective impairment provisions for bad and doubtful debts less intangible assets, investment properties and property, plant and equipment.

– 'Mean total assets' represents 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 and balances with the Bank of England, loans and advances to credit institutions and investment securities.

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

Information relating to Directors' and Officers' other directorships and interests at 31 March 2010

Name, Qualification and Date of Birth	Role	Date of Appointment	Other Directorships
David Huw Davies BA, MBA, FCA 22 July 1956	Non-Executive Director	27 September 2006	Wates Group Ltd including subsidiaries and associated companies WBBS (SRS) Limited WBH (Financial Services) Limited
Edwin Hucks BSc (Hons), MSc 7 June 1944	Deputy Chairman and Senior Independent Director	26 September 2000	
Lesley James CBE BA (Hons), MA, CCIPD, FRSA 7 April 1949	Non-Executive Director	1 January 2001	Anchor Housing Trust St. Modwen Properties PLC WBBS (SRS) Limited
Mark Nicholls MA (Cantab), MBA 5 May 1949	Chairman	1 January 2010	Burcot House Management Limited The Evolution Group PLC National Lottery Fair Share Fund Northern Investors Company PLC EcoSecurities Group Limited
Martin Ritchley FCA, FCIB, Hon DBA 1 July 1946	Non-Executive Director	1 September 2009	NFU Mutual Insurance Pension Fund Trust Company Limited The ARC Addington Fund The National Farmers Union Mutual Insurance Society Limited
Bharat Shah FCCA 8 December 1953	Non-Executive Director	22 July 2004	Audit Commission BCS Business Consultants Limited Evans Mechanical Services Limited Firstglaze Limited F J Jones Holdings Limited F J Jones Heating Engineers Limited Fusiontint Limited Glenloom Limited Mileorder Limited Places for People Group Limited including subsidiaries and associated companies Questoak Limited Speedfit Limited Stockloom Limited Sure Maintenance Limited Sure Maintenance Group Limited WBBS (SRS) Limited
Richard Sommers BA, ACIB 4 September 1956	Non-Executive Director	1 October 2009	
Robert Sharpe 14 February 1949	Chief Executive	13 October 2008	Barclays Pension Fund Trustees Limited Robert Sharpe Consultancy Limited Vaultex (UK) Limited
Jonathan Westhoff BA (Hons) Fin Serv, FCMA, ACIB 11 July 1964	Group Finance Director	5 May 2009	Millinet Limited West Bromwich Commercial Limited West Bromwich Homes Limited

All Directors are members of the Society. None of the Directors have at any time in the year, or as at the year end, any beneficial interest in shares or debentures of any associated body of the Society.

Service Contracts

For details of the Executive Directors' service contracts, see the Directors' Remuneration Report on pages 27 to 29.

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

OFFICERS Director	Role	Society and Subsidiary directorships
Shaun Astley-Stone	Sales & Marketing Director	
Divisional Directors	**Role**	
Paul Field CMS	Divisional Director, Operations	West Bromwich Homes Limited West Bromwich Mortgage Company Limited
Stuart J Hislop	Treasurer	Millinet Limited
Andrew R Jones BSc (Hons), FCIB, FCIS	Group Secretary and Divisional Director, Risk	Insignia Finance Limited
Thomas M Lynch MA, ACA	Divisional Director, Finance	West Bromwich Mortgage Company Limited
Peter Southcott	Divisional Director, Credit Management	Insignia Finance Limited West Bromwich Commercial Limited
Other Executives	**Role**	
David Barton BSc (Hons), ACIB	Head of Structured Finance	
Peter Collingridge BSc (Hons), MEng	Head of IT	
Kevin Duffy	Managing Director, Mortgage Force	Mortgage Force Limited
Manjit Hayre	Head of Credit Risk	
John McErlean MIIA, FIIA	Head of Internal Audit	
Christopher J Miller AIS&MM	Head of Commercial Lending	West Bromwich Commercial Limited
Neil Noakes	Head of Risk & Compliance	
Jacqui Randle BSc, Chartered FCIPD	Head of Human Resources	

HEAD OFFICE: 374 HIGH STREET, WEST BROMWICH,
WEST MIDLANDS B70 8LR

REGISTERED NUMBER: 651B

WEST BROMWICH
BUILDING SOCIETY

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