

Corporate governance report

The board regards good corporate governance as being extremely important, as the board is accountable to the Society's members for the operation of the Society.

The board is firmly of the view that, to comply with best practice in corporate governance, it should aim to adhere to the principles and provisions of the Combined Code issued by the Financial Reporting Council (the Code) which applies to listed companies, to the extent that they are relevant to a building society.

In 2006 the Society also complied with the Code of Governance for building societies contained in the Interim Prudential Sourcebook issued by the Financial Services Authority (FSA). This code was repealed on 1st January 2007. However, in the interest of transparency, the FSA encourages each building society to explain in its Annual Report and Accounts whether, and to what extent, it adheres to the Code.

The objective of this report is to communicate the key elements of the Group's governance structure and relate this to the principles in the Code. The board considers that it complies with all relevant aspects of the Code unless the contrary is stated within this report.

The board

The board applies principles of good governance by adopting the following procedures:

- the board meets a minimum of eleven times a year for board meetings and, in addition, meets at least once a year for a detailed review of the Society's strategy;
- the board's principal role is to focus on the Society's strategy and ensure that the necessary resources are in place for the Group to meet its objectives and that financial controls and systems of risk management are robust. In particular, its role is to provide general direction to the organisation and to safeguard the interest of members;
- the board maintains a schedule of reserved matters in order to ensure that it exercises control over the Group's affairs. These include, amongst other things, approval of the annual results and strategic aims of the Group as well as approval of policies and matters which must be approved by the board under legislation and the Society's Rules. The board is also responsible for the recruitment and terms of employment of the General Management team, which is made up of the executive directors and other General Managers, details of which can be found on pages 10 and 11.

Other matters are delegated to the General Management team or to other specified members of staff or committees including the Board committees referred to on pages 25 to 27 and the Group Asset and Liability Committee;

- all directors have access to independent professional advice if required and have the benefit of appropriate liability insurance cover at the Society's expense; and
- the size and composition of the board is kept under review to ensure that there is adequate succession planning for executive and non-executive directors and that there are the optimum skills and experience represented on the board for the direction of the Group's activities.

Appointments to the board and re-elections

The appointment of new directors is considered by the Nominations Committee (see page 26) which makes recommendations to the board. All directors are subject to election by members at the Annual General Meeting (AGM) following their appointment. In addition, all directors must receive approval from the FSA as Approved Persons in order to fulfil their controlled function as a director.

Under the Society's Rules, directors have to submit themselves for re-election at least once every three years. Non-executive directors are usually expected to serve for two full three-year terms following their first election to the board (subject to the board reviewing their performance prior to any proposal for re-election), and may be asked to serve for a further term.

At the 2007 AGM, members will be asked to re-elect Ed Anderson, Chairman, Frank Beckett, non-executive director, and Iain Cornish, Chief Executive. The board has confirmed that the performance of these directors continues to be effective and that they continue to show commitment to their role. Lynne Charlesworth and David Paige, who were appointed as non-executive directors by the board on 31st December 2006, will be subject to election by members at the 2007 AGM.

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Set out below are details of the directors during 2006 and their attendance record at board meetings and relevant board committee meetings in the year. The figure in brackets indicates the number of meetings that the director was eligible to attend during the year.

Board and Committee Membership and Attendance Record 2006

Director	Board	Board Committees				Risk
	Meetings	Audit	Chairman's	Nomin	Remun	
Ed Anderson Non-executive Director Vice Chairman from 01.07.06	11(11)	–	4(4)	3(3)	3(3)	–
Julie Baddeley Non-executive Director	10(11)	–	–	–	3(3)	–
Frank Beckett Non-executive Director	11(11)	4(4)	–	–	3(3)	4(5)
Colette Bowe Non-executive Director (retired 31.12.06)	9(11)	4(4)	–	–	2(3)	4(5)
Andy Caton Corporate Development Director	10(11)	–	9(11)	–	–	3(5)
Lynne Charlesworth Non-executive Director (appointed 31.12.06)	0(0)	–	–	–	–	–
Iain Cornish Chief Executive	11(11)	–	11(11)	3(3)	–	4(5)
Richard Davey Non-executive Director	11(11)	4(4)	–	–	3(3)	0(2)
Andrew Gosling Finance Director	11(11)	–	10(11)	–	–	4(5)
Rob Jackson Operations Director	11(11)	–	9(11)	–	–	3(5)
Paul Lee Non-executive Director Vice Chairman to 30.06.06	7(11)	1(4)	7(7)	–	1(3)	–
David Paige Non-executive Director (appointed 31.12.06)	0(0)	–	–	–	–	–
Christopher Sheridan Chairman (retired 31.12.06)	11(11)	4(4)	11(11)	3(3)	3(3)	–
Sue Tinson Non-executive Director (retired 26.04.06)	3(4)	–	–	–	2(2)	–
Simon Turner Non-executive Director	10(11)	3(4)	–	–	3(3)	–

On 1st January 2007, Ed Anderson was appointed Chairman and Richard Davey was appointed Vice Chairman.

Chairman and Chief Executive

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose.

The Chairman is responsible for leadership of the board and ensuring that the board acts effectively. The Chief Executive has overall responsibility for managing the Society and its subsidiaries and for implementing the strategies and policies agreed by the board.

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Board balance and independence

As at the date of this report, the board consists of four executive directors and eight non-executive directors.

In the opinion of the board, each non-executive director, including the Chairman, is independent in character and judgement.

Paul Lee, non-executive director, is a partner in Addleshaw Goddard, a firm of solicitors, which provides certain legal services to the Society. Despite this connection, the board considers Mr Lee to be independent and that his partnership status with Addleshaw Goddard does not interfere with the exercise of his independent judgement for the following reasons:

- Mr Lee does not personally undertake any legal work on behalf of the Group;
- Addleshaw Goddard is a major commercial legal firm locally and nationally and is the leading national firm for specialist building society work;
- the Society instructed Addleshaw Goddard before Mr Lee was appointed to the board;
- the Society undertakes periodic reviews of the solicitors it uses and Mr Lee's membership of the Society's board has no bearing on this review; and
- a schedule of fees paid to Addleshaw Goddard in 2006 has been submitted to the FSA. A copy is available to members on request from the Group Secretary.

The Vice Chairman is the Society's Senior Independent Director. The non-executive directors meet without the executive directors present at least once a year.

Copies of the letters of appointment of the non-executive directors are available on request from the Group Secretary.

Information and professional development

To ensure that the board functions effectively, all directors receive accurate, timely and clear information and it is the responsibility of the Chairman to ensure that this is periodically reviewed. In September 2006 the board undertook a review of the information provided to it, as part of the annual board evaluation process. The board is satisfied that the board papers provide adequate and relevant information and focus on key strategic issues.

The Chairman also ensures that, on appointment, non-executive directors receive a comprehensive tailored induction programme on the Group's business and regulatory environment. All non-executive directors update their skills, knowledge and familiarity with the Group through regular internal presentations by senior managers and through relevant external and internal courses. Individual training requirements for non-executive directors are discussed during the performance evaluation process (see below).

All directors have access to the advice and services of the Group Secretary who is responsible for ensuring that board procedures are complied with and for advising the board, through the Chairman, on governance matters.

Performance evaluation

The Group has a formal performance evaluation system for all members of staff including the executive directors. The Chief Executive appraises the executive directors on their performance and the Chairman undertakes an appraisal of the Chief Executive.

A performance evaluation system for non-executive directors, including the Chairman, has been in place since 2003. In 2006, this took the format of an appraisal of each individual director by other members of the board and the General Management team through the completion of an anonymous questionnaire. The Chairman and Chief Executive reviewed the output of all questionnaires and used these as a basis for an evaluation interview with each non-executive director. The Vice Chairman and Chief Executive undertook the evaluation interview for the Chairman. This procedure identifies any individual and board training requirements and provides the evidence for the board as to whether to recommend to members that a director should be re-elected.

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In 2006 an internal performance evaluation process of the board, the Audit Committee and the Remuneration Committee were carried out in order to review the effectiveness of how the board and the board committees operate. This was undertaken through the means of a questionnaire which asked all directors and General Managers to appraise a range of factors relating to the make-up and operation of the board. A similar process was undertaken by the members of each of the above mentioned board committees. The relevant results were reviewed by the board and each committee and any appropriate improvement was identified for action.

A review of the Risk Committee was not undertaken as this was a new committee in 2006. However, a review will be carried out in 2007.

Board committees

The board has established a number of committees which have their own terms of reference. Details of the board committees are set out below.

The terms of reference of the Audit Committee, the Nominations Committee, the Remuneration Committee and the Risk Committee are available on request from the Group Secretary or on the Society's website www.ybs.co.uk.

Audit Committee

The membership of the committee is set out below:

Frank Beckett, non-executive director (Committee Chairman)
Colette Bowe, non-executive director (retired 31st December 2006)
Richard Davey, non-executive director
Paul Lee (resigned 30th November 2006)
Simon Turner, non-executive director

On 24th January 2007, David Paige was appointed to the Audit Committee.

All members of the committee have relevant audit committee experience and Frank Beckett, Colette Bowe and Richard Davey have relevant financial experience.

The responsibilities of the committee are in line with the provisions of the Smith Guidance on Audit Committees. The main function of the committee is to assist the board in fulfilling its oversight responsibilities, specifically the ongoing review, monitoring and assessment of:

- the integrity of the financial statements, any formal announcements relating to financial performance and significant financial reporting judgements contained in them;
- the effectiveness of the system of internal control and risk management processes;
- the internal and external audit processes;
- compliance with applicable laws and regulations;
- the Society's ethical and business standards;
- the appointment, re-appointment and removal of external auditors; and
- the policy on the use of the external auditors for non-audit work.

During 2006 the committee met four times in the execution of its responsibilities and considered reports on:

- the system of internal control;
- the integrity of financial statements;
- high level risks and associated controls;
- compliance with laws and regulations, including adherence to Money Laundering regulations;
- enhancements to risk management methodologies;
- new accounting policies and application of existing policies;
- the activities of internal and external auditors;
- the effectiveness of the Group Internal Audit function;
- the performance of the external auditor; and
- the effectiveness of the committee.

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The reports were provided by the independent Group Internal Audit function, the Group Finance function, the Group Risk function and the external auditors.

The committee considers that it has met its responsibilities and performed its duties with appropriate levels of care and expertise during 2006.

Chairman's Committee

The committee is made up of the Chairman, Vice Chairman and the executive directors.

The committee's main function is to decide on any item that requires attention before the following board meeting except for specific issues that have to be determined by the full board.

Nominations Committee

The committee is made up of the Chairman, Vice Chairman and the Chief Executive.

The committee is responsible for nominating candidates for the position of non-executive director, taking into account the balance of skills, knowledge and experience on the board, and for making appropriate recommendations to the board.

On 31st December 2006 two new non-executive directors were appointed by the board. The positions were advertised in national and local press to enable them to be brought to the attention of as wide a number of members as possible. In addition, an independent specialist agency was used to assist in the recruitment and search process.

On 1st January 2007, Ed Anderson, an existing non-executive director, was appointed Chairman following Christopher Sheridan's retirement on 31st December 2006. The board considered it appropriate to appoint an existing non-executive director to this position who therefore already had an in-depth knowledge of the business. As part of the process to appoint an internal successor to the position of Chairman, the Chairman and Vice Chairman sought the views of each director on an individual basis and the resulting recommendation was considered by the full board (in the absence of Ed Anderson as the recommended candidate).

Remuneration Committee

The committee previously consisted of all the non-executive directors of the Society (as identified in the table on page 23) and the Society's Chairman was Chairman of the committee.

However, following the 2006 board evaluation review, the board approved a revised make-up of the committee, with effect from 1st January 2007, to consist of three non-executive directors, namely Ed Anderson, Julie Baddeley (Chairman of the committee) and Simon Turner.

The committee is responsible for considering and approving the remuneration of the executive directors and other senior managers. Further details of the committee, the remuneration policy and directors' service contracts can be found in the Directors' Remuneration Report on pages 29 to 32. The contract in respect of Rob Jackson, Operations Director, pre-dates the Society's policy for one year notice periods for new executive director appointments and also the Code provision that notice periods should be set at one year or less. Mr. Jackson's contract is terminable by the Society on two years' notice or by the payment of an amount equivalent to two years' remuneration.

Whilst the Code states that the committee should set the remuneration of the Chairman, the board believes that it is more appropriate for the remuneration of the Chairman to be set and reviewed in the same manner as that used to determine the remuneration for all other non-executive directors. It is therefore dealt with by the board and not by the Remuneration Committee.

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Risk Committee

The membership of the committee is set out below:

Iain Cornish, Chief Executive (Committee Chairman)

Frank Beckett, non-executive director

Colette Bowe, non-executive director (retired 31st December 2006)

Andy Caton, Corporate Development Director

Robin Churchouse, General Manager Risk and Planning (appointed 1st June 2006)

Richard Davey, non-executive director (appointed 1st November 2006)

Andrew Gosling, Finance Director

Rob Jackson, Operations Director

On 24th January 2007, Lynne Charlesworth and David Paige were appointed to the Risk Committee.

The Risk Committee has delegated responsibility for the more detailed ownership of the Group's risk appetite, risk monitoring and capital management framework.

The committee's primary responsibilities, which evolved during 2006, include:

- establishing and reviewing the overall method by which the Group's risk appetite is determined;
- establishing and reviewing the Internal Capital Adequacy Assessment Process (ICAAP) framework by which the Group's existing and forecast risk positions and the resulting capital absorption are calculated and monitored;
- monitoring on an on-going basis the Group's actual and forecast risk and regulatory capital positions;
- considering whether existing activities constitute appropriate utilisation of the Group's available capital;
- recommending, for full board consideration, changes to capital utilisation, including utilisation of any spare capital available to the Group, or the raising of additional capital as required; and
- monitoring the performance and actions of its sub-committees, and ensuring that full coverage of all risk issues is achieved by the structure.

The Risk Committee has established a number of sub-committees with day-to-day responsibility for risk management oversight. Some of these committees have been in place for a number of years, others were established in 2006 following a review of the Group's risk management structures. All of the sub-committees meet at least quarterly and are chaired by a General Manager. At 31st December 2006 the sub-committees were as follows:

- Group Asset and Liability Committee
- Group Credit Committee
- Group Capital Committee*
- Group Operational Risk Committee*

* first meeting held in January 2007

Further details of the Group's risk management can be found in the Risk Management Report on pages 17 to 21.

System of internal controls

The Society recognises the importance of a sound system of internal control in the achievement of its objectives and the safeguarding of member and Society assets. Internal control facilitates the effectiveness and efficiency of operations, helps ensure the reliability of internal and external reporting and assists in compliance with applicable law and regulations.

The Society operates in a dynamic business environment and, as a result, the risks it faces are continually changing. The system of internal control has been designed to ensure thorough and regular evaluation of the nature and extent of risk and the ability to react accordingly. It is the role of the Society's management to implement the board's policies on risk and control. It is also recognised that all employees have some responsibility for internal control as part of their accountability for achieving objectives. Staff training and induction is designed to ensure that they are clear on their accountabilities in this area and are competent to operate and monitor the system of internal control.

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The Group Internal Audit function provided independent assurance to the board on the effectiveness of the system of internal control through the Audit Committee. The information received and considered by the committee provided reasonable assurance that during 2006 there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate system of internal control that met the principles of the Code and the supplementary Turnbull guidance.

Further details of actual risk management practices are provided in the Risk Management Report on pages 17 to 21.

Auditors

The Society has a policy on the use of the external auditor for non-audit work which is implemented by the Audit Committee. The purpose of this policy is to ensure the continued independence and objectivity of the external auditor. The external auditor, KPMG Audit Plc, undertook a small number of non-audit related assignments for the Group during 2006 and these were conducted within the limits set out in the policy and are considered to be consistent with the professional and ethical standards expected of the external auditor in this regard.

Relations with members

The Society's members are made up of its investors (except deposit account holders) and borrowers. The majority of its customers are therefore its members and the Society encourages feedback from them on any aspect of the Society's activities.

This feedback takes various forms, including member 'Question Time' meetings which give members the opportunity to meet and ask questions of the Chief Executive, the senior management team and local branch staff. The Members' Forum was established in 2005 and continued to meet in 2006. It is currently made up of 17 members who are drawn from a cross section of the Society's membership. The aim is to debate and obtain views on specific relevant issues.

The Society operates a Member Panel, consisting of more than 6,000 members, who are invited to complete surveys on a variety of topical issues. In addition, a monthly customer satisfaction survey is undertaken, the results of which are a key performance indicator which is monitored by the board on a monthly basis.

All members who are eligible to vote at the AGM receive a proxy voting form, which includes a 'vote withheld' option and a pre-paid reply envelope to encourage them to exercise their vote. At the AGM, the Chairman calls for a poll on all resolutions so that all proxy votes are recorded. The results of the proxy votes, and the votes cast at the AGM, are published on the Society's website, in branches and are available on a telephone results line for a specified period after the AGM. A separate resolution is proposed on each issue, including a resolution on the Annual Report and Accounts.

On behalf of the board

Ed Anderson
Chairman

5th March 2007