

**Yorkshire Building Society – Appendix 1**  
**Corporate Governance Statement (extract from the Report**  
**and Accounts 2003)**

**Myners Review of the Governance of Life Mutuals**

**Response of Yorkshire Building Society to the Consultation Document**  
**published in July 2004.**

**Introduction**

This response is submitted by Yorkshire Building Society (“the Yorkshire”) and is restricted to the view of the board and senior management of the Yorkshire on corporate governance in relation to building societies. In particular, it does not attempt to give an opinion on corporate governance within other financial mutuals including life mutuals.

**Yorkshire Building Society**

By way of background, the Yorkshire was established in 1864 and is the third largest building society (based on 2003 audited accounts) with assets in excess of £14 billion. It is based in Bradford, West Yorkshire and has 131 branches and 81 agencies throughout the United Kingdom.

The Yorkshire has 1.82 million members of which the majority, 1.58 million, are investing members; the remaining are borrowing members. The Yorkshire’s investment products are predominantly short and long term deposit based savings accounts.

The Society has a number of operational subsidiary companies including Yorkshire Guernsey Limited, which offers offshore deposit accounts and Accord Mortgages Limited which offers residential mortgages via the intermediary market. The customers of these two companies are not members of the Yorkshire.

The Yorkshire’s purpose is to maximise long term benefits for a growing membership and its key objectives are:

- to deliver member value through consistently attractive interest rates for borrowers and savers (the Society estimates that it has delivered £600m of additional interest rate benefits over the last 8 years when compared with the former building societies)
- to maintain low costs and a high level of service
- to balance the interests of current and future members as fairly as possible in a highly competitive market environment.

**Key Points**

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### **Corporate Governance Statement (extract from the Report and Accounts 2003)**

The Yorkshire has set out its response to the questions to which it considers it is qualified to answer. The principal points which the Society would wish to emphasise are:

- The Yorkshire strongly supports the extension of the Combined Code to the mutual sector, although it is considered that the Code could usefully be adapted to reflect the specific nature of mutual organisations. The Yorkshire has attempted to put itself at the forefront of accountability to members and has found the Code to be an appropriate vehicle for this.
- The composition and structure of a board should reflect the specific demands and circumstances of a mutual in the same way as for any other organisation. In the Society's view, mutuality requires that a high level of member engagement should be encouraged, and that corporate governance processes and organisational performance should be transparent to, and open to question from, members.
- The demands on non-executive directors of financial services organisations in terms of time and expertise have grown significantly. This is a growing challenge for organisations and individuals. However, this is not an issue specific to mutual financial service organisations, but is an issue faced by the entire sector.

#### **Response to Specific Questions**

The Yorkshire's specific comments, by reference to the numbering within the Consultation Paper, are as follows:

##### **Q1. To what extent does the current guidance on corporate governance particularly the Combined Code provide an appropriate framework for mutual life offices. Would another approach be more effective?**

The board of the Yorkshire agrees strongly that the Combined Code provides an appropriate framework and has voluntarily agreed to adhere to the Combined Code (in so far as its provisions are transferable to building societies) and included a Corporate Governance statement within its Report & Accounts for the year ended 31<sup>st</sup> December 2003 reporting on adherence to the Code. A copy of this statement is attached as Appendix 1.

It is considered that there is merit in developing a separate version of the Combined Code so that it is more tailored towards the structure of building societies (and other financial mutuals).

The main area of the current Code which is not easily transferable to building societies is Section E relating to Institutional Shareholders as well as reference to Institutional Shareholders in Section D.1. Building societies have no concept of Institutional Shareholders given that the majority of their customers are the members of the society with the statutory requirement of one member, one vote (irrespective of the balance within an investment / savings account or size of the mortgage). However, interaction with members is considered to be extremely important in order to gauge members' views not only on particular products and services but also on how the business is managed. Please refer to the response to question 7 in relation to the Yorkshire's methods of member involvement.

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The Yorkshire considers that the “comply or explain” principle in the Code is an effective method explaining to members adherence to any code (whether voluntary or mandatory).

**Q2. What is the best way of securing mutual life offices compliance with corporate governance best practice?**

It is considered that a non-statutory route would be more cost effective and be quicker to introduce than a regulatory requirement. There are a number of current examples of this method within the financial services sector such as adherence to the Mortgage Code and Banking Code. Whilst these are stated to be voluntary codes there is publicity given to those organisations that do not sign up to them which can act as a deterrent.

It is envisaged that any such code would require the organisation to publish an annual ‘comply or explain’ statement to members, similar to the one now required to be published by Plcs, and that that statement be reviewed by the organisation’s external auditors.

**Q3. In your opinion, should the ownership structure or the nature of the business conducted by a life mutual affect the composition or structure of its board? If so, how?**

The ownership structure of the business should not affect the composition or structure of the board. The duty of the board and management of a building society is to its owners, the members. All directors should represent the interests of both current and future members. The composition and structure of the board should reflect the demands and circumstances of the business in the same way for a mutual as for a Plc.

In particular, it is therefore not considered appropriate to have, for example, a specific member representative on the board. In fact, such a move could be detrimental as it creates a risk that effectively delegating “members’ interests” to an individual non-executive director dilutes the collective responsibility of the board as a whole.

The Yorkshire does believe strongly, however, that the governance processes of a mutual should reflect its ownership structure by incorporating high standards of transparency and accountability.

**Q4. In your experience, is the information and advice (including actuarial advice) used by the non-executive directors of life mutuals sufficient – in terms of quality and relevance – to enable them to exercise effective oversight of the executive? In what ways might it be improved? If more information and advice is needed, what are the resource implications? Do similar issues arise for the non-executives of other complex businesses, such as wholesale banking or science-based businesses?**

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The Yorkshire is not in a position to comment on the quality and relevance of information and advice used by non-executive directors of life mutuals or complex business beyond mutual lenders.

However, it is considered that, in the Yorkshire's experience, the most effective methods of determining the quality and relevance of information and advice used by the non-executive directors are:

- Annual reviews by the board of information presented to the board as a whole as part of the board evaluation process undertaken in compliance with the Combined Code requirements.
- Training of non-executive directors to enable them to understand and challenge the information presented, particularly on technical issues. The Yorkshire has, where required, used independent trainers (without the executive directors or senior management present) which has enabled a process of an experienced third party critique of technical information submitted to the board. Please refer to the responses to Q5 and Q6 on the training aspects.
- An open culture throughout the organisation, with explicit debate of corporate values by the board, and assessment of the executive directors against adherence to these values.

**Q5. What is the role of the non-executive director in a complex or technical business? In particular what is their capacity to understand and to challenge the executive over technical aspects of the business?**

**Q6. What can the owners of a complex or technical business reasonably expect of its non-executive directors? How would you characterise the practical limitations of a non-executive director? What steps might be taken to codify what is reasonable and realistic in this context? Should executives and non-executives have the same legal duties to the company?**

Questions 5 and 6 have been taken together.

It is considered that the role of the non-executive director in a complex or technical business is a similar role in any other organisation, for example to:

- bring an independent perspective to board debate and decisions
- constructively and rigorously challenge senior management
- ensure the adequacy of controls and risk management
- play an active part in setting and monitoring the organisation's strategy
- utilise their own specialist skills within the role
- develop their knowledge of the business so that they can make an informed contribution.

All non-executives need to have sufficient understanding of the technical aspects of the business in order to effectively fulfil their role although it is accepted that some areas, initially within building societies, are more complex than others. The board should therefore ensure that there is

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sufficient expertise within the non-executive directors to understand the particular complex issue in-depth. It would neither be practicable nor desirable for all of the non-executive directors to be experts in every technical issue as it would inhibit the breadth of skills and experience needed for the board, as a whole, to operate effectively.

It is suggested that the capacity to understand and challenge aspects of the business should arise from:-

- adequate and relevant information
- relevant training (internally and externally) both on a group basis and, where necessary on a 1:1 basis
- specific expertise within the non-executive directors
- the right to obtain external independent advice at the organisation's expense
- an open culture.

The practical limitations of a non-executive director are based on individual expertise and time constraints. Time devoted to the business needs to be carefully balanced to ensure sufficient time is spent on understanding the business against getting drawn into day to day management issues whereby the non-executive directors' objectivity and independence may be jeopardised.

It is the nature of mutual financial services organisations generally that they are becoming increasingly complex and more heavily regulated. As a consequence, the demands on non-executive directors in terms of both time and expertise have grown rapidly and will continue to do so. However, this issue is not related to the ownership structure of firms within the sector, and nor does the ownership structure make it any easier or harder to address this challenge. Rather it is considered that effective governance of complex businesses is a growing issue for the financial services sector as a whole.

It is considered that any code which sets out what is reasonable and realistic would have to be extremely broad and flexible in order to enable the board (and, in particular, the Chairman) to ensure that the board is structured so that it is appropriate to that organisation's circumstances.

It is considered that executive and non-executive directors should have the same legal duties to the organisation but that the distinction should be in how those duties are fulfilled.

**Q7. What role should policyholders play in the running of mutual life companies? Are there practical barriers to policyholder participation in UK life mutuals? What action would be needed to allow more effective engagement?**

It is considered that policyholders/ members should not be involved in the "running" of the organisation (it is assumed that "running" in this context means day to day decision making whether of strategic and/or operational issues). Rather, it is the responsibility of the board as a whole to ensure that the organisation is run in the best interests of both current and future

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members. Critical to ensuring that the interests of all parties are fairly balanced, however, is ensuring that board processes are transparent and that members are kept informed on how the organisation is managed, with adequate opportunity to question management and to have a say in the affairs of a society. The methods which the Yorkshire has adopted are set out in Appendix 2.

The practical barriers to greater member participation are principally those of member apathy and cost (with the former considered to be of greater significance).

Overcoming member apathy can only be addressed by providing as many different and flexible options as possible to encourage member participation, and by seeking to refresh those options on a regular basis. For this reason, it is not considered that a prescriptive formula for member engagement would be effective. However, it is considered that the board of a mutual should review on a regular basis the extent and effectiveness of member participation so that this remains an area of focus. This is an area which could be addressed in a mutual Combined Code.

**Q8. Lord Penrose says that in a life mutual "... it is the policyholders who are the source of the risk capital for the enterprise." (chapter 20, paragraph 51). What does this mean for the relationship between a mutual life office and its policyholders?**

As a building society, the capacity to raise capital is more limited than that of a Plc. The Yorkshire has a finite source of capital which is in the form of retained reserves although supplementary capital could be issued. Money deposited with the Society is not considered by members to be a speculative risk, societies being seen as "safe houses". These are clearly considerations which need to be taken into account by the boards of mutual organisations in setting strategy. It is also important in this context that decisions relating to the use of capital are taken in the context of the benefits which will be delivered to current and future members and the associated risks.

A society's strategy and its use of capital should be subject to the same levels of transparency and accountability as the other aspects of the business. The Yorkshire's approach to this is set out elsewhere in this response.

**Q9. Lord Penrose acknowledges that the FSA's work since 1997 "... has sought to anticipate many of the lessons that might be drawn by this enquiry, and it should come as no surprise that it has largely succeeded in that." (chapter 30, paragraph 3). Insofar as corporate governance is concerned, do you agree?**

The sample Code of Governance for Boards & Management (as set out in Chapter 3 of the Interim Prudential Sourcebook, entitled 'Boards and Management') is fairly limited and does not directly ensure that corporate governance within the building society sector is as rigorously reviewed as that within Plcs. It is for this reason that the Yorkshire was committed to reviewing its own adherence to the Combined Code earlier this year and to

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review compliance on an annual basis (please refer to the response to Q1. above). It should be noted that the FSA encourages building societies to “have regard to” the Combined Code.

**Q10. Is there a further role for the FSA to play in improving firms' corporate governance?**

Any further role for the FSA would need to ensure that it did not remove any flexibility within individual boards to manage their own organisations.

**Q11. Listed companies are subject to the influence of their shareholders, particularly large shareholders, and the risk of take-over. What market forces are most relevant for mutual life offices? How effective are they in promoting good performance and how might they be enhanced?**

The main external influence for the Yorkshire is competition. All organisations operating within the market are subject to the same pressures on competition and subject to the same regulation.

Other external influences include reviews by the rating agencies, commentary from the media, guidance and regulation of the regulator, and the views of members through the various feedback mechanisms in place (see response to Q7 above and Appendix 2) and through voting at the AGM.

Building Society members also have the ability to exert influence through their statutory rights to nominate a director (subject to the support of 250 “qualified” members) and to call for a Special General Meeting to consider a resolution or propose a resolution at the Annual General Meeting (subject to the support of 500 “qualified” members and the resolution being legally valid). It is understood that these thresholds are lower than the equivalent thresholds for members of the Equitable Life.

It should be noted that member influence can be substantial. In the mid-1990s when the conversion movement was at its height, (ie. speculative account opening in order to receive windfalls on conversion) it did cause the sector to reappraise its mutual behaviour and had a major influence on the strategy of many societies.

**Q12. Do specific barriers exist to the success of mutual businesses in the UK? If so, how might they be addressed?**

It is believed that there are two main areas that limit the success of building societies, namely:

1. The fact that the mortgage market favours “short termism”. The Miles Report into the UK mortgage market, which was published in March 2004, recognised the potential unfairness of existing borrowers cross subsidising new borrowers and, as a result, made recommendations to improve the market in this regard. The Miles Report recognised that the market may not remedy the situation without regulatory intervention. This is a particular issue for those building societies and some Plc lenders which try and focus as much benefit as possible on existing members.

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2. The statutory funding limit (ie. that at least 50% of funding should come from members) particularly when other forms of funding may be more effective such as wholesale or securitisation. Plc lenders do not have this restriction and changes to building society legislation would be required to amend this funding limit.

**Q13. What are the forces that drive de-mutualisation? What are the implications of de-mutualisation for members and customers?**

It is suggested that the forces that have driven de-mutualisation are varied and include such factors as:-

- corporate failure
- management decision – justifications given have been to raise further capital or to compete more effectively although it is not considered that these reasons have been wholly convincing. Some of the converters (eg. the Halifax (now known as HBOS) and the Bradford & Bingley have looked for ways of returning capital to their shareholders)
- Self interest of the board/senior management
- member pressure (for example, conversion of Bradford & Bingley Building Society) and the ability to influence the vote through speculative ‘windfall’ benefits.

Evidence suggests that member/customers of societies that have converted have generally suffered through:

- reduced value to customers (both in terms of rates as shorter term view is taken and loss of service/customer focus);
- Commitment to local communities including closure of branches particularly in more rural areas which are less financial viable;
- loss of choice of financial provider;
- reduced competition within the financial services sector – whilst the building society sector is reducing (both in terms of the number of societies and the market share of investment and lending business), it still does provide a significant presence within the financial industry.

In addition, there can be a loss of trust with the organisation. The Yorkshire took part in research in 2003 undertaken by MUTUO to consider whether financial mutuals were more trustworthy than banks (‘Trust Rewards:Realising the Mutual Advantage’). The results of various surveys conducted with the Yorkshire’s members, as part of this research, concluded that the majority of members trusted the Society more than they trusted banks and that the most important factor for this level of trust was the lack of external shareholders.

**Q14. What specific governance arrangements currently apply to other financial mutuals? In what ways do their governance arrangements differ from those that apply to life mutuals? Which, if any, of the options for life mutuals could be applied more widely in the financial mutual sector? What would the consequences be?**

The Yorkshire is not in a position to comment on this question.

**Q15. Do small, affinity group-based, mutual life firms face different governance issues from the largest firms in the sector?**

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Whilst the Yorkshire is not in a position to comment in detail on this question, it is anticipated that the growing demands on non-executive directors may represent a particular challenge for smaller mutuals, although it is not considered that size should represent a barrier to adopting high standards of transparency and accountability to members (indeed a strong affinity or regional link may make it easier to encourage member participation).

**Q16. Are you aware of effective governance regimes for life (or other) mutuals in other countries? Is this the result of a formal (regulatory or government) requirement or is it voluntary, driven by the industry? Are there aspects of the arrangements in other countries that it would be desirable and practical to adopt in the UK?**

The Yorkshire is not in a position to comment on this question.

Yorkshire Building Society

17 September 2004

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**YORKSHIRE BUILDING SOCIETY**

**MEMBER INVOLVEMENT - 2004**

<b>Activity</b>	<b>What is it?</b>	<b>Benefits/Aim</b>	<b>Activity to Date</b>
<b>Non-Executive Director ('NED') Recruitment</b>	<ul style="list-style-type: none"> <li>Advertising nationally when a vacancy arises for a NED.</li> </ul>	<ul style="list-style-type: none"> <li>Provides an opportunity for members to be considered for the position.</li> <li>Transparency of the recruitment process.</li> </ul>	<ul style="list-style-type: none"> <li>The last 3 NED vacancies have all been advertised in national and main regional (Yorkshire) press including an advertisement placed in July 2004.</li> </ul>
<b>Question Time Meetings</b>	<ul style="list-style-type: none"> <li>Informal meetings with members held throughout the country.</li> <li>Involves a short informal presentation about the Society/current issues and a Q&amp;A session followed by a buffet when members can talk to other Society staff.</li> <li>The Chief Executive and other General Managers host the meeting which is also attended by senior managers from Head Office and local branch staff.</li> </ul>	<ul style="list-style-type: none"> <li>Enables senior management to listen to concerns (and compliments!) from members and respond directly.</li> <li>Raises awareness amongst members who are sent an invite that the Society is proactive in canvassing members' views.</li> <li>Tangible demonstration of difference in behaviour between mutuals and plcs which some members do acknowledge in their feedback comments.</li> <li>Interaction between staff from Head Office and branches on informal basis.</li> <li>Generally positive comments received from members through a feedback questionnaire on each event.</li> </ul>	<ul style="list-style-type: none"> <li>Since meetings commenced in 2001, 27 events have been held up to August 2004.</li> <li>A further 2 events are organised for the remainder of 2004.</li> <li>Up to the end of 2004, it is anticipated that c.225,000 members will have been invited to such an event which represents approx. 12.5% of the total membership.</li> </ul>
<b>Member Panel</b>	<ul style="list-style-type: none"> <li>A panel of members – currently in excess of 5k – who are easily accessible to assist the Society in research through the use of questionnaires.</li> <li>The maximum number of questionnaires a member will receive each year is 12.</li> </ul>	<ul style="list-style-type: none"> <li>Provides the Society with a robust and valid research tool.</li> <li>Issues covered have range from views on community involvement and research on the AGM pack and voting to product research.</li> <li>A profile of each Panel Member is maintained so that the research requests can be targeted (if required).</li> </ul>	<ul style="list-style-type: none"> <li>The Panel was set up in 2001 and approx. 40 surveys have been conducted with the Panel up to August 2004 with a further 3 planned for the remainder of the year.</li> </ul>
<b>Online Q&amp;A Event</b>	<ul style="list-style-type: none"> <li>An opportunity for members to pose questions to the Chief Executive on any topic that is relevant to them.</li> <li>The event is advertised on the Society's website and notified to members by email (where the Society</li> </ul>	<ul style="list-style-type: none"> <li>Similar to those for Question Time meetings (see above) in that Senior Management can 'hear' the concerns of members direct and explain the Society's position.</li> <li>Generally positive comments received from</li> </ul>	<ul style="list-style-type: none"> <li>An event was held in October 2003 at which approx. 180 questions were received.</li> <li>A further event is planned for November 2004.</li> </ul>

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<b>Activity</b>	<b>What is it?</b>	<b>Benefits/Aim</b>	<b>Activity to Date</b>
	has a valid email address).	members on the exercise.	
<b>Focus Groups</b>	<ul style="list-style-type: none"> <li>Ad hoc meetings of small groups of members and non-members which are held throughout the country to provide more in-depth views on particular issues than that provided via questionnaires.</li> </ul>	<ul style="list-style-type: none"> <li>See previous column.</li> </ul>	<ul style="list-style-type: none"> <li>14 Focus groups and 53 in-depth interviews (74 hours) held on issues to date in 2004 including research on products, the Society's brand and attitudes towards financial services.</li> <li>In addition, telephone research has also been conducted to gain feedback on specific issues amongst customers.</li> </ul>
<b>Customer Satisfaction Questionnaire</b>	<ul style="list-style-type: none"> <li>Standard service questionnaire sent to approx. 6,000 members each month.</li> </ul>	<ul style="list-style-type: none"> <li>Results form the basis of the service Key Performance Indicator which is reported to the Board each month and also an element for the calculation of performance pay.</li> </ul>	<ul style="list-style-type: none"> <li>42,000 questionnaires mailed Jan-July 2004.</li> <li>Average 'Overall' satisfaction remains at 90%, the Society's benchmark.</li> <li>Since January 2004 we have received 1,252 comments on customer satisfaction surveys. All comments are distributed to the manager responsible for the area that the comment relates to in order that they are aware of the feedback and can action as appropriate.</li> </ul>
<b>'Have your Say'</b>	<ul style="list-style-type: none"> <li>Channel for members to send comments/suggestions via email.</li> </ul>	<ul style="list-style-type: none"> <li>See previous column.</li> </ul>	<ul style="list-style-type: none"> <li>Approx 900 emails have been received year to date, the majority of which were general queries relating to investment accounts. However, there have been specific suggestions which have been acted upon such as improvement to online facilities.</li> </ul>
<b>Branch Open Days</b>	<ul style="list-style-type: none"> <li>Invitation to members to meet the branch staff and senior managers when new branch is opened following a re-location.</li> </ul>	<ul style="list-style-type: none"> <li>See previous column.</li> </ul>	<ul style="list-style-type: none"> <li>The number depends on new branch openings/ refurbished.</li> </ul>
<b>Charitable Foundation (CF) and Community Investment Fund (CIF)</b>	<ul style="list-style-type: none"> <li>The Charitable Foundation provides the focus of the Society's and its members' charitable giving.</li> <li>A Community Investment Fund was launched in September 2003 to assist other local causes/sponsorship that do not fall within the CF criteria for support.</li> </ul>	<ul style="list-style-type: none"> <li>See previous column.</li> </ul>	<ul style="list-style-type: none"> <li>Since inception of CF giving in 1999, approx. £1.5m has been donated to 2,200 causes. 75% of donations have been nominated by members.</li> <li>CIF has already supported 100 initiatives with over £23,000. Assistance is varied and has ranged from an advert in a local show programme/ website to the Society's name displayed on a park bench in a play area and on a number of sponsored sports kits.</li> </ul>

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<b>Activity</b>	<b>What is it?</b>	<b>Benefits/Aim</b>	<b>Activity to Date</b>
<b>‘Getting Closer to the Customer’</b>	A programme of initiatives to encourage senior managers to become more involved with members/customers in order to understand their issues and concerns.	See previous column.	First initiative introduced is call listening by senior managers via the call centre.
<b><u>Proposed Activity</u></b>			
<b>Members’ Forum – Under Consideration</b>	<ul style="list-style-type: none"> <li>• Small group of visible, knowledgeable and interested members who will meet with the Chief Executive and other senior managers approx. 3 times a year.</li> </ul>	<ul style="list-style-type: none"> <li>• Will enable senior management to obtain views and engage in debate on more strategic (as opposed to operational) issues than those considered by other existing channels of communication.</li> <li>• Topics will be initiated both by the Society and the members.</li> </ul>	<ul style="list-style-type: none"> <li>• Subject to Board approval, to be launched in early 2005 with recruitment to take place from the Member Panel.</li> </ul>

**NB Above figures correct as at 27 August 2004**

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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 Society complies with the sample Code of Governance contained in the Interim Prudential Sourcebook issued by the Financial Services Authority. However, in July 2003 a new Code of Corporate Governance ("the Code") was published and it will be a requirement for all listed companies to explain their governance policies in the light of the principles contained in the Code and to confirm that it complies with the Code provisions or provide an explanation where it does not so comply.

Whilst the Society does not have to comply with the Code, as it is not a listed company, the board is firmly of the view that, to uphold good corporate governance practices, it should aim to adhere to the principles and provisions of the Code that are relevant to a building society or explain to members why this is not the case.

The Code applies for reporting years beginning on or after 1st November 2003. The Code would therefore not apply until the 2004 financial year but the board believes it is appropriate to review compliance with the Code for the financial year ended 31st December 2003,

#### **The board of directors**

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 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 retained powers relating to approval of the 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 senior managers within the Society.

Other powers are delegated to the General Management team (which comprises the Chief Executive, the Finance Director, the Operations Director and the Society's General Managers) or are delegated to other specified members of staff or committees including the Asset and Liability Committee;

- 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;
- 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

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and familiarity with the Group through regular internal presentations by senior managers and through relevant external courses. Individual training requirements for non-executives are discussed during the performance evaluation process;

- 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 advising the board, through the Chairman, on governance matters; and
- the board currently consists of three executive directors and eight non-executive directors. 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.

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## Corporate Governance Statement (extract from the Report and Accounts 2003)

Set out below are details of the directors during 2003 and their attendance record at board meetings and relevant board committee meetings in the year.

### Board committees

Name/Title	Number of Board Meetings - 11	Number of Audit and Compliance Committee Meetings - 5	Number of Chairman's Committee Meetings - 3	Number of Nominations Committee Meetings - 1	Number of Remuneration Committee Meetings - 4
Christopher Sheridan Chairman	11	5	3	1	4
John Watson Vice Chairman	11	5	3	1	4
David Anderson Chief Executive (resigned 30 <sup>th</sup> June 2003)	6* <sub>1</sub>	■	■	1	■
Ed Anderson Non-executive Director (appointed 19 <sup>th</sup> May 2003)	7* <sub>2</sub>	■	■	■	1* <sub>3</sub>
Julie Baddeley Non-executive Director	11	■	■	■	4
Frank Beckett Non-executive Director	11	5	■	■	4
Colette Bowe Non-executive Director (appointed 19 <sup>th</sup> May 2003)	5* <sub>2</sub>	■	■	■	0* <sub>3</sub>
Iain Cornish Chief Executive (appointed 1 <sup>st</sup> July 2003)	5* <sub>4</sub>	■	3	■	■
Andrew Gosling Finance Director	9	■	3	■	■
Rob Jackson Operations Director	11	■	3	■	■
Paul Lee Non-executive Director	10	4	■	■	4
Sue Tinson Non-executive Director	10	■	■	■	4

\*<sub>1</sub> The maximum number of meetings is 6

\*<sub>2</sub> The maximum number of meetings is 7

\*<sub>3</sub> The maximum number of meetings is 1

\*<sub>4</sub> The maximum number of meetings is 5

### 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 (formerly known as Addleshaw Booth & Co), a firm of solicitors, which does provide 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 national leading firm for specialist building society work;
- the Society instructed Addleshaw Goddard before Mr Lee was appointed to the board;

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- a Schedule of Fees paid to Addleshaw Goddard is submitted to the Financial Services Authority ("FSA") each year. A copy is available to members on request; and
- the Society undertakes periodic reviews of the solicitors it uses and Mr Lee's membership of the Society's board has no bearing in this review.

The Vice-Chairman, John Watson, is the Society's Senior Independent Director.

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### **Corporate Governance Statement (extract from the Report and Accounts 2003)**

#### **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.

#### **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.

In 2003 a performance evaluation system for non-executive directors, including the Chairman, was introduced. 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 reviewed the output of all questionnaires and used these as a basis for an evaluation interview with each non-executive director. The Vice Chairman undertook the evaluation interview for the Chairman. This procedure identifies any individual and board training requirements and provides the evidence for the board whether to recommend to members that a director should be re-elected.

An internal performance evaluation process of the board and its committees is to be undertaken in 2004 in order to review the effectiveness of how the board and the board committees operate.

#### **Appointments to the board**

The appointment of new directors is considered by the Nominations Committee (see below) 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 an Approved Person 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).

#### **Board committees**

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### **Corporate Governance Statement (extract from the Report and Accounts 2003)**

The board has established a number of committees which have their own terms of reference. Details of the principal board committees, including their membership during 2003, are set out below.

#### **Audit and Compliance Committee**

The committee consists of:

John Watson, Vice Chairman and Chairman of the Committee (non-executive director)

Frank Beckett, non-executive director

Colette Bowe, non-executive director (appointed 1st January 2004)

Paul Lee, non-executive director

Christopher Sheridan, Chairman (non-executive director)

Three of the above members, Frank Beckett, Colette Bowe and Christopher Sheridan, have relevant financial sector experience.

Due to the wide experience of the Chairman of the Society within financial services, including significant treasury experience, the board deems it appropriate and beneficial for the Chairman to remain a member of the committee.

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The responsibilities of the committee were reviewed by the board in November 2003 and 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 with specific regard to:

- the integrity of the financial statements and any formal announcements relating to financial performance, reviewing significant financial reporting judgements contained in them;
- the systems of internal control and risk management processes;
- the internal and external audit processes;
- compliance with applicable laws and regulations; and
- the recommendation to the board on the appointment, re-appointment and removal of external auditors.

During 2003 the committee met five times in the execution of its responsibilities. During the meetings the committee 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;
- the impact of International Financial Reporting Standards; and
- the activities of internal and external auditors.

The reports were provided by the independent Group Audit and 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 2003.

**Chairman's Committee**

This committee consists of the Chairman, Vice Chairman and the three executive directors (the Chief Executive, the Finance Director and the Operations Director). Its main function is to decide on any exceptional item that requires attention before the following board meeting (subject to specific issues that have to be determined by the full board).

**Nominations Committee**

The committee consists of:

Christopher Sheridan, Chairman and Chairman of the Committee (non-executive director)

John Watson, Vice Chairman (non-executive director)

David Anderson, Chief Executive (resigned 30th June 2003)

Iain Cornish, Chief Executive (appointed 1st July 2003)

The committee is responsible for nominating candidates for the position of

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non-executive director, taking into account the balance of skills, knowledge and experience on the board, and for making appropriate recommendations to the board.

During 2003 two new non-executive directors were appointed. The vacancies were advertised in national and local newspapers to enable them to be brought to the attention of as wide a number of members as possible. All applicants were asked to submit a curriculum vitae to external consultants. The Nominations Committee provided a short list of preferred candidates to the board for consideration.

**Remuneration Committee**

The committee consists of all the non-executive directors of the Society (as identified in the table on page 16) and the Society's Chairman is Chairman of the committee.

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The committee is responsible for considering and approving the remuneration for executive directors and other members of the Group Management team. Further details of the committee, the remuneration policy and directors' service contracts can be found in the Directors' Remuneration Report on pages 20 to 23. As stated in that report, 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.

The terms of reference of the Audit and Compliance Committee, the Nominations and Remuneration Committees and the letters of appointment of the non-executive directors are available on request from the Group Secretary.

**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, other senior members of the Society and local branch staff. In October 2003 members were also given the opportunity to put questions to the Chief Executive through an on-line event.

The Society operates a Members' Panel, consisting of more than 4,000 members, who are invited to complete surveys on a variety of topical

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issues. In addition, a monthly customer satisfaction survey is undertaken, the results of which are a key performance criteria which is monitored by the board on a monthly basis.

All members who are eligible to vote are encouraged to exercise their vote at the AGM by sending to them a proxy voting form and pre-paid reply envelope. At the AGM, the Chairman calls for a poll on all resolutions so that all proxy votes are recorded. A separate resolution is proposed on each separate issue including a resolution on the Annual Report and Accounts.

### **System of internal controls**

The board has delegated responsibility for managing the system of internal control to senior management. The Group Audit and Risk function provides independent assurance to the board on the effectiveness of the system of internal control through the Audit and Compliance Committee.

The information received and considered by the committee provided reasonable assurance that during 2003 there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate system of internal control.

### **Auditors**

The Society has a policy on the use of the external auditor for non-audit work which is implemented by the Audit and Compliance 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 number of non-audit related assignments during 2003 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.