Annual Report & Accounts 2014

SKIPTON
BUILDING SOCIETY
For life ahead

Contents

Five Year Group Financial Highlights

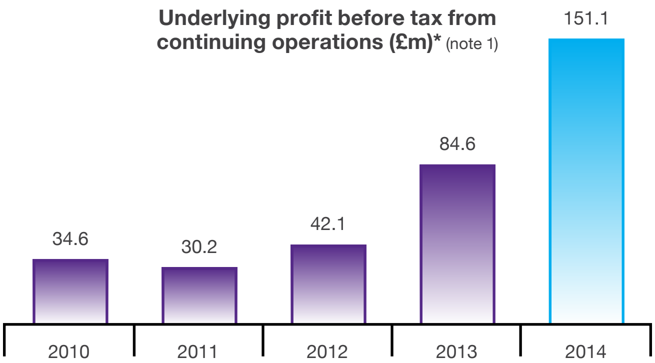
Year ended 31 December – from continuing operations	2014	2013 Restated*	2012 Restated*	2011 Restated*	2010 Restated*
Net interest income	**£213.3m**	£142.6m	£84.2m	£71.2m	£54.9m
Net interest margin	**1.40%**	1.01%	0.61%	0.52%	0.37%
Administrative expenses	**£426.7m**	£399.4m	£352.8m	£317.7m	£321.4m
Impairment losses	**£16.6m**	£22.7m	£16.3m	£30.0m	£14.9m
Provisions for liabilities	**£17.5m**	£19.0m	£27.7m	£8.4m	£(3.3)m
Profit before tax	**£156.8m**	£102.7m	£35.3m	£30.7m	£39.2m
As at 31 December					
Member savings balances	**£11,442m**	£10,246m	£9,420m	£9,231m	£9,366m
Loans and advances to customers	**£12,692m**	£11,417m	£10,456m	£10,100m	£9,688m
Total assets	**£15,982m**	£14,487m	£13,760m	£13,910m	£13,740m
Liquidity	**18.36%**	18.61%	21.10%	24.79%	27.75%
Wholesale funding	**14.15%**	15.37%	16.93%	19.79%	17.63%
Group Common Equity Tier 1 ratio (2012 and earlier: Core Tier 1 capital ratio)	**16.23%**	14.24%	11.16%^	10.60%^	11.06%^
Tier 1 capital ratio	**16.23%**	14.24%	12.67%^	12.09%^	12.64%^
Total capital ratio	**16.99%**	15.07%	16.02%^	15.60%^	16.60%^

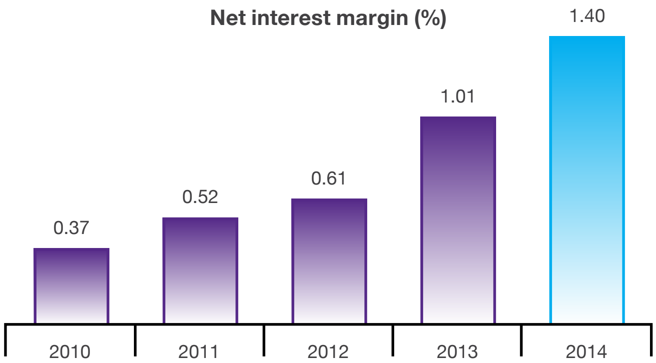
* The comparative figures have been restated due to a change in accounting policy relating to the Financial Services Compensation Scheme (FSCS) levy. Further details are provided in note 1b). Prior periods have also been re-presented in accordance with IFRS 5 *Non-current assets held for sale and discontinued operations*, to reflect the disposal of Homeloan Management Limited and its subsidiary companies, which became a discontinued operation during 2014. Further details are provided in note 17b).

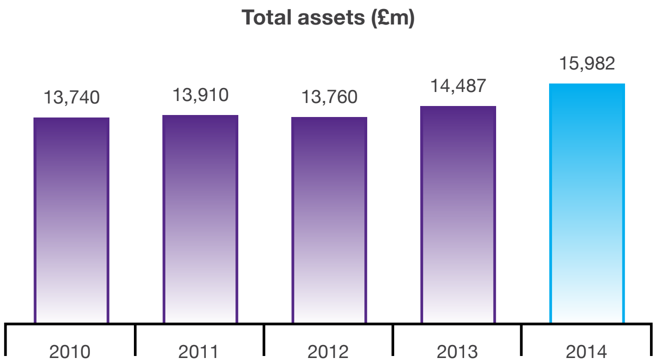
^ Prior to 2013, the Group's capital position was reported under Basel II at a full Group level of consolidation, and as such the comparative figures above for 2012 and earlier are presented on this basis. The 2013 and 2014 figures are presented at a prudential consolidation group level (the 2013 comparative is as at 1 January 2014); the prudential group consists of the entire Group except a small number of entities (including the estate agency business Connells Limited) whose activities are not aligned with the core financial services businesses.

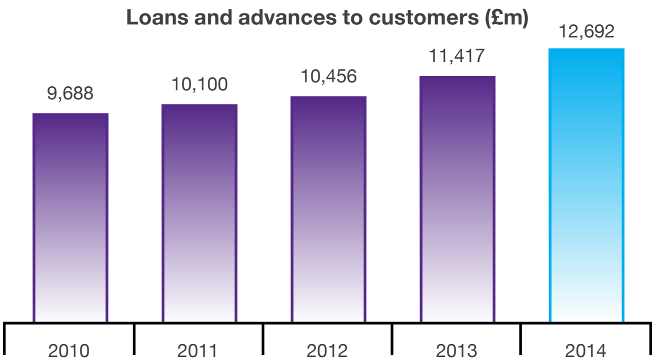
Key Performance Highlights

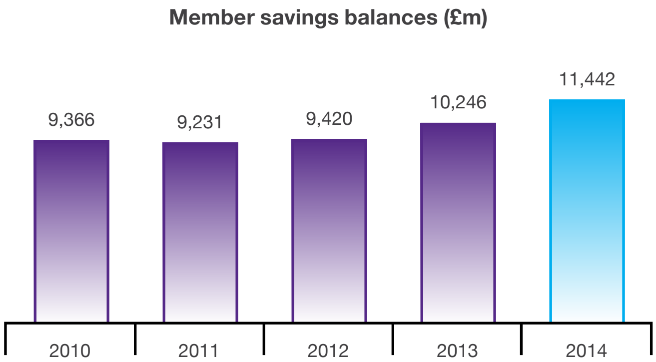
- **31,276 increase** in members to **794,739**;
- Savings balances **grew** by **£1.2bn** to **£11.4bn** (2013: £10.2bn), an annual growth rate of **11.7%** (2013: 8.8%);
- Skipton's mortgage book **grew** by **£1.3bn** to **£12.7bn** (2013: £11.4bn), an annual growth rate of **11.2%** (2013: 9.2%);
- Gross residential mortgage lending **up 23%** to **£3.0bn** (2013: £2.4bn);
- Group net interest margin **increased** to **1.40%** (2013: 1.01%);
- **75% increase** in total Group profit before tax (PBT) to **£181.6m** (2013: £103.6m) – includes profits from the disposal of HML;
- **53% increase** in Group PBT from continuing operations to **£156.8m** (2013: £102.7m);
- The sale of subsidiaries generated a combined profit of £25.8m in 2014;
- Underlying Group PBT from continuing operations (prior to Financial Services Compensation Scheme (FSCS) charges, gains on the disposal of subsidiary, associate and equity share investments and profits from discontinued operations) **increased** by **79%** to **£151.1m** (2013: £84.6m);
- Group Common Equity Tier 1 (CET 1) ratio **increased** to **16.2%**, from 14.2%;
- Group leverage ratio **increased** to **6.0%**, from 5.6%; and
- The Society's credit ratings were **upgraded** by both Fitch and Moody's during the year.

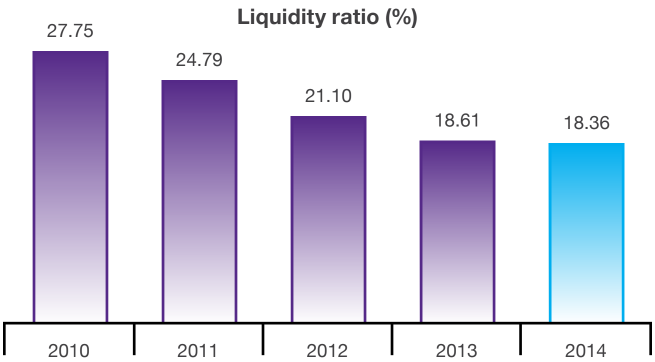


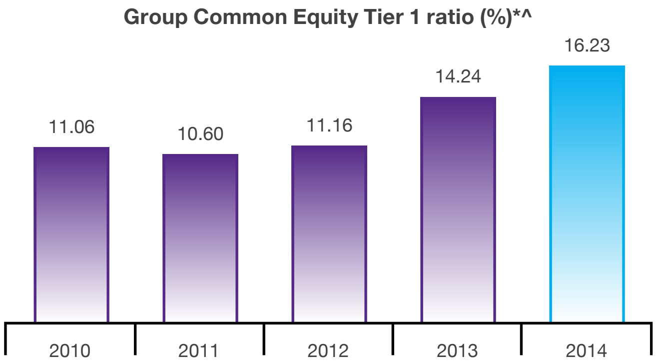












Note

1. Since the signing of the Annual Report and Accounts, a late correcting adjustment has been made to the 2010, 2011 and 2012 figures included in the 'Underlying profit before tax from continuing operations' graph above - the basis of the calculation is explained on page 4. The figures approved at the date of signing for the years 2010, 2011 and 2012 were £29.4m, £24.4m and £40.0m respectively. These figures do not form part of the audited accounts and do not appear elsewhere in the Annual Report and Accounts.

Chairman's Statement

I am pleased to report another year of significant progress; increasing financial strength, growing our membership and simplifying our business model.

Indeed, 2014 saw some major changes as we sold our mortgage services subsidiary Homeloan Management Limited (HML), Torquil Clark which was one of our financial advice subsidiaries, and The Private Health Partnership (PHP) which was part of our Investment Portfolio. We wish these former subsidiaries all the best for the future and thank all their employees for the support they have given to the Skipton Group over many years.

In addition, we ceased to provide computer services to other building societies through Bailey Computer Services. Since the year end, we have agreed the sale of another financial advice subsidiary, Pearson Jones, subject to regulatory approval and certain other conditions, to Standard Life.

These disposals simplify our business model, which is now focused on mortgages and savings, the provision of financial advice through Skipton Financial Services (SFS), and estate agency services through Connells and its subsidiaries.

Our core mortgage and savings business goes from strength to strength in terms of balance sheet growth, capital reserves and underlying profitability. The Society's savings and mortgage customers are our members and I am delighted to report another increase in members of more than 31,000 bringing our total membership to nearly 795,000.

The mortgage and savings business has also benefited from a commendable performance from our Guernsey-based subsidiary, Skipton International Limited (SIL). We continue to manage the run-off of our specialist lending portfolios, which have now been closed to new business for over six years.

In recent years the mortgage market and borrowers have benefited from continuing low interest rates and Government initiatives such as 'Help to Buy' and the Funding for Lending Scheme which have contributed to generally lower funding costs for banks and building societies. 2014 was no exception and it seems likely that low interest rates will be with us for some time to come.

This has not been good news for savers who have seen their rates and income reduce. We have sought to balance what we pay savers and other providers of funds, against what we can earn on mortgages and other assets, thereby producing a net interest margin that sustains our business for the benefit of all members.

Government initiatives through National Savings and Investments (NS&I), such as pensioner bonds launched in January 2015, offer some respite for older people, but also divert funds away from the financial sector which could otherwise be available for lending. This creates some market distortion but is not expected to impact materially on our plans. We aim to remain competitive and safeguard our members' interests.

Our members can also benefit from the provision of financial advice available within our branches through SFS. We recognise that some of our members will want financial advice, while others may be quite content to do their own planning 'for life ahead'. Our 'no pressure' promise means that our members can approach us with confidence. We will listen and help them to make choices that are right for them.

Once again the Society has been well supported by its highly successful estate agency operation, Connells, which continues to expand in its core business areas: house sales, lettings, surveys and valuations and financial services, such as mortgage and protection products. In 2014, Connells acquired the estate agency business of Peter Alan in Wales from the Principality Building Society and now operates through 520 branches in the UK.

Looking at the housing market, we saw it perform more strongly in the first half of 2014 than the second half, but the performance of our estate agency business has proved resilient in different market conditions and continues to add value for the Society.

During 2014, the Society invested significantly in improving services to customers; including the refurbishment of 15 branches and the creation of a new digital team to overhaul our approach to serving customers online. Our call centre, Skipton Direct, has also expanded as the Society responds to customers' preference to pick up the phone. We saw call volumes to Skipton Direct increase by almost 25% last year, with our friendly teams having 1.15 million conversations. We also introduced lower rate 0345 contact numbers to make it cheaper for people to call us. In all these areas further investment is planned in 2015 as we seek to ensure our customers can do business with us through the channels that suit them best.

Nowhere is this investment more apparent than in meeting the learning and development needs of our own people who make the Society so distinctive. We have enabled our customer-facing teams to receive dedicated training in 'service excellence', with increasing numbers having completed our 'Modern Leaders' and 'Aspiring Leaders' internal development programmes.

We are proud to have achieved the 'Gold Standard' with Investors in People and to be named in the Sunday Times 'Top 100 companies to work for' survey.

We have also continued to support communities across the UK in which our members and people live and work. Through our award winning Grassroots Giving community funding scheme launched in 2013 as part of our 160th anniversary, we gave £500 donations to 160 small community groups, clubs and organisations who would otherwise struggle to access vital funding from elsewhere. The shortlisted groups were voted for by the public to determine the 160 winners. Such was the success of Grassroots Giving, we extended it in 2014 with 161 donations of £500 being awarded. I am delighted to report we will be continuing with Grassroots Giving in 2015 with 162 donations.

In addition, we continued to support key community partners such as The Great Yorkshire Show and the Skipton Building Society Camerata. We also donated £120,000 to the Skipton Building Society Charitable Foundation in 2014 which provides financial support to registered charities involved in helping people of all ages.

2014 also saw a number of Board changes. As reported last year, Richard Twigg, our former Group Finance Director, left the Society in April 2014 to become the Finance and Commercial Director of Connells, our estate agency operation. In February 2015, Bobby Ndawula, who was previously the Society's Chief Financial Risk Officer, took over as Group Finance Director and became a member of the Board. Bobby is standing for election to the Board at our Annual General Meeting (AGM) in April 2015.

Our Distribution Director, Mark Fleet, left the Society at the end of the year having worked for the Group for six years, including three years as a Board Director. Mark made a significant contribution as Director of Distribution responsible for branches and Skipton Direct, and as Chairman of our financial advice subsidiaries and HML. We wish Mark all the best in his future career. The process to recruit his successor has commenced.

In 2015, we will also be losing the services of Peter Hales who is retiring from the Board after eight years of service and is therefore not standing for re-election, although to ensure a smooth transition he has agreed to serve on the Board of Skipton Financial Services for the rest of 2015, subject to regulatory approval. Peter has been a stalwart of the Board through difficult times and during its more recent success. He was instrumental in establishing the Board Risk Committee which he chaired from its inception in 2010 until the end of 2014. I would like to thank Peter for his service and wish him a long and healthy retirement.

Last but certainly not least, I want to pay tribute to the unstinting efforts of all Skipton people who make the Society and its subsidiaries such a friendly and helpful organisation with which to do business. It is our people who make the Society what it is and so special in the eyes of our customers and members.

The Society and Skipton Group is in robust health and we look forward to serving the interests of our customers and members for many years to come.

M H Ellis
Chairman

24 February 2015

Group Chief Executive's Report

I am very pleased to report an excellent performance. The Society has remained true to its mutual heritage, continuing to balance the needs of savers and borrowers.

Our commitment to our members extends further than remaining a financially strong society for them. I am proud to be the Group Chief Executive of a building society that remains independent, growing in strength, stability and members. I'm also very pleased about the continued excellent service we have delivered to our members and I look forward to this developing even further over the next 12 months and beyond.

Our vision is 'Building a better Society', and considerable progress was made during 2014 towards making this a reality:

- The Society continued to grow with a 31,276 increase in members, taking our membership to 794,739;
- We are helping more people to save their money and buy their own homes, with an 11.7% growth in savings balances and an 11.2% growth in mortgage balances;
- Total Group profit before tax (PBT) increased by 75% to £181.6m; and
- The Group Common Equity Tier 1 (CET 1) ratio increased to 16.2%.

However, it still remains a difficult environment for savers, with Bank Base Rate held at 0.5% for six years and the existence of the Funding for Lending Scheme creating a reduction in demand for retail savings from participating banks and building societies. Against this backdrop it is good to be able to report strong growth of more than 11% in both savings and mortgage balances, well in excess of market growth, reflecting our competitive pricing and service proposition. Strong underlying profits and a robust capital position give us the foundation to enhance our customer proposition as we seek to fulfil our vision of 'Building a better Society'.

During the year, our business model has been simplified with the disposal or closure of certain non-core subsidiaries allowing us to focus on our core mortgages and savings business and financial advice, whilst maintaining a significant presence in estate agency.

Unwavering focus on our members and our people

Over the last 12 months we have run an extensive programme of engagement with our members. Our members have told us this honest dialogue is important to them, and the results demonstrate that our personal touch means a great deal.

A significant achievement saw Skipton ranked 13th place out of 263 UK brands, and across many different industries, in the annual Nunwood Customer Experience Excellence survey. In the same survey, we were delighted to be named as the UK's third best Financial Services organisation for customer experience excellence, outshining some of the UK's top companies. This demonstrates we are definitely on the right track to provide our customers with a brilliant experience and putting them at the heart of the Society's strategy.

“I am very pleased to report an excellent performance. The Society has remained true to its mutual heritage, continuing to balance the needs of savers and borrowers.”

In addition to first-rate service, we've improved the customer experience in other ways. We launched a new Retirement Review service, enabling all new and existing customers to start planning their life ahead with support and advice at hand from our financial planning managers. 2014 saw us invest significantly in areas highlighted by our customers as most important to them. We grew our Skipton-based customer contact centre staffing levels by over 40% in response to increasing customer demand over the telephone and online. This means we can now talk to more people and spend longer talking to them, understanding their specific needs, and delivering an even better customer service.

We have also invested in refurbishing branches, enhancing the Society's digital capability and training, developing and inspiring our own people, at all levels of our business. As a result of the latter we're delighted to have been re-accredited as a Customer First organisation, the national standard for customer service. We've also been awarded the 'Gold Standard' by Investors in People, one of only two building societies in the UK to achieve this. In addition, we are delighted to have been successful in achieving top 100 status for the first time in 2014 in the Sunday Times 'Top 100 companies to work for' survey.

As a proud mutual we are working hard to make sure Skipton continues to be relevant to our members and therefore remains a successful modern mutual for the 21st century. The Society continues to invest across all channels so customers can easily interact through the channel of their choice. We strive to deliver excellent customer service and I would like to thank all our people for their commitment and engagement in making this happen throughout 2014. The Society achieved a record Employee Engagement level of 88%, significantly ahead of industry norms.

Enabling our members to achieve their home ownership, savings and 'life ahead' aspirations

During 2014 we continued to support our savings and borrowing members, with a suite of competitive and award winning accounts. From delivering on a promise to reward member loyalty with the introduction of a Loyalty Regular Saver account, to launching our Help to Buy Shared Equity new build mortgage, we continued to provide good value to our savers and borrowers.

Gross mortgage lending increased by 23% to £3.0bn, whilst our mortgage book grew by £1.3bn to £12.7bn, an annual growth rate of 11.2%. Our net mortgage lending accounted for 5.3% of the growth in the UK residential mortgage market, compared to our 0.9% share of UK residential mortgage balances. This meant we helped 19,512 homeowners to purchase or remortgage their properties, including 2,946 first time buyers, and 667 through participation in the Government's Help to Buy equity loan scheme.

Our savings balances grew by £1.2bn to £11.4bn. The growth in Skipton's savings balances accounted for 2.3% of the growth in the UK deposit savings market, compared to Skipton's 0.9% share of UK deposits from households.

Market conditions continue to have an impact on savers, with the average savings rate paid across all our accounts reducing by 0.30% during the 12 month period. Nevertheless, rates averaged 1.94% during the year, compared to Bank Base Rate remaining at 0.5%. Skipton paid on average 0.53% higher interest than the market average for banks and building societies during the period for which data is currently available, being the 10 months to 31 October 2014 (Source: CACI Savings Market Database). Our savings rates were highlighted by 448 independent media best-buy table mentions over the year. We were also awarded 'Best National Building Society' for 2014 by What Mortgage?, 'Best Junior / Children's Savings Provider' by Personal Finance, 'Best Service from a Buy-To-Let Provider' by Business Moneyfacts and 'Best Lender for Discount Mortgages' by Moneywise Mortgage.

Strong financial performance

- Group total assets increased by 10.3% during the year to £16.0bn;
- Group PBT from continuing operations increased by 53% to £156.8m;
- Underlying Group PBT from continuing operations (prior to Financial Services Compensation Scheme (FSCS) charges, gains on the disposal of subsidiary, associate and equity share investments and profits from discontinued operations) increased by 79% to £151.1m;
- A combination of strong retained profits, a reduction in capital requirements due to subsidiary disposals and maintenance of a prudent risk appetite for new lending, have all contributed to strengthening Skipton's Group CET 1 ratio, which increased to 16.2%;
- The Group's leverage ratio increased to 6.0%, well in excess of the expected regulatory minimum;

- In addition to reporting good growth in mortgage and savings balances (of 11.2% and 11.7% respectively) the core Mortgages and Savings division produced PBT of £98.4m, from £51.5m, an increase of £46.9m (or 91%) and was the major driver of the increase in overall Group profitability. This was due to interest earned on higher mortgage balances and lower funding costs as well as a reduction in mortgage impairment losses by £8.4m;
- The Group net interest margin increased by £70.7m to £213.3m, equating to 1.40% of mean assets (2013: 1.01%);
- The management expense ratio of the Mortgages and Savings division was 65bps (2013: 59bps), reflecting the investment we have made in our customer proposition, processes and our people, and its cost income ratio was 44.5% (2013: 50.0%);
- Our prudent approach to lending is demonstrated by the number of Group residential mortgages where the amount of arrears was more than 2.5% of the total outstanding balance. These were only 0.82% of our Group mortgages (2013: 1.07%) and compared to the Council of Mortgage Lenders (CML) industry average of 1.05%;
- During the year, the Society completed its third securitisation transaction, raising £400m of funds, and at 31 December 2014 had drawn down £650m under the Government's Funding for Lending Scheme (2013: £460m); and
- The Society received an improved assessment of its financial strength with upgrades to our credit ratings by both Fitch and Moody's.

Subsidiary performance

- Connells, our Estate Agency division, increased PBT by 26% to £63.2m. The 2014 figure includes a profit of £10.1m arising from the part disposal of shares on the flotation of Zoopla Property Group Plc;
- House sales by Connells in 2014 increased by 11% compared to 2013, on a like-for-like basis (excluding properties sold by Peter Alan which was acquired during the year), despite the market cooling during the second half of the year;
- Combined profits of £25.8m arose on the disposals of Homeloan Management, The Private Health Partnership and Torquil Clark. A further £12.4m profit arose from the deemed part disposal of shares in Wynyard Group Limited and part disposal of shares in Zoopla Property Group Plc. In 2013, profits on disposal of subsidiary undertakings amounted to £24.7m, and related to a deemed disposal of shares in Wynyard;
- Since 31 December 2014, the Group has agreed to sell Pearson Jones plc, with completion conditional upon regulatory approval and certain other conditions. In exchange for the sale of its 100% shareholding, the Group will receive an undisclosed sum. In 2014, Pearson Jones reported PBT of £1.9m (2013: £1.1m). There will be an immaterial profit on disposal which will be accounted for in 2015;
- Our Mortgage Services division, comprising Homeloan Management Limited and its subsidiaries, was sold in November 2014 and became a discontinued operation. Proceeds of sale amounted to £56.6m, generating a profit on disposal of £24.7m. Together with five months trading profits of £0.1m (2013: full year £0.9m), total profits for the division amounted to £24.8m (2013: £0.9m);
- Skipton Financial Services recorded PBT of £0.2m (2013: £1.6m), where an increase of £2.5m in rebate of charges under its ongoing monitoring service proposition was offset by an increase in other income lines;
- PBT for Skipton Business Finance totalled £2.9m (2013: £2.7m);
- Jade Software Corporation recorded a loss of £(0.7)m (2013: underlying loss of £(4.0)m); and
- Our share of Wynyard losses was £(2.6)m (2013: £(2.6)m).

Conclusion and outlook

2014 was an outstanding year for Skipton Building Society. We have maintained good growth of both mortgage and savings members whilst further improving the financial strength of the Society. We remain committed to listening to our members to understand and deliver what is important to them and providing a service with a human touch.

The mortgage market has enjoyed a favourable tail wind over the last couple of years, in particular in the first half of 2014, which saw relatively rapid house price increases in the South East combined with the availability of low mortgage rates for those customers who could satisfy lenders' new affordability assessments. The continued reduction in mortgage rates is a result of the ultra low interest rate environment and the impact of FLS reducing the need for financial institutions to compete aggressively for retail funding. Government initiatives such as the Help to Buy schemes also provided a boost to the mortgage and the wider housing market.

We believe that we are now starting to see the early signs of more aggressive competition in the mortgage markets, with the major banks showing an increased appetite to lend. We also expect competition to gradually increase in the savings market over the medium term as the Government's FLS scheme is withdrawn; both of these impacts will start to squeeze margins over the medium term.

The pension announcements made by the Chancellor in his Budget in 2014 will also undoubtedly change the savings market in the months and years to come and we believe we are well placed to help our customers take advantage of the opportunities that arise from these changes.

We are acutely conscious of the impact of the low interest rate environment on savers but the Society's competitiveness is demonstrated by a strong growth in savings balances. The strength of the economic recovery, mortgage market and housing market all moderated towards the end of 2014 but very early indications in 2015 are that there has been a slight improvement in many of these areas since the year end. The Society anticipates a gradual but affordable reduction in its net interest margin in the short to medium term due to increased competition. Uncertainties will remain regarding the strength of the Eurozone, and if there is no clear mandate emanating from the UK General Election in May 2015. Skipton Building Society is well positioned to face such uncertainties, to react to the pension reform agenda and to serve its members well.

Looking ahead we will continue to focus on what matters to our members, supporting them at key life stages with great value products and first-rate service with the human touch. 2015 will see Skipton continue to be a destination for people looking for an alternative to the high street banks when dealing with mortgages, savings, investments and pensions. We plan to enhance our digital capability, forge closer links with the communities where our people and members live and work, and further increase customer satisfaction. It has been an outstanding year for Skipton Building Society, and we will build on this in the coming year, investing in the business to ensure we continue to serve our members for their lives ahead.

D J Cutter
Group Chief Executive

24 February 2015

Strategic Report

Our Vision:

Building a **better** Society

This Strategic Report sets out how we strive to achieve our vision of 'Building a better Society' and discusses in detail the strategies we have in place to achieve this. The report also provides a review of our performance in the year against our strategic objectives, which remain to grow our mortgages and savings business, provide high quality financial advice through Skipton Financial Services and maintain a significant presence in estate agency.

Our Business Model and Group Structure

Skipton Building Society is the fourth largest building society in the UK, with £16bn of assets, almost 795,000 members and a national presence of branches and agencies. The Group's business model is based on a divisional structure and each division fulfils a distinct purpose aligned to the Group's overall strategy. The Society is at the heart of the Skipton Group and the key member of the core Mortgages and Savings division, whose business model is built on providing a secure home for our members' savings which allows us to lend to borrowers and enable home ownership. The Group's business model also includes our interests in Estate Agency (through the Connells group) which provides a significant income stream that further strengthens the Society's financial position, and the provision of financial advice through Skipton Financial Services as part of the extended Society offering. In addition, the Group holds interests in a number of other smaller companies as part of the Investment Portfolio.

The Board is the chief operating decision maker and reviews the performance of the Group across a number of reportable segments as detailed below. Each segment offers different products and services and is managed on a divisional basis in line with the Group's management and internal reporting structure. The divisions are:

- Mortgages and Savings – the core division of the Group, principally the Society but also including specialist mortgage businesses Amber Homeloans Limited (Amber) and North Yorkshire Mortgages Limited (NYM), as well as deposit taking and mortgage lending in the Channel Islands and the UK through Skipton International Limited (SIL). The division also includes the Group's special purpose vehicles (SPVs) Darrowby No. 1 plc, Darrowby No. 2 plc and Darrowby No. 3 plc, formed to acquire funds from the wholesale markets, and the intermediate holding company Skipton Group Holdings Limited (SGHL).
- Estate Agency – includes property sales, surveys and valuations, conveyancing, lettings, asset management and mortgage broking carried out through the Connells group.
- Financial Advice – provision of financial advice through Skipton Financial Services (SFS) and, prior to its disposal in 2014, Torquil Clark Limited, together with Pearson Jones plc which has been sold since the year end, subject to regulatory approval and certain other conditions.
- Investment Portfolio – includes a small number of trading companies that do not fall within the core operating segments.
- Mortgage Services – provision of mortgage administration services through Homeloan Management Limited (HML) and its subsidiaries which, following its disposal, became a discontinued operation in 2014.

In addition to the sale of HML, during 2014 the Group also sold its entire shareholdings in The Private Health Partnership (PHP) and its subsidiary companies (who were part of the Investment Portfolio) and, as outlined above, Torquil Clark Limited and its subsidiary companies (who were part of the Financial Advice division). As both PHP and Torquil Clark were not considered major lines of business to the Group, neither are classified as discontinued operations in these financial statements. Further details on the disposals are provided in note 17b) to the accounts.

Since the end of the reporting period, on 6 February 2015, the Group agreed the sale of its entire shareholding in Pearson Jones plc and its subsidiary businesses, subject to regulatory approval and certain other conditions. As this business is also not considered a major line of business to the Group it is not classified as a discontinued operation at 31 December 2014.

Our Strategy and Objectives

Our strategic objectives are to grow our mortgages and savings business, provide high quality financial advice through SFS and maintain a significant presence in estate agency. The recent corporate transactions detailed above will enable us to further focus on these objectives. By growing a high quality mortgage business, funded predominantly by retail savings, whilst maintaining appropriate levels of liquidity to ride out periods of uncertainty, we will further strengthen our capital position. This will in turn provide the Society with the opportunity to deliver long term sustainable value to its growing membership. We recognise that this strategy will need to be delivered in an operating environment where customers are increasingly using digital channels, whilst the Financial Services industry is becoming increasingly competitive and is still adjusting to more onerous regulatory capital and conduct requirements which have been introduced in the aftermath of the global financial crisis.

We remain committed to mutuality because we believe that this is in the best long term interests of our members. Our mutual status provides us with the advantage that we do not need to maximise our profits to pay shareholders; instead, we focus on ensuring a balance exists in our measures of success; supporting our members, generating sufficient profit to maintain a strong balance sheet and taking long term decisions to invest in the future development of the business.

Our primary purpose remains to provide a secure home for our customers' savings which allows the Society to lend to borrowers and enable home ownership.

In order to achieve the objective of growing the mortgages and savings business, principally through the Society, we have adopted strategic plans that focus on defined medium term objectives built around the following four pillars:

Our Customers

Our customer strategy is to put the customer at the heart of our business, providing a compelling and differentiated proposition that resonates with our customers and makes them want to become and remain Skipton members.

In order to achieve this we continue to invest in developing a deep understanding of the needs of our customers through research, insight and feedback. We use this insight to refine, develop and improve the products and services that we offer.

Our target savings and investment customers are those planning for and moving through retirement. Over the last two years, we have focused on developing a compelling proposition to meet the needs of these target customers, with the ultimate objective of 'helping them towards a worry free retirement'. We launched this to our customers in 2014 under the strapline 'For Life Ahead' and will seek to further develop and promote this over the coming years.

We continue to focus on helping customers to own their own homes by providing good value mortgages, together with excellent personal service, to both our mortgage customers and intermediary partners. We also provide finance to customers seeking to invest in buy-to-let properties which supports the rented housing sector.

Fundamental to the delivery of our customer strategy is the continued development of a truly customer centric culture across the Society. In 2014 we progressed the roll out of our customer strategy, further developing our capability to meet the needs of our customers. Going forward we will continue to develop and improve our internal capability and infrastructure to deliver an exceptional customer experience. Investment in enhanced digital capability will underpin and support the improved customer experience. We will also develop our Skipton-based contact centre, Skipton Direct, and seek to adapt our branch network to match the changing needs and requirements that our customers have for face-to-face interactions.

A review of performance in the year against our customer strategy is set out on page 15.

Our People

Our people strategy is to ensure that we have the right people, with the right skills and knowledge, who are highly engaged and who perform well to deliver a great experience for our customers.

We invest in developing a culture in which all our people work to deliver according to our customer strategy. We continue to develop leadership capability, as well as investing in leaders of the future. We support all our people to perform and develop their skills and knowledge in a range of ways including training and coaching.

One of the things that sets our service apart is our human touch, developing the skills of all our people to have empathy and build relationships with our customers and with each other.

Our reward strategy is an important part of retaining the right skills and experience and reinforcing our culture. Importantly, conduct risk (i.e. ensuring we always deliver a fair outcome for our customers) will remain at the forefront of our minds to ensure any remuneration package relating to performance encourages the right behaviours and customer outcomes.

We have a high level of employee engagement and we intend that all of the above will help to sustain this at a level above the Financial Services industry benchmark and make Skipton a great place to work.

A review of performance in the year against our people strategy is set out on page 15.

Our Proposition

Our proposition is to make it easy for our customers to do business with Skipton, both online and offline, to personalise the products and services that we offer, and show real empathy in dealing with our customers.

Our proposition is based on striving to understand what is important to our customers, listening to their feedback and ensuring that the mortgage and retail savings products and services we offer are aligned with their needs. We focus on meeting the needs of customers planning for and in retirement, through our 'For Life Ahead' proposition. Our mortgage proposition 'Real Life Lending' focuses on building strong relationships with our mortgage customers and intermediary partners.

Our core services are savings, mortgages and investment advice, complemented by protection, pensions, legacy and inheritance tax planning. The way in which our people deliver them is central to our proposition. The provision of financial advice for our target market is a key differentiator and we continue to provide this through our wholly-owned subsidiary, SFS. SFS is integral to the delivery of our 'For Life Ahead' customer proposition, which will be strengthened through the further development of the retirement planning proposition.

A key strategic objective is to provide customers with a choice as to how they engage with us; face-to-face (branch or home-based advice), through Skipton Direct or digitally, in order that they experience a high quality, seamless and personalised service.

Investment in enhanced digital capability is a key area of focus, recognising that customers are adopting digital technology at an ever increasing pace. A dedicated digital team has been created and will be strengthened further as part of our commitment to improve digital capability for our people and our customers. Our digital strategy will include enhancing and developing our website, www.skipton.co.uk, and investing in software to enable personalisation of our online experience to enhance the service customers receive.

A review of performance in the year against our proposition strategy is set out on page 16.

Our Financial Strength

Our financial strength is of fundamental importance to our members. Therefore our main objectives are to maintain strong capital levels, in particular focusing on the Common Equity Tier 1 (CET 1) and leverage ratios, and deliver sustainable profits which provide a balance between ensuring the business is financially strong and ensuring we are providing good long term value for our customers.

Our key financial performance measures are set out in the table on page 17.

Maintaining a quality mortgage book and managing impairment losses to an acceptably low level is also critical to the strength of the business and to our members. We will continue to enhance our credit risk framework to ensure effective pricing, provisioning and use of capital, and in the short to medium term we aim to obtain permission to use the Internal Ratings Based (IRB) methodology as the basis for calculating our capital requirements.

A detailed review of performance in the year against our financial strength strategy is set out on pages 17 to 28.

Performance Against Our Objectives

We monitor our progression against our strategic goals using a number of non-financial and financial key performance indicators (KPIs), aligned to each of our strategic pillars. The following sections summarise how we performed against our KPIs during 2014.

Our Customers

Key Performance Indicator	Strategic Goal	2014	2013	2012
Our Customers				
Growth in membership (Society only)	To ensure we are attracting and retaining members	**31,276**	21,046	(13,566)
Increase in member savings balances (Society only)	To help more members save for their future	**£1,196m**	£826m	£189m
Group gross mortgage advances	To enable us to meet our goal of enabling homeownership through prudent and controlled lending	**£2,981m**	£2,415m	£1,484m
Group net mortgage growth	To enable us to meet our goal of enabling homeownership through prudent and controlled lending	**£1,275m**	£961m	£356m

A key measure of success as a mutual is the growth of our membership and mortgage and savings balances. In 2014 we grew the Society's membership by 31,276 to take its total membership to 794,739. We grew mortgage balances by 11.2% (2013: 9.2%), despite the run off of our specialist mortgage portfolios, and member savings balances by 11.7% (2013: 8.8%). Within our prudent credit risk appetite we achieved growth which was significantly ahead of the market, where net mortgage growth was 1.4% and net savings growth was 4.3% (Source: Bank of England Statistics, December 2014). This demonstrated our success in delivering products and services that are valued by both new and existing Skipton members.

Gross mortgage advances totalled £2,980.8m (2013: £2,415.4m) across the Group during 2014, representing an increase of 23% compared to 2013. During the year we continued to help a broad spectrum of homeowners, by offering loans requiring only a 10% deposit for first and next-time buyers, longer term deals offering fixed interest rates up to seven years and a suite of buy-to-let loans.

We aim to grow our customer base in a sustainable manner, bringing the benefits of membership to an increasing number of customers going forward.

Our People

Key Performance Indicator	Strategic Goal	2014	2013	2012
Our People				
Employee engagement (Society only) (note 1)	To ensure our people are passionate, loyal and committed	**88%**	83%	80%

1. As measured by Towers Watson, an independent company who provide benchmarking on employee surveys in both the UK and globally.

The delivery of our people strategy is primarily measured by employee engagement which increased to 88% in 2014. Building and sustaining high engagement (above 85%) is achieved through a range of activities reflecting all aspects of our people strategy including learning and development, recruitment and reward.

During 2014 we have supported our customer facing teams to further develop their skills through programmes such as 'Delivering Service Excellence' and 'Managing Service Excellence', which 504 of our people experienced.

To support our growth we have invested in attracting the right people with the right skills into the Society. In 2014 we recruited, welcomed and trained 443 new people across the Society's teams. In keeping with our culture we have removed bonuses linked to individual sales targets and introduced a new bonus scheme for all our employees in the Society, which is based on financial and customer-focussed measures.

Overall our progress was recognised when we were awarded 'Gold' status by Investors in People, reaccredited by Customer First and were placed in the 'Top 100 best companies to work for' in the Sunday Times Survey.

Employee diversity

The Society is committed to the principles of diversity. We aim to create an environment where the contributions of all our people are recognised and valued, to provide a working environment that promotes dignity and respect to all, is safe and accessible, free from unfair treatment, discrimination and harassment and gives fair access to learning, development, reward and promotion opportunities. We have a range of policies and practices which support these aims and monitor their application.

The number of employees of each sex employed in the Group as at 31 December 2014 is outlined below:

	Male	Female	Total
Directors	8	3	**11**
Senior managers	56	27	**83**
Other employees	3,458	4,555	**8,013**
	3,522	**4,585**	**8,107**

Our Proposition

Key Performance Indicator	Strategic Goal	2014	2013	2012
Our Proposition				
Society net customer satisfaction score (note 1)	To ensure we are putting the customer at the heart of our business	**88%**	85%	84%
Society FOS complaints, change in outcome rate	To ensure we are treating customers fairly	**16%**	13%	13%
Number of 'best-buy' media mentions	To demonstrate that we are offering highly competitive mortgages and savings products	**804**	586	528

1. As measured from a survey by Nunwood of 2,400 Skipton members. The net customer satisfaction score is calculated by subtracting dissatisfied customers (those scoring satisfaction with the Society as 1-3 on a scale of 1-7) from those who are satisfied (those scoring satisfaction as 5-7 on the same scale).

One of the ways in which we monitor the success of our proposition is by measuring net customer satisfaction. We do this quarterly, using an independent third party to ask our customers about their levels of satisfaction with the service they have received. In 2014 net satisfaction increased to 88% (2013: 85%), demonstrating the delivery of high quality products and services to our customers.

Skipton came 13th out of 263 UK brands in an independent 'Customer Experience Excellence' survey of 7,500 consumers undertaken by Nunwood. This represented an improvement of 23 places from the 36th position achieved in 2013 and made Skipton the third best placed Financial Services organisation.

Independent third party recognition of our products and services is another key demonstration of the value that we are delivering to our members. We received 804 independent 'best-buy' mentions for our products in 2014 (2013: 586), featuring in 'best-buy' tables every week of the year. Additionally we received a number of awards for both the quality of products and service offered.

Whilst we strive to get things right for our customers first time, every time, we recognise that on occasions things can go wrong and our customers have cause for complaint. We aim to deal with these complaints efficiently and with empathy, putting right what has gone wrong. A measure of our success in doing this is the proportion of the Society's complaints going to the Financial Ombudsman Service (FOS) that have their outcomes changed. The Society's change in outcome rate for 2014 was 16% (2013: 13%), which compared very favourably with the industry average of 54% for 2014 (Source: FOS industry data for banks and building societies).

Our Financial Strength

Key Performance Indicator	Strategic Goal	2014	2013	2012	Discussed further
Our Financial Strength					
Total Group profit before tax (PBT)	To ensure we generate the necessary capital to enable the business to develop	**£181.6m**	£103.6m^	£36.1m^	Page 17
Group net interest margin (% of mean assets)	To demonstrate the earnings of our core Mortgages and Savings division	**1.40%**	1.01%	0.61%	Page 18
Mortgages and Savings division cost income ratio	To maintain a manageable cost base to ensure the business is cost efficient	**44.54%**	49.97%	72.58%	Page 19
Mortgages and Savings division management expense ratio	To maintain a manageable cost base to ensure the business is cost efficient	**0.65%**	0.59%	0.55%	Page 19
Group mortgages in arrears by more than 2.5% of the total outstanding balance	To continually manage and monitor our arrears and credit risk management	**0.82%**	1.07%	1.34%	Page 22
Core liquidity buffer as a % of liquidity balance	To ensure we are holding a cost-effective mix of liquidity within our liquidity risk appetite and regulatory requirements	**59.08%**	49.84%	48.98%	Page 22
Liquidity as a % of shares, deposits and borrowings	To ensure we hold sufficient levels of overall liquidity	**18.36%**	18.61%	21.10%	Page 22
Group retail funding as a % of total funding	To ensure we fund the majority of our mortgages through retail savings, in line with our customer proposition	**85.85%**	84.63%	83.07%	Page 23
Group Common Equity Tier 1 ratio	To ensure the Group remains financially strong by having a strong (risk weighted) capital base	**16.23%**	14.24%^	N/A*	Page 24
Group leverage ratio	To ensure the Group remains financially strong by having a strong (non risk weighted) capital base	**6.0%**	5.6%	N/A*	Page 24

* These measures were not reported or collated in 2012.

^ These financial KPIs have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b) to the accounts.

Group PBT from continuing operations in 2014 was £156.8m (2013: £102.7m), and total Group PBT was £181.6m (2013: £103.6m), an increase of £78.0m year-on-year.

Underlying Group PBT from continuing operations (prior to Financial Services Compensation Scheme (FSCS) charges, gains on the disposal of subsidiary, associate and equity share investments and profits from discontinued operations) amounted to £151.1m, an increase of £66.5m on the previous year from £84.6m.

The improvement in underlying trading performance was driven by the strong performance in the core Mortgages and Savings division, together with another good trading performance from our Estate Agency division, Connells.

We continued to focus on the core Mortgages and Savings businesses, in particular the Society which is at the heart of this division, and our Guernsey-based subsidiary SIL. Through a combination of increased lending and careful management of our retail savings portfolio, offering attractive savings rates that were also sustainable for the Society in the marketplace, the Group net interest margin saw a further improvement, increasing to 1.40% (2013: 1.01%). The Group's margin also benefited from the impact of the Government's Funding for Lending Scheme (FLS), which has driven down the market price of retail funding since its introduction in August 2012, and from a one-off gain from the unwind of merger fair value adjustments following the sale of a number of treasury assets in the year which accounted for 5bps of the increase in margin. The strengthening of the net interest margin was a key driver of the results of the division, which achieved statutory profits before tax for the year of £98.4m, up from £51.5m in 2013.

Also integral to the Group's business model is Connells, which again delivered a good performance for the year, reporting PBT of £63.2m (2013: £50.2m). These results include a one-off gain of £10.1m following the sale of approximately 25% of Connells' holding in Zoopla Property Group Plc when it listed on the London Stock Exchange in June. Excluding the profit from the part disposal of Zoopla shares, Connells' PBT increased by 6% to £53.1m. House sales (exchanges) were up 11% on the previous year (on a like-for-like basis, excluding properties sold by Peter Alan), however activity within the housing market slowed during the second half of the year and as a result Connells enters 2015 with a lower pipeline than at the same time in 2014.

The Financial Advice division reported PBT of £1.4m (2013: £3.9m), which includes a loss of £(1.1)m on the sale of Torquil Clark Limited. Excluding the loss on disposal the underlying trading profit before tax for the division was £2.5m (2013: £3.9m).

The Investment Portfolio's results were boosted by the disposal of The Private Health Partnership Limited that gave rise to a profit before tax of £2.2m, together with a deemed disposal of part of our shareholding in Wynyard Group Limited that generated a profit of £2.3m (2013: £24.8m). Excluding these one-offs, the division reported a trading profit of £0.7m (2013: loss of £(4.3)m) in the year.

During the year, we took further steps to simplify the Group in order to focus on our core strategic objectives. We disposed of our entire shareholding in HML, generating a profit on sale of £24.7m, with HML's trading profits before tax of £0.1m (2013: £0.9m) bringing the total profit from the division to £24.8m (2013: £0.9m). As HML represented the whole of our Mortgage Services division, its results are classed as being derived from discontinued operations.

Further information on performance by division is set out on pages 26 to 28.

Financial performance

Total Group PBT for 2014 was £181.6m (2013: £103.6m). The table below sets out the profit contribution of the Group's continuing and discontinued operations:

	2014 £m	2013 Restated* £m
Profit before tax from continuing operations	**156.8**	102.7
Profit before tax from discontinued operations (note 17b)	**0.1**	0.9
Profit on disposal of discontinued operations (note 17b)	**24.7**	-
Total Group profit before tax	**181.6**	103.6

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b) to the accounts.

Underlying Group PBT from continuing operations for 2014 was £151.1m (2013: £84.6m) as follows:

	2014 £m	2013 Restated* £m
Total Group profit before tax	**181.6**	103.6
Less profit before tax from discontinued operations	**(0.1)**	(0.9)
Less profit on disposal of discontinued operations	**(24.7)**	-
Less profit on disposal of subsidiary undertakings	**(1.1)**	(24.7)
Less profit on part disposal of associate and equity share investments	**(12.4)**	-
Add back FSCS levy	**7.8**	6.6
Underlying Group profit before tax from continuing operations	**151.1**	84.6

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b) to the accounts.

Group PBT from continuing operations for 2014 was £156.8m (2013: £102.7m) as set out in the table below:

	2014 £m	2013 Restated* £m
Net interest income	**213.3**	142.6
Net non-interest income	**395.6**	370.2
Fair value (losses) / gains on financial instruments	**(2.0)**	3.9
Losses on treasury assets	**(3.7)**	-
Share of (losses) / profits from joint ventures and associates	**(0.2)**	1.3
Dividend income from equity share investments	**1.1**	1.1
Profit on disposal of subsidiary undertakings	**1.1**	24.7
Profit on part disposal of associate	**2.3**	-
Profit on part disposal of equity share investments	**10.1**	-
Total income	**617.6**	543.8
Administrative expenses	**(426.7)**	(399.4)
Operating profit before impairment losses and provisions	**190.9**	144.4
Impairment losses on loans and advances to customers	**(13.3)**	(21.5)
Impairment losses on debt securities	**(2.0)**	(1.2)
Impairment losses on equity share investments	**(1.3)**	-
Provisions for liabilities	**(17.5)**	(19.0)
Profit before tax from continuing operations	**156.8**	102.7
Profit before tax from discontinued operations	**24.8**	0.9
Total Group profit before tax	**181.6**	103.6
Taxation	**(34.9)**	(26.4)
Profit after tax	**146.7**	77.2

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b) to the accounts.

Net interest income

Net interest income is the amount earned on assets (mortgages, other loans and liquidity), less that paid on liabilities (retail savings, wholesale funding and subscribed and subordinated capital). The Group's net interest margin, which measures net interest income as a percentage of mean assets, increased to 1.40% for the year, up from 1.01% in 2013.

The improvement in the Group's net interest income was the result of increased mortgage lending at competitive pricing, without increasing our credit risk appetite, together with continuing prudent management of the retail savings portfolio by offering attractive rates to savers which also deliver sustainable returns for the business. The unwind of merger fair value adjustments following the sale of treasury assets in the year resulted in a one-off gain to the interest margin of £8.1m.

The Group's margin also benefited from the impact of the FLS which reduced the overall cost of funding. We have continued to participate in the scheme during the year, and at 31 December 2014 we had drawn £650.0m (2013: £460.0m) of FLS funding.

Net non-interest income

The Group's other income represents the net non-interest revenue generated by the Society and its subsidiaries.

Net non-interest income from continuing operations by division is set out below:

	2014 £m	2013 £m
Mortgages and Savings	**14.0**	19.2
Estate Agency	**322.9**	281.9
Financial Advice	**36.6**	40.5
Investment Portfolio	**26.4**	33.0
Inter-divisional adjustments*	**(4.3)**	(4.4)
	395.6	370.2

* Inter-divisional adjustments relate primarily to the elimination of intra-divisional trading.

The Group's other income for the year from continuing operations was up by 7% to £395.6m (2013: £370.2m). Within the Mortgages and Savings division, other income fell by £5.2m due partly to a one-off gain of £2.6m from a capital buy back exercise in 2013. In addition a greater proportion of our mortgage products offered in the year were free from fees or had lower fees associated with them, benefiting our mortgage customers.

Estate Agency income increased by £41.0m year-on-year driven largely by an 11% increase in the number of properties sold by Connells (on a like-for-like basis, excluding properties sold by Peter Alan) and the acquisition of Peter Alan part way through the year, together with improved returns on its investments in its lettings capability and mortgage services headcount. The Financial Advice division saw a decrease in income in the year of £3.9m, predominantly as a result of the disposal of Torquil Clark Limited part way through the year, but also partly due to an increased rebate of ongoing charges within SFS under its fund monitoring service proposition.

The decrease in net non-interest income in the Investment Portfolio was mainly driven by the loss of revenues following the disposal of PHP during the year and the flotation of Wynyard in July 2013, at which point Wynyard was no longer accounted for as a subsidiary but as an associate investment.

Further details of the Group's performance by business area are set out on pages 26 to 28.

Fair value gains on financial instruments

All derivatives are recorded within the Statement of Financial Position at fair value. Amounts recognised in the Income Statement in relation to derivatives represent valuation movements of certain derivatives held by the Group. Further details are provided in note 1e) to the accounts. Derivatives are only used to the extent to which the Group will be affected by changes in interest rates or other market indices and are therefore used solely to hedge risk exposures and not for speculative purposes.

The £(2.0)m loss (2013: £3.9m credit) relating to net fair value losses on financial instruments represents fair value adjustments on derivatives that are matching risk exposures on an economic basis and the fair value movement on the associated hedged item. Some Income Statement volatility arises on the net of these items due to partial accounting ineffectiveness of designated hedges or because hedge accounting has not been adopted or is not achievable. Ineffectiveness is primarily due to timing differences in cash flows and interest rate reset dates between the derivative instrument and the hedged asset or liability. The net impact can be volatile, but should trend towards zero over time.

Losses on treasury assets

Losses on treasury assets arise on the sale of debt securities and similar treasury instruments held at amortised cost, which have been sold in the normal course of business. During the year, the Group disposed of a number of these assets, generating a loss on sale of £(3.7)m (2013: £nil), which was offset by a larger gain of £8.1m (2013: £nil) arising from a resulting unwind of fair value adjustments, recorded within net interest income.

Profit on disposal of subsidiary undertakings (included in continuing operations)

On 29 July 2014, we disposed of our entire shareholding in PHP and its subsidiary companies, generating a profit of £2.2m and on 30 September 2014, we disposed of our entire shareholding in Torquil Clark and its subsidiary companies, resulting in a loss on sale of £(1.1)m.

Profit on part disposal of equity share investments

The profit on the disposal of equity share investments of £10.1m (2013: £nil) arose from the part sale of our shareholding in Zoopla Property Group Plc following its flotation on the London Stock Exchange in June 2014.

Administrative expenses

Administrative expenses for the Group of continuing operations increased by 7% during 2014 to £426.7m (2013: £399.4m). We continue to focus on managing costs to offset inflationary pressures and the ever increasing need to invest further in regulatory compliance. Additionally, investments made in our Estate Agency division since late 2011, particularly in relation to lettings, mortgage services and regulatory compliance, have increased the Group's cost footprint. Also included in the Group's administrative expenses is the cost of the Connells management incentive scheme, whereby members of the Connells senior management team purchased share options in the company in 2012 and 2014. These options, which are performance related, can only be exercised once certain timeframes have elapsed. The cost of the scheme was £5.4m for the year (2013: £7.7m).

The Society continues to manage its costs, and increase efficiency wherever possible, however the same inflationary pressures referred to above, together with the additional investment in our people and our customer strategy has resulted in the Mortgages and Savings division's ratio of administrative expenses to mean assets (its management expense ratio) increasing to 0.65% from 0.59% in 2013.

At a Group level, the cost to income ratio (from continuing operations) saw significant improvement during the year, reducing to 70.74% from 77.30%, as a result of increases in income and the continuing close management of our costs.

	2014	2013
	%	%
Mortgages and Savings division management expense ratio	**0.65**	0.59
Mortgages and Savings division cost income ratio*	**44.54**	49.97
Group management expense ratio	**2.80**	2.83
Group cost income ratio	**70.74**	77.30

* Administrative expenses as a percentage of total income before share of profits from joint ventures and associates, dividend income from equity share investments, profit on disposal of subsidiary undertakings, profit on part disposal of associate investments and profit on part disposal of equity share investments.

Impairment losses on loans and advances to customers

The Group's impairment charge on loans and advances to customers reduced to £13.3m (2013: £21.5m) and is broken down as follows:

	2014	2013
	£m	£m
Residential mortgages	**4.3**	7.5
Equity release mortgages	**5.7**	8.3
Commercial mortgages*	**3.1**	5.5
Other loans	**0.2**	0.2
	13.3	21.5

* Also known as loans fully secured on land.

The reduction in impairment losses on loans and advances to customers was driven by a decline in the number and value of balances in arrears across the Group. The performance of the Society's prime residential mortgage book remains good and arrears have also fallen within the specialist lending books in Amber and NYM, whilst there remain only a few cases in arrears in SIL.

The equity release charge relates to the equity release portfolio that was acquired when we merged with Scarborough Building Society in 2009. Losses on this portfolio relate to the no negative equity guarantee provided to customers (as described in note 38), and are a function of the actual and projected interrelationship between market-wide long term house prices and retail price inflation and the specific behaviour of this portfolio. During the year we have again aligned our assumptions of these metrics based on the performance of the wider economy and management's assessment of the specific characteristics of the portfolio, resulting in a charge of £5.7m for the year (2013: £8.3m).

Arrears levels within our commercial lending portfolio remain low and have improved throughout the year. Following a review of the provisions held against these loans, all of which were written prior to 2009, the charge to the Income Statement in the year for incurred losses for this portfolio has reduced to £3.1m from £5.5m in 2013.

Impairment losses on debt securities

We only invest in high quality liquid assets and continue to review the carrying value of this portfolio. During the year we have provided £2.0m (2013: £1.2m) against one investment (2013: two), where recovery in full of the principal amount appears doubtful. The quality of the remaining treasury portfolio remains good.

Provisions for liabilities

Provisions for liabilities amounted to £17.5m (2013: £19.0m) and include our share of the costs of the Financial Services Compensation Scheme (FSCS). The charge for the year from the FSCS levy is primarily based on our latest estimate of our share of what HM Treasury will charge the FSCS for loans to finance depositor protection, together with the second of three years' charges for anticipated losses on realisation of Icelandic banks' and Dunfermline Building Society's lending assets. The Financial Advice division is also subject to levies for particular market events such as the failure of Keydata. The total Group charge amounted to £7.8m (2013: £6.6m).

Other provisions for liabilities relate to items such as claims against Connells' survey and valuation division, customer compensation within our Financial Advice division and Mortgage Payment Protection Insurance (MPPI) claims in the Mortgages and Savings and Estate Agency divisions.

The table below provides a further breakdown of the total charge:

	2014	2013 Restated*
	£m	£m
FSCS levy	**7.8**	6.6
Provision for the costs of surplus properties	**-**	0.9
Commission clawbacks / rebates	**3.9**	5.4
Survey and valuation claims	**5.0**	3.1
Customer compensation	**0.2**	1.7
Other provisions	**0.6**	1.3
	17.5	19.0

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b) to the accounts.

We expect all these provisions to crystallise substantially within the next two years.

Profits from discontinued operations

On 17 November 2014, we disposed of our entire shareholding in HML and its subsidiary companies for initial consideration of £56.6m (representing a purchase price of £47.5m plus an adjustment of £9.1m for surplus working capital), which generated a profit of £24.7m. As described in note 17b) the transaction included a contractual agreement whereby any profits generated by HML since 31 May 2014 were due to the purchaser. Therefore, only profits generated by HML prior to this date have been retained by the Group and included in these financial statements.

Taxation

The Group's effective tax rate from continuing operations is 22.2% (2013: 25.9%) compared with the standard rate of UK Corporation tax of 21.5% (2013: 23.25%). The major impacts on the effective rate for the year are the costs of the Connells management incentive scheme which are not deductible for tax purposes. However this is offset by non-taxable income and the impact of lower tax rates on profits made by our Guernsey-based retail banking operation, SIL.

Other comprehensive income

During the year the Group recorded a £(6.5)m expense (net of tax) of other comprehensive income (2013: income of £17.4m). This included a £6.7m unrealised gain resulting from an increase in the fair value of the Group's shareholding in Zoopla. The £6.7m gain is based on the quoted share price as at 31 December 2014 and has been recognised in the available-for-sale reserve. This was offset by the transfer of £10.1m of unrealised gains to the Income Statement (£8.2m of which was recognised as an unrealised gain in 2013) following the sale of part of our shareholding in Zoopla on flotation. Various other movements in the Society's available-for-sale and cash flow hedging reserves account for the remainder of the overall movement in the Group's other comprehensive income.

Financial position

Loans and advances to customers

The Group has increased its lending during the year and continues to lend in a controlled manner, without increasing its credit risk appetite. Gross mortgage advances in the year increased to £2,980.8m from £2,415.4m in 2013.

An analysis of gross mortgage advances is shown below:

	2014 £m	2013 £m
Society	**2,808.1**	2,264.3
Amber Homeloans*	**0.7**	0.2
Skipton International	**172.0**	150.9
	2,980.8	2,415.4

* Following the decision to cease new lending in 2008, these advances represent further loans to existing borrowers.

Lending by the Society remains prudent and well diversified by product type and geographical distribution. This well-managed spread of risk ensures that the quality of the Society's mortgage lending remains high. As at 31 December 2014 the Society's average indexed loan-to-value (LTV) for the residential mortgage book was 47.8% (2013: 49.6%).

Due to the specialist nature of the Amber and NYM portfolios, these mortgage books have a typically higher average indexed LTV; however these have fallen during the year to 70.8% (2013: 78.7%) and 70.3% (2013: 78.5%) respectively. The mortgage balances within these two portfolios continue to be managed down and arrears have continued to fall.

SIL grew its mortgage book in the year, with gross residential mortgage advances totalling £172.0m (2013: £150.9m), and the average indexed LTV of the portfolio at 31 December 2014 has increased only slightly to 59.9% (2013: 59.5%), demonstrating our focus on managing our credit risk exposures.

Overall, the Group's average indexed LTV for the residential mortgage book reduced to 50.3% (2013: 52.9%).

The Group's total new advances on buy-to-let products, included in the table above, were £322.9m in 2014 or 10.8% of the Group's gross mortgage lending (2013: £411.0m or 17.0%). The risks attached to buy-to-let lending are managed by prudent consideration of the level of equity in the property, where we generally only accept lower LTV ratios compared with our other residential lending, and also the level of rental cover compared to the mortgage payments.

The Group's portfolio of commercial mortgages fell by 6.8% during the year to £382.1m as this closed portfolio continues to run off. The Group's portfolio of equity release mortgages increased by £3.2m to £273.9m (which includes a fair value adjustment of £39.8m (2013: £41.6m)), mainly due to the roll-up of interest into the capital balances.

Overall, the Group's loans and advances have increased by 11.5% to £12,836.8m from £11,516.9m at the end of 2013 as set out in the table below:

	2014 £m	2013 £m
Residential mortgages (including buy-to-let)	**11,926.2**	10,636.1
Equity release mortgages	**273.9**	270.7
Commercial mortgages	**382.1**	409.8
Other lending:		
Debt factoring loans	**63.8**	58.9
Other loans	**45.9**	41.2
Gross balances	**12,691.9**	11,416.7
Impairment provisions	**(58.9)**	(59.1)
Fair value adjustment for hedged risk	**203.8**	159.3
	12,836.8	11,516.9

The Group continues to manage loans that have gone into arrears, supporting the borrower where possible and ensuring fair outcomes for our borrowers, whilst protecting the business for the benefit of all members. Arrears, where the arrears balance exceeds 2.5% of the capital balance, were 887 cases (2013: 1,088 cases), representing 0.82% (2013: 1.07%) of the book. An analysis of the Group's residential arrears is shown below:

Cases where arrears balance was greater than 2.5% of the total outstanding balance	**2014**	2013
Society		
Number of cases	**401**	434
% of Society book	**0.43%**	0.50%
Impairment provision on residential mortgages (excluding equity release)	**£8.2m**	£11.7m
Amber Homeloans (Amber)		
Number of cases	**341**	446
% of Amber book	**5.00%**	5.96%
Impairment provision on residential mortgages	**£16.2m**	£19.1m
North Yorkshire Mortgages (NYM)		
Number of cases	**145**	205
% of NYM book	**3.65%**	4.64%
Impairment provision on residential mortgages	**£4.9m**	£5.7m
Skipton International (SIL)		
Number of cases	**-**	3
% of SIL book	**-**	0.09%
Impairment provision on residential mortgages	**-**	£0.2m
Total		
Number of cases	**887**	1,088
% of total book	**0.82%**	1.07%
Impairment provision on residential mortgages (excluding equity release)	**£29.3m**	£36.7m
Impairment provision on equity release mortgages	**£17.5m**	£11.8m
Total impairment provision on residential mortgages (note 16)	**£46.8m**	£48.5m

The Group stopped offering commercial mortgages in November 2008 and the book continues to run off. The quality of the Society's commercial book remains satisfactory with just 4 (2013: 9) cases where the arrears balance was greater than 2.5% of the total outstanding balance, with the capital value of these cases in arrears representing only 0.28% (2013: 0.52%) of the commercial portfolio. Close monitoring of the credit performance of the commercial book continues, which includes working closely with our commercial customers to ensure any changes in their individual circumstances are identified and taken into account, and impairment provisions are made where appropriate.

Where appropriate for customers, the Group applies a policy of forbearance. This may be applied where the actual or apparent financial stress of the customer is considered to be short term with a potential to be recovered. Forbearance may involve arrears capitalisation, a reduction in the monthly payment (known as a concession), a conversion to interest only or a mortgage term extension. These strategies are undertaken in order to achieve the best outcome for both the customer and the business through dealing with arrears at an early stage. Further details on the forbearance strategies of the Group can be found in note 37a) to the accounts. At 31 December 2014 the percentage of residential mortgage balances subject to forbearance, on this basis, was 1.3% (2013: 3.3%). For commercial balances the percentage is 6.1% (2013: 8.2%).

Liquidity

The Group's liquid assets increased broadly in line with the balance sheet, with the liquidity ratio (as a percentage of shares, deposits and borrowings) at 31 December 2014 relatively stable at 18.36% (2013: 18.61%). The Group continues to hold healthy levels of liquid assets to support business and counter economic uncertainty.

An analysis of the Group's liquidity position is shown below:

	2014	2013
Liquidity balance*	**£2,594.1m**	£2,381.1m
As % of shares, deposits and borrowings	**18.36%**	18.61%
Core liquidity buffer^- eligible assets	**£1,532.6m**	£1,186.8m
Core liquidity buffer^ as % of liquidity balance	**59.08%**	49.84%

* Represented by the sum of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities as shown within the Statement of Financial Position.

^ Buffer eligible assets include gilts, treasury bills, supranational bonds and reserves held with the Bank of England.

The Liquidity Coverage ratio (LCR), a new regulatory measure, is expected to be implemented across Europe over the next 12 months. The LCR is designed to ensure that financial institutions have the necessary assets on hand to ride out any possible short term liquidity disruptions. Under the Directors' interpretation of the basis of calculation of this measure, the assumptions of which are subject to regulatory approval, the Group's LCR at 31 December 2014 was above 100%, which is expected to be the recommended regulatory minimum following the full transition to the new rules.

The Group's treasury investments are held to provide liquidity and 96.7% (2013: 99.0%) of the Group's treasury investments are rated A3 or better (as shown below):

Rating	2014 £m	2013 £m
Aaa	**430.5**	436.9
Aa1	**1,419.0**	1,366.7
Aa2	**147.8**	143.1
Aa3	**152.9**	131.6
A1	**83.8**	22.1
A2	**245.1**	149.7
A3	**28.7**	106.9
Baa1	**84.6**	18.8
Ca	**-**	1.6
Unrated:		
Building societies	**1.7**	1.7
Other	**-**	2.0
	2,594.1	2,381.1

With the exception of some building societies and local authorities where separate credit analysis is undertaken, the Group's policy is that initial investments in treasury assets are typically A3 or better. We also lend a limited amount to other building societies and local authorities following detailed due diligence. All treasury investments are monitored for impairment on a regular basis.

The Group employs a rigorous credit assessment process and considers the risks of all assets before they are acquired and throughout the period they are held. Credit approval, along with monitoring the Group's exposure concentrations against a variety of criteria, including country of risk, is carried out by the Group Wholesale Credit Committee (a sub-committee of the Asset and Liability Committee).

During the year, the Group reduced its wholesale credit risk through the disposal of all outstanding commercial mortgage backed securities (CMBS) along with all non-conforming residential mortgage backed securities (RMBS).

These assets had previously been held as legacy investments following deterioration in their liquidity as a result of the economic downturn given heightened credit concerns. The Group used the opportunity of strong investor demand to reduce its risk to treasury assets it no longer has an appetite to invest in or hold, which also resulted in a small profit on disposal.

The Society regularly conducts an Individual Liquidity Adequacy Assessment (ILAA) in accordance with the Prudential Regulation Authority's (PRA) liquidity guidelines and the Board remains satisfied that the Group has sufficient liquid assets at its disposal in order to meet its obligations as they fall due.

Funding

As a building society, the Group is required to obtain the majority of its funding through retail deposits and the Society retains a strong retail base, placing less reliance on the wholesale markets.

Retail funding

The launch of the Government's FLS in August 2012, which the Society continued to participate in during 2014, has resulted in reduced price competition for retail funding. However, as a mutual building society, our focus has always been on offering competitive products to retain savings as the prime source of a stable funding base.

At 31 December 2014, £11,467.5m (2013: £10,260.1m) of our funding comes from retail savings representing 85.9% (2013: 84.6%) of our total funding. In 2014, retail savings balances increased due to strong retention of existing savings balances and attraction of new customers as a result of the competitive rates offered across our savings range, as well as our commitment to delivering excellent customer service and building long term relationships with our customers.

In addition to our UK retail funding, the Group also accepts deposits through our Guernsey-based subsidiary, SIL. SIL has increased its retail funding base and offshore deposits in the year to £899.2m (2013: £783.5m). These balances are included in 'Amounts owed to other customers' within the Group Statement of Financial Position.

Wholesale funding

The remainder of the Group's funding comes from the wholesale markets. At 31 December 2014 our wholesale funding balances amounted to £1,764.4m (2013: £1,748.3m), an increase of £16.1m during the year, resulting in the Group's wholesale funding ratio decreasing slightly to 14.15% at 31 December 2014 (2013: 15.37%).

In January 2014, £340m of funds were drawn down from the Government's FLS scheme in addition to £460m that had been drawn down by 31 December 2013. In April 2014, through Darrowby No. 3 plc, the Group completed its third securitisation transaction. The transaction raised £400m of funds, which provided the opportunity for the Society to repay £350m of previously drawn down funds from the FLS scheme. A further £200m of funds were subsequently drawn down, resulting in £650m of FLS funding remaining outstanding at 31 December 2014.

The following tables analyse the composition and maturity of our wholesale funding:

	2014 £m	2013 £m
Repo and other secured agreements	**691.1**	879.7
Deposits	**342.7**	313.8
Certificates of deposits	**7.0**	8.0
Medium term notes	**0.1**	41.8
Securitisation	**723.5**	505.0
	1,764.4	1,748.3

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	2014 £m	2013 £m
Repayable on demand	**44.3**	113.8
In not more than three months	**679.4**	755.4
In more than three months but not more than one year	**244.7**	113.5
In more than one year but not more than five years	**796.0**	763.0
In more than five years	**-**	2.6
	1,764.4	1,748.3

As outlined above, the Group's wholesale funding balances in the above tables exclude offshore funding in our Guernsey-based subsidiary, SIL, as shown below:

	2014 £m	2013 £m
Amounts owed to credit institutions	**789.8**	1,046.3
Amounts owed to other customers	**1,143.2**	930.8
Debt securities in issue	**730.6**	554.7
Less: Skipton International funding	**(899.2)**	(783.5)
	1,764.4	1,748.3

The Society's credit ratings assigned by two major credit rating agencies, Fitch and Moody's, were upgraded during the year, reflecting the strong performance in the Society's core Mortgages and Savings business and de-risking of the Group following the subsidiary disposals. The Society's long and short term credit ratings as at 31 December 2014 were as follows:

	Long term	**Short term**	**Outlook**	**Date of last rating action / confirmation**
Fitch	BBB	F2	Positive	September 2014
Moody's	Baa3	P-3	Stable	October 2014

The Class A Notes of all our securitisation transactions (Darrowby No. 1 plc, Darrowby No. 2 plc and Darrowby No. 3 plc) remain Aaa rated by both agencies.

Capital

Capital comprises the Group's general reserve, subscribed capital provided through Permanent Interest Bearing Shares (PIBS) and subordinated liabilities. Capital is ultimately held for the protection of depositors and other creditors by providing a buffer against unexpected losses.

On 1 January 2014 the Basel II regulation upon which capital calculations were previously based was replaced by Basel III which was implemented through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive, together referred to as CRD IV. CRD IV has introduced a number of changes to the capital framework which impact how our capital is calculated. The impact of CRD IV in some areas was immediate; however in some cases the impact is being phased in under transitional arrangements up to 2022. Under CRD IV the key level at which we monitor our capital is at a prudential consolidation group level; the equivalent consolidation group under Basel II was the UK consolidation group. The prudential group comprises the entire Group except Connells and a small number of other entities whose activities are not closely aligned with the core business. Further details regarding our capital position are set out in the Pillar 3 disclosures available on our website.

The PRA regulates the Group which is required to manage its capital in accordance with the rules and guidance issued by the PRA under CRD IV. The capital requirements of the Group are monitored on an ongoing basis to ensure the minimum regulatory requirement is always met and that the Group has sufficient levels of capital for current and projected future activities.

The following table shows the composition of the prudential group's regulatory capital as at 31 December 2014 under CRD IV fully loaded and transitional rules, with comparative figures given as at 1 January 2014:

	CRD IV Fully Loaded[1] 31.12.14 £m	**CRD IV Transitional 31.12.14 £m**	CRD IV Fully Loaded[2] 1.1.14 £m	CRD IV Transitional[2] 1.1.14 £m
Common Equity Tier 1				
Reserves (note 3)	**952.8**	**949.7**	821.3	817.1
Prudential adjustments (note 4)	**(0.9)**	**(0.9)**	(1.1)	(1.1)
Deductions from Tier 1 capital (note 5)	**(11.2)**	**(11.2)**	(29.7)	(29.7)
Unrealised gains on available-for-sale debt securities	**-**	**(2.6)**	-	-
Unrealised losses on cash flow hedges	**5.3**	**5.3**	11.0	11.0
Total Common Equity Tier 1	**946.0**	**940.3**	801.5	797.3
Additional Tier 1 capital – PIBS (note 6)	**-**	**72.0**	-	72.0
Total Tier 1 capital	**946.0**	**1,012.3**	801.5	869.3
Tier 2				
Subordinated liabilities (note 6)	**4.4**	**37.7**	6.4	54.1
PIBS (note 7)	**40.0**	**18.0**	40.0	18.0
Total Tier 2 capital (note 8)	**44.4**	**55.7**	46.4	72.1
Total Own funds	**990.4**	**1,068.0**	847.9	941.4
Risk weighted assets				
Retail mortgages	**4,454.9**	**4,454.9**	4,110.8	4,110.8
Commercial mortgages	**359.3**	**359.3**	392.5	392.5
Treasury assets (note 9)	**413.4**	**413.4**	461.7	461.7
Other assets (note 10)	**303.4**	**303.4**	322.3	322.3
Operational risk	**297.0**	**297.0**	339.5	339.5
Market risk	**-**	**-**	0.7	0.7
Total risk weighted assets	**5,828.0**	**5,828.0**	5,627.5	5,627.5
Capital ratios				
Common Equity Tier 1 (CET 1) (%) (note 11)	**16.23**	**16.13**	14.24	14.17
Tier 1 (%) (note 11)	**16.23**	**17.37**	14.24	15.45
Total capital (%) (note 11)	**16.99**	**18.33**	15.07	16.73

Notes

1. The key impact on Own funds of the CRD IV fully loaded rules are that all existing additional Tier 1 and Tier 2 instruments that become ineligible as capital by 1 January 2022 are excluded in full now. The fully loaded CET 1 ratio is higher than the transitional CET 1 ratio as certain fair value adjustments made in relation to these instruments are not deducted from reserves under the fully loaded position.
2. The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy and a revised interpretation of the CRD IV regulations. Further explanation of these movements is set out in the notes below.
3. Reserves consist of the general reserve, unrealised gains / losses on available-for-sale assets and the cash flow hedging reserve.
4. Prudential adjustments include deductions to capital for deferred tax and a valuation adjustment ('AVA') on fair value assets. AVA has been applied to prudently provide for the downside of fair value exposures that are intrinsically subjective in nature.
5. Under PRA rules intangible assets must be deducted from regulatory capital.
6. Under PRA rules Permanent Interest Bearing Shares (PIBS) and subordinated liabilities are included in the solvency calculation in accordance with UK GAAP rather than IFRS. The PIBS and subordinated liabilities are disclosed at par value, therefore the associated merger fair value adjustments are recognised in the general reserve. Subordinated liabilities with less than five years to maturity are amortised from a capital perspective. In addition, the fully loaded prior year figures have been restated to remove a £10m tranche of subordinated debt which has been reclassified as ineligible under CRD IV.
7. Under CRD IV all of our PIBS will be phased out of Tier 1 capital as they fail to satisfy the CRD IV requirements. However £40m of our PIBS will continue to satisfy the criteria for Tier 2 capital and will therefore be phased into Tier 2.
8. Historically Tier 2 capital has included the add-back of collective provisions. This is no longer permitted under CRD IV. The prior year figures have also been restated to reflect this treatment.
9. The Group is already required to hold regulatory capital in order to cover potential losses which could arise if the counterparties to its derivative contracts fail to meet their financial obligations before the maturity date; this is known as the counterparty credit risk. It places a valuation on the risk that the counterparty will default on its obligations before the maturity of the contract. CRD IV extends this concept by introducing the requirement to hold additional regulatory capital in order to protect the Group from exposure to potential mark to market losses that could arise if the creditworthiness of those same counterparties were to deteriorate; this is known as a credit valuation adjustment charge. The prior year figures have been restated to include a credit valuation adjustment charge.
10. Other assets include capital required for debt factoring loans, property, plant and equipment, cost of investment in subsidiary companies outside the prudential group, other debtors and the fair value of hedged assets. The calculation of the capital required for the fair value of hedged assets in relation to mortgage assets has been revised reflecting regulatory guidance. The prior year figures have also been restated to reflect this treatment.
11. Calculated as relevant capital divided by risk weighted assets.

The increase in Own funds (total capital) during 2014 was driven by the accumulation of profits during the year, which are added to the general reserve.

During the year the Group has continued to perform regular stress tests on its capital base, and these tests have demonstrated consistently a capital surplus after allowing for severe stress scenarios.

Leverage ratio on CRD IV basis

The CRD IV regulations include the introduction of a capital leverage ratio defined as the ratio of Tier 1 capital to total exposure, i.e. total assets per the Statement of Financial Position (subject to some regulatory adjustments).

In January 2014 the Basel Committee set out a revised definition of the leverage ratio. We have applied this definition to calculate a leverage ratio at a prudential group level, being the key consolidation level at which the Group is regulated under CRD IV.

Fully loaded leverage ratio – prudential group	31.12.14	1.1.14
Leverage ratio (%) (Tier 1 capital / LR Exposure measure) (note 1)	**6.0**	5.6

Notes

1. Tier 1 capital is based on the end-point definition as set out in the final 30 November 2013 CRR text.

Pension funds

The Group manages three funded defined benefit schemes as described in note 29 to the accounts. The aggregate valuation of the three defined benefit schemes at 31 December 2014 resulted in a deficit of £73.0m (2013: £53.3m) using the methodology set out in IAS 19.

We continue to take steps to manage this deficit, and all the schemes are closed to new members and future accrual of benefit. Special contributions totalling £23.6m have been paid into the schemes in the last five years. We have also undertaken a number of other initiatives aimed at managing the funding deficit and associated long-tail risk including early retirement exercises and enhanced pension transfer exercises which resulted in £20.8m of the liability being extinguished in early 2011 and a further £3.1m in 2013.

During 2014, as a result of the recent triennial valuations, revised levels of annual special contributions were agreed with the Trustee with a view to, combined with expected asset growth, eliminating the funding deficit over the agreed recovery period. The aggregate actuarial deficit or funding deficit based on the latest triennial valuations was £45.0m. We will continue to monitor the deficit on the schemes to manage the funds in a responsible manner, with the aim of ultimately eliminating the actuarial funding deficit.

We also operate defined contribution stakeholder schemes into which eligible employees are automatically enrolled.

Performance by Business Area

The Group's results from continuing operations by business area are as follows:

Business area	2014 £m	2013 Restated^ £m
Mortgages and Savings	**98.4**	51.5
Estate Agency	**63.2**	50.2
Financial Advice	**1.4**	3.9
Investment Portfolio	**5.2**	20.5
Sundry, including inter-divisional adjustments*	**(11.4)**	(23.4)
Profit before tax (PBT)	**156.8**	102.7

* Sundry, including inter-divisional adjustments relate primarily to the elimination of intra-divisional trading, the write down of goodwill arising on consolidation relating to subsidiary investments and the cost of the Connells management incentive scheme.

^ The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b) to the accounts.

Mortgages and Savings

The Mortgages and Savings division made a PBT of £98.4m, compared to a PBT of £51.5m in 2013.

The key driver of the improvement in the financial performance of the division has been the increase in its net interest income to £210.6m, up from £140.8m in 2013, with the net interest margin increasing by 39bps to 1.40% from 1.01%.

The improvement in the net interest margin is attributable to a strong lending performance, as well as lower retail funding costs which have fallen consistently during the year. The margin also benefited from a one-off gain of £8.1m generated from the sale of treasury assets in the year, which was offset by a £(3.7)m loss recognised in non-interest income, resulting in a net gain of £4.4m on the sale of these assets.

Mortgage balances grew by £1,268.7m to £12,626.1m (excluding fair value adjustments and impairment provisions), whilst retail savings balances grew by £1,195.9m to £11,442.0m, excluding fair value adjustments. Wholesale funding (excluding SIL), predominately secured funding transactions, grew by £16.1m to £1,764.4m.

Other income saw a decrease of £5.2m in the year from £19.2m to £14.0m, partly due to a one-off gain in 2013 of £2.6m from a capital buy-back exercise not being repeated in 2014. In addition, mortgage fees reduced year-on-year, reflecting a change in the mix of 'fee' and 'no fee' products offered in 2014 compared to 2013.

Costs have increased in the year to £97.5m (2013: £81.9m). This increase has in part been driven by investment in the promotion and marketing of our proposition, which is aimed at growing and deepening relationships with our customer base, and investment in the development of our people proposition aimed at improving and developing the skills of our people and retaining a highly engaged, quality and well-skilled workforce. Regulatory costs also increased and there was further investment in our risk management framework.

Impairment charges on loans and advances to customers for the division reduced to £13.0m from £21.4m, reflecting a significant reduction in the level of arrears during the course of 2014 and an improvement in the outlook for unemployment and house price indices used to determine loss provisions. The charge for provisions for liabilities increased slightly in the year to £8.0m, from £7.8m. This charge predominantly consisted of the FSCS levy.

Our specialist lending businesses, Amber and NYM, reported an aggregate profit before tax of £4.8m (2013: £7.4m), with the reduction in profits mainly due to the run off of these books. The focus for these businesses continues to be on managing the level of arrears in the portfolios through proactive collections processes, whilst ensuring good customer outcomes and continuing to manage down the mortgage assets. Arrears balances greater than 2.5% of the outstanding balance in these businesses decreased by 27% during the year, and the aggregate mortgage balances decreased to £1,435.8m, from £1,592.5m in 2013.

Our Channel Island operation, SIL, continues to perform strongly and reported a profit before tax of £12.2m for the year (2013: £8.7m). SIL has grown its mortgage book further in the year, with balances now standing at £782.8m, up by £93.4m from last year. The quality of this book remains very good, with no cases in the mortgage book in over 2.5% arrears. SIL also increased its savings balances during the year by 14.8% to £899.2m (2013: 783.5m), which represents 115% of its mortgage loans.

Estate Agency

The Group's estate agency operations are carried out through the Connells Limited group of companies. Performance highlights are outlined below:

	2014	2013
Total income	**£337.2m**	£285.7m
Profit before tax	**£63.2m**	£50.2m
Movement in:		
Estate agency house exchanges	**+11%**	+14%
Residential lettings properties under management	**+21%**	+50%
Surveys and valuations completed	**+10%**	+14%
Number of conveyancing transactions arranged	**+14%**	+16%

Connells once again produced a good performance in 2014, with PBT increasing by £13.0m; this includes £10.1m from the partial sale of its shareholding in Zoopla Property Group Plc following the flotation of that company on the London Stock Exchange in June 2014. Excluding the profit arising from the part disposal of Zoopla shares, Connells' PBT increased by 6% to £53.1m. During 2014, Connells continued its programme of significant investment within the business. Growth in the estate agency, lettings, financial services and surveying parts of the business, all deliver long term benefits in terms of future profitability, but at the expense of significant cost and no immediate payback within the year the investments are made.

Within estate agency, the improved market in the latter part of 2013 resulted in a strong sales pipeline entering 2014. This healthy market continued into the early part of the year, but cooled in the second half of the year, particularly following the inception of the Mortgage Market Review (MMR) in April, which appears to have constrained the availability of mortgages. Nevertheless, Connells sold 11% more residential properties during the year compared to 2013, on a like-for-like basis, and residential estate agency income increased by 16.3%. During the year, Connells purchased the 26-branch South Wales estate agency, Peter Alan Limited, for £16.4m, which firmly establishes the group as a major player in that region and this, together with new branch openings during the year, brought the total number of estate agency branches to 520 at the year end.

Connells continued the investment in its lettings business during 2014 and continued its expansion within its existing estate agency network which, together with four acquisitions of lettings businesses during the year, brought the total number of lettings branches to 263 at 31 December 2014 (three of which are stand-alone branches). Consequently, the number of properties let during the year, or 'move-ins', increased by 25.1%.

Connells continued to invest in its financial services capability during the year and, whilst financial services income growth slowed during the second quarter of 2014 following MMR, it did increase towards the end of the year.

Connells Survey and Valuation made further investment in surveyor numbers, new technology and support infrastructure during the year. 2014 saw this division deliver income 26% above last year. As part of the transaction to acquire Peter Alan, Connells Survey and Valuation entered into a long term panel management appointment with Principality Building Society.

Income derived from conveyancing increased by 11.5% during 2014 as Connells continues to focus on this important aspect of ensuring a smooth property transaction experience for its customers.

As noted above, Connells sold around 25% of its existing shareholding in Zoopla in June 2014, but retains a holding of approximately 3.9%. As at 31 December 2014, the market value of this remaining shareholding was £32.2m.

Financial Advice

Following the sale of Torquil Clark in September 2014, the Financial Advice division consisted of Skipton Financial Services (SFS), which provides restricted financial advice, primarily to Skipton Building Society members, and Pearson Jones which provided independent financial advice to high net worth clients.

Both firms have seen significant change over the past two years with the implementation of the Retail Distribution Review and in 2014 invested in improving quality standards and providing their advisers with the appropriate support levels to support the level of administration now required. These changes will create more capacity for advisers to spend time with their existing and new clients as we enter 2015.

The financial performance of the division was impacted by the loss on disposal of Torquil Clark. Both SFS and Pearson Jones reported profits in the year although SFS was impacted by the rebates provided to customers, which is part of their ongoing monitoring service proposition. High quality financial advice through SFS remains a core part of the overall Skipton Building Society customer strategy.

Since the year end however, Pearson Jones has been sold subject to regulatory approval and certain other conditions.

Investment Portfolio

The PBT for the Investment Portfolio was £5.2m, which is £15.3m below the prior year. The 2013 profit before tax of £20.5m was largely driven by the £24.8m profit on the flotation of Wynyard Group Limited (intelligence and investigations software business) which enhanced the figures for that year.

In the first half of 2014, Wynyard undertook two further share issues to raise NZ$35m, to which the Group did not subscribe. This diluted our shareholding from 24.5% to 21.7% but also crystallised an accounting gain of £2.3m due to the deemed disposal of shares.

In addition, The Private Health Partnership (PHP) (specialising in private medical insurance and medical support) was sold during the year for a profit of £2.2m.

Excluding the profit arising from the share issues by Wynyard in early 2014 and the disposal of PHP, the division recorded a PBT of £0.7m, £5.0m better than the prior year after excluding the profit on flotation of Wynyard in 2013. This was due to improvements in both Skipton Business Finance and Jade's underlying performance. However, this was countered by the Group's share of Wynyard's trading losses.

Inter-divisional adjustments

Inter-divisional adjustments relate primarily to the elimination of intra-divisional trading and the costs of the management incentive scheme for the senior managers at Connells Limited.

In 2012 and 2014, senior managers of Connells purchased equity shares in that company, and at the same time the Group issued options to these shareholders to require SGHL to purchase their shareholdings in Connells at some future dates. The maximum option length within the scheme is 10 years from 31 December 2014, and the fair value of the liability is being spread over the vesting period to the assumed dates of exercise. During the year the Group recognised a charge in respect of the management incentive scheme of £5.4m (2013: £7.7m).

In 2013, the inter-divisional adjustments also included a £16.2m charge for impairment against the carrying value of consolidated goodwill held against businesses within the Estate Agency, Financial Advice, Investment Portfolio and Mortgage Services divisions, following an assessment of the recoverable amounts of the subsidiaries in question. The carrying values of our remaining subsidiaries have again been reviewed during 2014, and a further £3.3m was provided against the consolidated goodwill held against the Financial Advice division; otherwise it has been assessed that no further provision against consolidated goodwill is required.

Principal risks and uncertainties

As a result of its normal business activities, the Group is exposed to a variety of risks, the most significant of which are conduct and operational risk, credit risk, market risk and liquidity risk. The Group has established a number of committees and policies to manage these risks. These principal risks and uncertainties are set out in the Risk Management Report on pages 49 to 55 and in notes 35 to 37 to the accounts.

The risk management objectives and policies of the Group are also shown in the Risk Management Report.

This Strategic Report was approved by the Board of Directors on 24 February 2015 and signed on behalf of the Board by:

D J Cutter
Group Chief Executive

B Ndawula
Group Finance Director

“Our customer strategy is to put the customer at the heart of our business, providing a compelling and differentiated proposition that resonates with our customers and makes them want to become and remain Skipton members.”


A significant achievement saw Skipton ranked 13th place out of 263 UK brands in the annual Nunwood Customer Experience survey.

Corporate Responsibility Report

Introduction

Corporate Responsibility is fundamental to our vision of 'Building a better Society' and is all about making sure that we carry out business in a sustainable way with mutual benefit for both business and society. As a mutual building society, that has always been at the heart of what we do. We believe that we have an opportunity to make a positive difference to our customers, our people and our communities and we are committed to making the most of those opportunities.

Customers

Our customers are at the heart of everything we do and providing them with great products and service is our opportunity to make a difference every day.

Listening to customers

- **Surveys**: An important part of making sure our customers are at the heart of everything we do is getting feedback from them. The Society uses external third parties to carry out detailed customer satisfaction measurement for our branch network, our website and our contact centre (Skipton Direct). That detailed feedback is shared with our teams and helped us improve satisfaction to 88% (2013: 85%) of those responding.

  A significant achievement saw Skipton ranked 13th place out of 263 UK brands, and across many different industries, in the annual Nunwood Customer Experience Excellence survey. This represented an improvement of 23 places from the 36th position achieved in 2013 and made Skipton the third best placed Financial Services organisation.

- **Customer Panels**: The Society has also been using customer panels to get detailed feedback on specific things throughout the year. Some of that has involved online feedback from over 4,000 customers who have signed up to get involved in online surveys. The Society also carries out face-to-face customer forums at intervals throughout the year, which around 35 customers have taken part in.

Award-winning products

In October 2014, the Society was successfully re-accredited by Customer First, an external independent organisation which assesses against 30 indicators relating to customer relationships, market awareness and people.

Best provider awards

- Best Junior / Children's Savings Provider – Personal Finance Awards 2014/15
- Best National Building Society – What Mortgage? Awards 2014
- Best Lender for Discount Mortgages award – Moneywise Mortgage Awards 2014
- Best Service from a Buy-To-Let Provider – Business Moneyfacts Awards 2014

People

Our people have so many opportunities to make a difference and contribute to society. Making the most of those opportunities is all about enhancing their skills to deliver for customers, creating the right environment and appropriate culture in which they can perform at their best and giving them opportunities to get involved and make a difference to communities that are important to them.

Developing our people

- The Modern Leaders Programme is into its third year of roll-out in 2015. The programme equips managers with the skills required to coach and develop their teams in order to perform well and provide the best possible service to our customers. All our leaders have completed or will be participating in the programme which, together with other development programmes, has contributed significantly to increasing employee engagement.
- All the Society's customer-facing employees have completed three days training in service excellence in the past year, equipping them with the skills to really understand our customers' needs and get to know them in a personal and human way.
- Our Aspiring Leaders talent development programme is in its third year. It develops up and coming talented individuals over the course of 12 months. This year they have been tasked with developing and promoting employee volunteering.

Volunteering

- We encourage our people to share their skills, experience and some of their time through volunteering. In 2014, we launched a formal volunteering policy which supports our people to spend up to two days a year within communities to make a difference. Our 'Aspiring Leaders' have been working on how to encourage more volunteering as part of their development programme so that we can encourage more people to make even more of a difference.

External Feedback

- **Investors in People**: In 2014, the Society achieved the prestigious Investors in People Gold award. This national standard assesses all elements of business improvement through people management, including strategy, learning and development, leadership, reward and recognition and continuous improvement. It is designed for organisations to benchmark themselves against standards of excellence. The assessment consists of an independent review of documentation and a series of confidential interviews with colleagues from across the Society. Three years ago, we attained the standard accreditation and have since made significant progress in our approach to people management and culture, achieving the Gold award.
- **Best Companies**: Getting feedback is central to improving our culture and we therefore entered the Sunday Times 'Top 100 companies to work for' survey in both 2013 and 2014. The feedback has helped us to prioritise and improve and we are delighted to have been successful in achieving top 100 status for the first time in 2014.

Employee Engagement

- We know how important our culture is and what a difference that makes to our people and our customers. Employee engagement measures how loyal, passionate and committed people feel. Engaged employees perform better, go the extra mile and provide better service for our customers. The Society carries out annual surveys to get feedback from our people on how they feel about the Society. The survey feedback has helped us to improve every year and in 2014 we reached the level of high performing organisations, increasing by 5% to 88% of those responding. Over 88% of the Society's employees completed the annual survey in 2014.

In 2014, the Society achieved the prestigious Investors in People Gold award.

Communities

As the UK's fourth largest Building Society with a national presence through our branch network, we are connected to a lot of communities. In 2014 we took a decision to join Business in the Community to support us in making the most of our efforts to make a positive difference and build on what we already do. Business in the Community (BITC) is an external organisation which supports businesses in every sector across the UK to make a positive difference in the way they do business. They have supported the Society by sharing best practice and helping us to develop action plans.

Supporting Charities

- The Skipton Building Society Charitable Foundation was established in 2000 and in 2014 the Foundation gave £122,000 to 79 charities ranging from out of school groups to community projects and care groups.
- Our people also get involved in raising funds for charities through various creative activities and overall have raised around £30,000 for local charities.

Supporting Communities

- Our support of charities is complemented with our support for other community projects through our award winning Grassroots Giving programme. Grassroots Giving was launched in 2013 to celebrate the Society's 160th anniversary. It was designed to reflect our mutual roots and established to help people and communities to help themselves. In 2014 we gave away £500 to 161 community projects ranging from sporting groups to choirs and nature reserves across the country. We love the way it connects us to our communities – we received 320 applications and over 27,000 people voted.

Kaye Bartle, Fundraising Manager
from Pendleside Hospice said:

“We are absolutely delighted by the support of the staff of Skipton Building Society and Skipton Financial Services and thank them for their efforts; not only in taking part in a 10k race but for raising such a fantastic amount of money for Pendleside Hospice. Their efforts will help us to improve the quality of life for people diagnosed with a life limiting illness and to support them and their family through a difficult time.”

Following a donation for over £1500,
Stewart Lythe from the Royal British Legion said:

“Wow, I'm speechless....and staggered by the generosity of your colleagues.”

Andrew Hartley
from Lancaster Bulldogs said:

“The Lancaster Bulldogs have been able to use the money that Skipton Building Society kindly raised to help purchase a new basketball wheelchair for one of our disabled members. The chair will enable the player to enjoy and take part in a disabled sport that is designed for that player.”

One of the winning groups of our Grassroots Giving programme, Nelly's Craft Group.

We get involved in our local communities in many different ways. Some examples are:

- **The Great Yorkshire Show**: The Great Yorkshire Show is England's premier agricultural event which takes place in July every year, attracting around 135,000 people over the three day event. Skipton has been delighted to support the Skipton Building Society Fashion Pavilion for nearly a decade where the best of Yorkshire's fashion and design talent can showcase their work on the catwalk. In 2014 Skipton also occupied a second building at the Great Yorkshire Show enabling visitors to come and talk to us – and hundreds of people did come and discuss their retirement plans.
- **The Skipton Building Society Camerata**: The Skipton Building Society Camerata was formed in 2004 with the aim of bringing high-quality, accessible, classical music to new audiences in North Yorkshire and beyond. The orchestra's cutting edge approach has been recognised with several awards for excellence in performance and audience development. This diversity is made possible due to Skipton Building Society's financial support.
- **Craven Citizens Advice Bureau**: As a responsible lender and a member of the local business community, Skipton recognises that the current economic environment is a difficult one for individuals and organisations alike, and is therefore proud to support organisations offering money advice through an annual financial donation. The Craven Citizens Advice Bureau (CAB) helps people in Skipton, Settle, Bentham, Ingleton and the surrounding areas, to resolve issues via free, independent and confidential advice.
- **Craven Volunteer Centre**: Craven Volunteer Centre is a registered charity based in Skipton. It links would-be volunteers with good causes in the Craven area which could benefit from a share of their valued time.

Environment

We continue to focus on minimising our impact on the environment by ensuring our carbon footprint is as low as possible. We remain committed to the Government's Carbon Reduction Commitment Scheme which requires us to purchase allowances for every ton of energy related CO_2 we emit.

To aid this, during our branch refurbishments we have, wherever possible, incorporated energy efficient technologies into our procurement decisions. This includes the installation of new, efficient air conditioners (providing both heat and cooling) and LED lighting. We have also upgraded our Head Office building in Skipton with new, energy efficient boilers and IT equipment. We harvest rainwater for use in our Head Office building and have selected a renewable energy electricity supplier. All this is supported by colleague engagement around education, understanding and avoidance, for example by 'switch off the lights' and 'think before you print' campaigns.

We have an active recycling and waste management policy, encouraging colleagues to recycle at source by providing appropriate recycling facilities with different bins for different waste. In addition, a major factor in selecting waste suppliers is the level of recycling they carry out.

We are fully supportive of Skipton town's ambition to achieve Fairtrade status and select, wherever feasible, Fairtrade goods for use in our Head Office restaurant, the Café Society. Environmental considerations form part of our procurement approach where applicable.

We seek to reduce our travel impact on the environment by sourcing low carbon emission company vehicles and support alternative travel options for colleagues, such as our Cycle to Work and Rail Season Ticket schemes.

The Board of Directors

David Cutter, 53

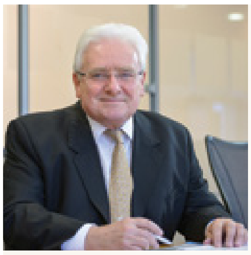
Joined Board 2000

Responsibilities: Group Chief Executive, Chairman of the Executive and Retail Credit Committees and member of the Asset & Liability Committee.

Previous experience: A chartered accountant, joined the Society as Head of Internal Audit.

Other roles: Chairman of the Building Societies Association and Trustee of the Craven Educational Trust.

What I bring to the Board: Over 20 years' experience working in many areas of the business, including periods as Operations Director and Group Corporate Development Director.



Mike Ellis, 63

Joined Board 2011

Responsibilities: Chairman of the Board and Nominations Committee.

Previous experience: Held various senior executive positions with Halifax Building Society and its successor Halifax plc. Board member of Halifax plc 1997-2001 and HBOS plc, where he was Group Finance Director 2001-4 and 2008-9.

Other directorships: M H Ellis Consulting Limited and Leeds Theatre Trust Limited.

What I bring to the Board: Over 25 years' experience in financial services.

Cheryl Black, 56

Joined Board 2013

Responsibilities: Member of Audit, Remuneration and Nominations Committees.

Previous experience: Senior customer service and operations roles at Orange and NTL, member of Scottish Water Board 2002-6, Customer Service Director for Telefonica 0_2 2006-11.

Other major directorships: Non-Executive Director at Unum Limited and Director of Telefonica UK Pension Trustee Limited.

What I bring to the Board: I'm passionate about using great customer service as a route to business success.

Marisa Cassoni, 63

Joined Board 2012

Responsibilities: Chairman of Audit Committee and member of Nominations Committee.

Previous experience: Group Finance Director of John Lewis Partnership; and previously at Royal Mail, Britannic Assurance and the Prudential.

Other major directorships: Non-Executive Director of GFI Group Inc, the FTSE All-Share listed AO World plc and the AIM listed The People's Operator plc.

What I bring to the Board: Chartered accountant with 40 years' experience as a financial professional and 20 as a Board director across various customer-facing industries including financial services.

Ian Cornelius, 46

Joined Board 2012

Responsibilities: Commercial Director, member of the Executive Committee and Chairman of the Skipton International Limited Board.

Previous experience: Commercial Director of Homeloan Management Limited, senior roles at Virgin Money, Bradford & Bingley, Capital One and Boots.

What I bring to the Board: A strong and clear focus on customers. Ensuring that we continually improve our products and services.

Robert East, 54

Joined Board 2011

Responsibilities: Chairman of the Risk Committee and member of the Nominations Committee.

Previous experience: Senior roles in retail and commercial banking with Barclays PLC.

Other major directorships: Chief Executive of Cattles Limited and Non-Executive Director of Hampshire Trust PLC.

What I bring to the Board: Extensive experience in, and understanding of, retail and commercial banking in the UK and internationally over 35 years.

Peter Hales, 68

Joined Board 2007

Responsibilities: Member of the Risk and Nominations Committee.

Previous experience: Sales and Marketing Director of Norwich Union, Director of General Accident and CGU.

Other directorships: Chairman of Sandringham Financial Partners Limited, Trustee of Chartered Insurance Institute Pensions Scheme and Clear View Assured Limited.

What I bring to the Board: Experience of working at a senior level in regulated financial services for over 25 years.

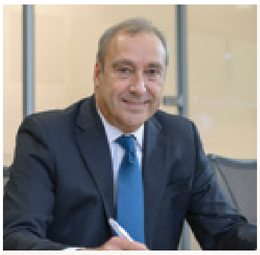
Bobby Ndawula, 41

Joined Board 2015

Responsibilities: Group Finance Director, Chairman of Asset and Liability and Model Governance Committees, member of Executive and Retail Credit Committees and Chairman of our subsidiaries Amber and NYM.

Previous experience: A chartered accountant, joined the Society in 2003 and has held a number of senior positions including General Manager - Group Finance and latterly Chief Financial Risk Officer before appointment as Group Finance Director.

What I bring to the Board: 11 years' experience with the Society, including managing all aspects of financial risk, and a desire to ensure that our customers' financial and service interests are safeguarded.



Graham Picken, 65

Joined Board 2012

Responsibilities: Member of Audit, Risk and Nominations Committees and a Non-Executive Director of Connells Limited.

Previous experience: Senior positions at HSBC, including Executive Chairman of First Direct and Chief Executive of Forward Trust Group; Non-Executive Director then Chief Executive of Derbyshire Building Society, 2005-9.

Other directorships: Chairman of the FTSE listed HICL Infrastructure Company Limited and Non-Executive Chairman of Hampshire Trust PLC.

What I bring to the Board: Wide experience of financial services and business management generally.

Helen Stevenson, 54

Joined Board 2013

Responsibilities: Member of Risk, Remuneration and Nominations Committees.

Previous experience: 19 years with Mars Inc, Group Marketing Director of Lloyds TSB 2003-6, Chief Marketing Officer of Yell Group 2006-11.

Other directorships: Non-Executive Director of St Ives plc, Non-Executive Director of Trinity Mirror Group PLC and member of Henley Business School Advisory Board.

What I bring to the Board: A passion for maintaining a strong connection in the board room between the customer and commercial agendas.

Nimble Thompson, 68

Joined Board 2009

Responsibilities: Deputy Chairman, Chairman of the Remuneration Committee and member of the Audit and Nominations Committees.

Previous experience: Deputy Chairman of Eversheds and Chairman of NG Bailey.

Other directorships: Deputy Chairman of the Institute of Directors, Non-Executive Director of Rushbond PLC, TEP Electrical Distributors Limited and Giggleswick School.

What I bring to the Board: I try to bring a straightforward, common sense approach, backed by a wide business and legal experience.

Directors' Report

The Directors have pleasure in presenting their Annual Report and Accounts for the year ended 31 December 2014.

As set out more fully in the statement of accounting policies in note 1, the Annual Report and Accounts are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The financial information given in this Directors' Report is taken from the statutory accounts prepared on this basis. Further unaudited information which allows comparison between 2014 and 2013 is set out in the Strategic Report.

Business objectives

The business objectives of the Group are set out in the Strategic Report on pages 12 to 14.

Business review and future developments

The Chairman's Statement set out on pages 6 to 7, the Group Chief Executive's Report set out on pages 8 to 11 and the Strategic Report set out on pages 12 to 28 report on the performance of the business and its future objectives.

Profits and capital

Profit before tax based on continuing operations for the year ending 31 December 2014 was £156.8m (2013: £102.7m). Total Group profit before tax was £181.6m (2013: £103.6m). Total profit after tax transferred to the general reserve was £146.7m (2013: £77.2m).

Total Group reserves at 31 December 2014 were £1,072.6m (2013: £932.0m) including the available-for-sale reserve of £26.4m (2013: £20.5m) and the cash flow hedging reserve of £(5.3)m (2013: £(11.0)m).

Gross capital at 31 December 2014 was £1,264.2m (2013: £1,153.4m) including £98.0m (2013: £124.4m) of subordinated liabilities and £94.3m (2013: £94.1m) of subscribed capital. The ratio of gross capital as a percentage of shares, deposits and borrowings at 31 December 2014 was 8.95% (2013: 9.02%) and the free capital ratio was 7.38% (2013: 7.14%). The Annual Business Statement on pages 164 to 166 gives an explanation of these ratios.

Mortgage arrears

Group mortgage balances at 31 December 2014 included 272 cases (2013: 363) either in possession or where payments were 12 months or more in arrears. The capital balances of these loans were £44.7m (2013: £70.8m). The total amount of arrears on these loans was £3.4m (2013: £6.0m).

Charitable donations

During the year the Group made charitable donations of £0.2m (2013: £0.2m), primarily through the Skipton Building Society Charitable Foundation. No contributions were made for political purposes (2013: £nil).

Creditor payment policy

The Group's policy concerning the payment of suppliers is to negotiate and agree terms and conditions with all suppliers and upon complete provision of goods and services, unless there is an express provision for stage payments, undertake to pay suppliers within the agreed payment period, usually 30 days. The number of trade creditor days as at 31 December 2014 for the Group was 11 days (2013: 13 days).

Principal risks and uncertainties

The principal risks and uncertainties are set out in the Risk Management Report on pages 49 to 55 and in notes 35 to 37.

The risk management objectives and policies of the Group are also referenced in the Risk Management Report.

Employees

The Group remains committed to its policy of treating all employees and job applicants equally at all times. Our policy is that no employee, or potential employee, is treated less favourably on the grounds of age, race, colour, religion, nationality, ethnic origin, gender, marital status or sexual orientation. We also give all applications from disabled people full consideration in relation to the vacancy concerned and their own aptitudes and abilities. In the event of an existing employee becoming disabled, we make every effort to maintain their present position or to employ them in alternative suitable work.

We also aim to provide high quality relevant training and development opportunities to all employees, which enables them to achieve their full potential and helps the Group meet its corporate objectives.

The Board meets 10 times a year and is briefed regularly on key employee matters as they arise. There is a comprehensive internal communications structure to cascade relevant business information to employees throughout the organisation in an appropriate and timely way. The Society's subsidiary companies have similar arrangements in place to ensure that their employees are effectively managed.

The Society and certain Group companies recognise an independent employee trade union (Aegis), with which management meets regularly to consult and negotiate on a wide variety of matters and to which employees may make their views known on issues affecting their interests.

Property, plant and equipment

The Directors consider that the overall market value of the Group's freehold and leasehold properties, excluding the principal office of the Society, is in excess of the book value. In arriving at this view, the Directors have taken account of internal and external valuations of the Group's property portfolio. It is difficult to ascertain a reliable market value for the principal office of the Society, which is a special purpose facility; however the Board considers that its value in use to the Group is greater than its book value.

Directors' responsibilities in respect of the preparation of the Annual Accounts

This statement, which should be read in conjunction with the Independent Auditor's Report on pages 66 to 68, is made by the Directors to explain their responsibilities in relation to the preparation of the Annual Report and Accounts.

The Directors are responsible for preparing the Annual Report, Annual Business Statement, Directors' Report and the Annual Accounts in accordance with applicable laws and regulations.

The Building Societies Act 1986 (the Act) requires the Directors to prepare Group and Society annual accounts for each financial year. Under that law they are required to prepare the Group Annual Accounts in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the Society Annual Accounts on the same basis.

The Group and Society Annual Accounts are required by law and IFRSs as adopted by the EU to present fairly the financial position and the performance of the Group and the Society; the Building Societies Act 1986 states that references to IFRS accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing these Annual Accounts, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the Annual Accounts on the going concern basis unless it is inappropriate to presume that the Group and Society will continue in business.

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

The Directors are also required by the Disclosure and Transparency Rules of the Financial Conduct Authority to include a management report containing a fair review of the business – this is set out in the Strategic Report on pages 12 to 28, and a description of the principal risks and uncertainties facing the Group, which are set out in the Risk Management Report on pages 49 to 55.

The Directors have decided to prepare voluntarily a Report on Corporate Governance as if the Society were required to comply with the Listing Rules and the Disclosure and Transparency Rules of the Financial Conduct Authority in relation to those matters.

A copy of these Annual Accounts is placed on the Society's website. Information in respect of the Capital Requirements (Country-by-Country Reporting) Regulations 2013 is included as an annex to these Annual Accounts on page 163.

Directors' responsibilities for accounting records and internal controls

The Directors are responsible for ensuring that the Group:

- keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society, in accordance with the Act; 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 Conduct Authority and Prudential Regulation Authority under the Financial Services and Markets Act 2000.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Society's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' responsibilities in respect of going concern

The Group's business activities together with its financial position, capital resources and the factors likely to affect its future development and performance are set out in the Strategic Report on pages 12 to 28 and the Risk Management Report on pages 49 to 55. In addition, notes 34 to 37 of the Annual Accounts include the Group's objectives, policies and processes for managing its liquidity risk, details of financial instruments and hedging activities, and its exposure to credit risk and liquidity risk.

In common with many financial institutions, 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 forecasts and objectives, which take into account potential changes in trading performance and funding retention, indicate that the Group should be able to operate at adequate levels of both liquidity and capital for the foreseeable future.

Consequently, after reviewing the Group's forecasts and the risks it faces, the Directors are satisfied that there are no material uncertainties that may cast significant doubt about the Group's ability to continue as a going concern for the foreseeable future and have, therefore, continued to adopt the going concern basis in preparing the Annual Accounts.

Directors

The Directors of the Society during the year were as follows:

Mr M H Ellis	(Chairman)
Mr P J S Thompson	(Deputy Chairman)
Mrs C Black	
Ms M Cassoni	
Mr I M Cornelius*	
Mr D J Cutter*	(Group Chief Executive)
Mr R D East	
Mr M R Fleet*	(resigned 31 December 2014)
Mr P R Hales	
Mr G E Picken	
Ms H C Stevenson	
Mr R J Twigg*	(resigned 7 April 2014)

* Executive Directors

Mr B Ndawula was appointed as a Director on 23 February 2015 and will stand for election to the Board at the AGM in April 2015.

Details of Directors' service contracts are disclosed in the Directors' Remuneration Report.

No Director of the Society had any interest in the shares of any Group undertaking at 31 December 2014.

Auditor

Our external auditor, KPMG Audit Plc, has instigated an orderly wind down of business. The Board has decided to put KPMG LLP forward to be appointed as auditor and, in accordance with Section 77 of the Building Societies Act 1986, a resolution concerning their appointment will be put to the forthcoming Annual General Meeting of the Society.

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Society's auditor is unaware; and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Society's auditor is aware of that information.

Responsibility statement of the Directors in respect of the Annual Report and Accounts

The Directors who held office at the date of approval of this Directors' report confirm that to the best of their knowledge:

- the Annual Accounts, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Society; and
- the Strategic Report 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.

We consider the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for members to assess the Group's and Society's position and performance, business model and strategy.

Signed on behalf of the Board

M H Ellis
Chairman

24 February 2015

Directors' Report on Corporate Governance

The Board believes that good governance is at the heart of a well-run business and is committed to complying with best practice in this area. This report sets out the framework of how the Society operates and conducts its business in a prudent and well organised manner, thereby maintaining high standards of governance for the benefit of its current and future members.

Our approach is based on the principles and provisions of the UK Corporate Governance Code (the Code) published by the Financial Reporting Council (FRC) which applies to listed companies, to the extent that they are relevant to a building society. This report benchmarks the Society against the prevailing version of the Code applicable to firms with accounting periods commencing on or after 1 October 2012. Revisions to the Code were issued in September 2014 for firms with accounting periods commencing on or after 1 October 2014 which we will report upon in respect of the 2015 year end. A copy of the Code is available at www.frc.org.uk.

The Board's philosophy is to comply with the Code, and the guidance issued by the Building Societies Association on it to the extent that they are relevant to a building society. Section E of the Code requires the Chairman to discuss governance matters with major shareholders and relay their views to the Board as a whole. As a mutual organisation owned by its members with each voting member having one vote, this specific requirement is not relevant to the Society.

During 2014 the Board believes that the Society complied with the guidance issued by the Building Societies Association on the Code.

Governance framework

The Group comprises Skipton Building Society (the Society) and its direct and indirect holdings in numerous legal entities, many of which are regulated by the Financial Conduct Authority (FCA).

The Society's governance arrangements are designed to ensure that it meets the requirements and expectations of its customers, employees and regulators through a framework which organises the Group into four divisions:

- Mortgages and Savings
- Estate Agency
- Financial Advice
- Investment Portfolio

Until November 2014 the Society had five divisions but the sale of Homeloan Management Limited, our mortgage administration business, saw this reduce to four.

The Society sits within the Mortgages and Savings division which also includes related subsidiaries, Amber Homeloans, North Yorkshire Mortgages and Skipton International Limited, our Guernsey-based banking subsidiary.

On a day-to-day basis the Group Chief Executive, Mr Cutter, is responsible for ensuring that the Group meets its strategic and operational objectives as defined in the corporate plan. Mr Cutter is assisted by the Executive Committee which comprises the Executive Directors and other senior Society Executives, and which he chairs.

Each principal subsidiary of the Group is governed by a board which normally contains at least two Society Executives as shareholder Directors (appointed by the Society) and the business' own executive management. In addition, independent Non-Executive Directors also sit on the boards of some subsidiaries. Mr Picken, a Society Non-Executive Director is also a director of Connells Limited and it is proposed that Mr Hales will join the board of Skipton Financial Services Limited as a Director in 2015, subject to regulatory approval. These Boards are responsible for the prudent management of the business, within delegated authorities, to meet the strategic and operational objectives as defined in the corporate plan.

The Board's 'Principles of Governance', which are summarised below, provide the framework through which the Society establishes its systems and processes concerned with the overall direction, effectiveness, supervision and control of the Group.

Directors

The role of the Board

The Board's terms of reference clearly set out its responsibility for the overall stewardship of the Group within the context of the Society's 'Principles of Governance' which are:

- **Governing body** – *The Society is headed by an effective Board which is collectively responsible for the long term success of the Group.*

  The Board formulates strategy and establishes the Society's risk appetite and balance sheet strategy. It is organised to have a proper understanding of, and competence to deal with, the current and emerging issues facing the business of the Group, exercising independent judgement and effectively reviewing and challenging the performance of management.

- **Management and oversight** – *The Society's management and oversight framework enables the Board to provide strategic guidance for, and effective oversight of, management throughout the Group.*

  The governance framework clarifies the respective roles and responsibilities of Directors and Senior Executives in order to facilitate Board and management accountability to both the Society and its members and ensures a balance of authority such that no single individual has unfettered powers. It has clear, risk-based, lines of sight into activities to support challenge and oversight, enabling the Board to obtain assurance over the integrity of reporting and the adequacy of the control framework and effectiveness of control implementation.

- **Recognise and manage risk** – *The Board has a sound system of risk oversight, risk management and internal control.*

  This framework identifies, assesses, manages and monitors risk. It informs Senior Executives and the Board of material changes to the risk profile of the Society or any of its divisions and facilitates challenge of the effectiveness of actions taken to mitigate risk. It is designed to be forward looking in approach so as to reduce both the likelihood and the impact of risks crystallising.

The Board has established a framework of authorities which maps out the structure of high level delegation below Board level and specifies those issues which remain the responsibility of the Board. The Board also has a general duty to ensure that the Group operates within the Society's Rules, relevant laws, regulations and guidance issued by relevant regulatory authorities and that proper accounting records and effective systems of internal control are established, maintained and audited.

The Board has agreed a formal schedule of matters which are reserved to it, and has also delegated authority in other matters to a number of Board Committees, as described below. The Board has set clear terms of reference for each of these Committees, and has established an organisational structure with clearly defined and documented delegated authority to Executive management, together with reporting systems for financial results, risk exposure and control assessment.

Board meetings

The Board meets at least 10 times per year and the Non-Executive Directors also meet, without Executive Directors present, at least once a year. The attendance record of each director at these meetings and each Committee member at relevant Board Committee meetings is set out on page 43.

The Board also holds two strategy meetings each year, in June and December, where the Society's strategic objectives are agreed as are the financial and operational resources to deliver these.

At each Board meeting, the Board receives a comprehensive management information pack covering financial and non-financial information (including operational, customer service and people metrics), with risk being an integral part of the information pack. The relevant Executive Director or General Manager highlights appropriate matters including the performance of particular aspects of the business against targets.

The Board agenda also includes the following:

- Minutes of Board Committee meetings held since the previous Board meeting and verbal updates from the chairmen of Board Committees on the main issues discussed and matters agreed. This ensures that all Board members are aware of the key discussions and decisions made by the Committees;
- Reports from both the Chairman and Group Chief Executive;
- Items for decision and key matters which need to be debated, including any new business initiatives;
- Matters for review which includes updates on specific areas of strategy allowing the Board to keep up to date with developments and challenge progress; and
- Matters for information aimed at drawing to the Board's attention matters it should be aware of such as proposed regulatory change.

For the Board to be effective, the relationship between the Executive and Non-Executive Directors must be constructive and one of openness and respect. The Boardroom environment at Skipton is collegiate with all encouraged to contribute. The role of the Non-Executive Directors is not only to challenge but to support the Executive team and bring their experience to bear. To this end, the Non-Executive Directors are welcomed to meetings outside of the Committee structure which develops their understanding of the business while allowing the management teams to benefit from their experience and fully understand the non-executive perspective on particular issues.

Board composition

The Society's Rules detail the appointment process for Directors and require that the Board comprises not less than six and not more than 15 Directors. At the date of this report the Board comprised 11 Directors; being three Executive Directors and eight independent Non-Executive Directors. Details of the Directors are set out on pages 34 to 35. This composition is designed to be able to meet the needs of the business and allow for efficient operation of the Board's Committees.

The Board considers all the Non-Executive Directors to have been independent at the time of their appointment and to have continued to be so in accordance with the criteria set out in the Code. None have previously been employed by the Group, have no direct business relations with the Society or any of its subsidiaries and have no personal or family ties with any of the businesses' advisers, Directors or senior employees.

The Chairman regularly reviews the size and composition of the Board and its Committees and these are reviewed formally by the Nominations Committee at least annually. This ensures that there exists the required mix of skills and experience on the Board and that succession planning is adequately addressed. The Board formally agreed its approach to this by approving a Board Composition Policy at its July meeting, a copy of which is available on our website. The Nominations Committee aims to ensure that the Board Committees are optimally resourced and are refreshed at appropriate intervals to reduce reliance on any one individual.

Non-Executive Directors

As part of their Board responsibilities, the Non-Executive Directors are responsible for bringing independent judgement to the Board, and for constructively challenging the Executive team. The Non-Executive Directors meet, without the Executive Directors present, at least annually to discuss relevant matters including succession planning and the overall performance of the Executive team.

The Board has appointed Mr Thompson (Deputy Chairman) as the Senior Independent Director. Whilst the Senior Independent Director role is more pertinent within a quoted company, the role does provide a point of contact for members and other stakeholders with concerns which have failed to be resolved or would not be appropriate to pursue through the normal channels of the Chairman, Group Chief Executive or Group Finance Director. The Senior Independent Director also provides a sounding board for the Chairman and serves as a trusted intermediary for other members of the Board, if necessary, and meets with the other Non-Executive Directors, without the Chairman present, at least annually, in order to appraise the performance of the Chairman.

One of the criteria which the Board takes into consideration when recruiting a Non-Executive Director is his or her ability to have sufficient time to take on the position. In addition, throughout their term of office with the Society, Directors are required to inform the Board in advance of any other positions that they wish to take up so that the time commitment and any potential conflict of interest can be considered. The Society's letters of appointment to Non-Executive Directors give an indication of the time commitment required, although this will depend on Board Committee memberships; typically it involves at least two to three days per month on Society business. For the Chairman this will usually involve an average of two days per week. The letters of appointment also identify the key responsibilities of the Non-Executive Directors in relation to:

i) Strategy – constructive challenge and contribution to the development of strategy.
ii) Performance – scrutiny of the performance of management in meeting agreed business goals and objectives.
iii) Risk – obtaining assurance that financial controls and systems of risk management are robust and allow for production of accurate financial reporting.
iv) People – determination of appropriate levels of remuneration for Executive Directors and oversight of succession planning.

Copies of the letters of appointment of each of the Non-Executive Directors are available for inspection on request from the Group Secretary.

Chairman and Group Chief Executive

The offices of the Chairman and Group Chief Executive are distinct and are held by different individuals. The role of each is set out in their role profiles and terms of appointment.

The Chairman is responsible for leading the Board and for ensuring the Board acts effectively, promoting high standards of corporate governance. The Chairman is also responsible for communicating with the Society's members on behalf of the Board. He is independent and has no conflicting relationships or circumstances that might affect his judgement.

The Group Chief Executive has overall responsibility for managing the Society and the subsidiaries. He leads the Executive team and is responsible for implementing the strategies and policies agreed by the Board.

The Board elects its Chairman and Deputy Chairman annually at the Board meeting immediately following the Annual General Meeting (AGM).

Appointments to the Board

The Nominations Committee, which comprises all the Society's Non-Executive Directors and is chaired by the Society Chairman, leads the process for Board appointments and succession planning. The Committee, at least annually, reviews the structure, size and composition (including diversity) of the Board to ensure it contains the required balance of skills, knowledge and experience relevant to the activities of the Group.

The Nominations Committee also carries out an annual review of succession planning for Non-Executive Directors. The succession plan ensures ongoing recruitment of Non-Executives to ensure that the Board continues to have the relevant skills and experience throughout any period of change in its composition.

During 2014, recruitment commenced for the replacement of Mr Twigg, Group Finance Director following his move to become Finance & Commercial Director at one of our principal subsidiaries, Connells Limited. Following a recommendation by the Nominations Committee the Board unanimously agreed that Mr Ndawula would be appointed as Group Finance Director, with effect from 23 February 2015. Mr Ndawula, a chartered accountant, joined the Society in 2003 and has held a number of senior positions including General Manager, Group Finance and latterly Chief Financial Risk Officer before his appointment as Group Finance Director.

Induction and professional development

On appointment, new directors receive a comprehensive and tailored induction programme on the Group's business and regulatory environment. Ongoing training and development needs are identified and addressed through regular review and usually take the form of attendance at external seminars and Board training sessions led by relevant internal and external specialists. Non-Executive Directors are encouraged to contact individual members of the Executive team to discuss any queries they may have and to undertake subsidiary, branch and department visits on an ad hoc basis.

Through the Secretary, the Chairman ensures that Directors receive accurate, timely and clear information to facilitate effective contribution to Board discussions and decision making. As noted previously, Directors are provided with a comprehensive management information pack and Board pack containing matters for review and approval. This is normally issued six days before the meeting to ensure that it reflects the most up-to-date position of the Group while allowing Directors sufficient time to review the content.

Directors have access to the advice and services of the Secretary who is responsible for advising the Board on all governance matters and who is responsible for ensuring that Board procedures are followed. The appointment of the Secretary is a matter reserved to the Board.

All Directors also have access to independent professional advice, if required, at the Society's expense and have the benefit of appropriate liability insurance cover.

Board diversity

The Board considers all aspects of diversity, including gender, when reviewing its composition. At its July 2014 meeting it formalised its Composition Policy which saw the Board agree to adopt the recommendations of the Davies Report and endeavour to maintain each of male and female representation at Board level of, at least, 25% of its composition. This, however, is based on the principle that all appointments shall be made on merit.

At 31 December 2014, three members (27%) of the Board and 20 members (45%) of the Society's Senior Leadership Team were female.

The Society takes into account diversity at all levels of recruitment and supports staff to take on various external interests, including voluntary roles such as school governorships and roles in other local voluntary organisations, to enable them to gain experience of Board roles.

Performance evaluation

The Board undertakes an annual evaluation of its performance and effectiveness and of its Committees; the performance of individual Directors is also reviewed annually. At least every three years, this review is conducted by an external facilitator. The reviews address matters including the balance of skills on the Board, its diversity, how the Board and its Committees work together and other factors relevant to its effectiveness.

In late 2013, the Board engaged Genius Methods, which has no other connection with the Society, to undertake an external performance evaluation of the Board and its Committees; the results were reviewed and discussed by the Board at its February 2014 meeting and reported upon in last year's report.

The Chairman, with the support of the Secretary, led an internal Board evaluation for 2014. This took the form of a questionnaire completed by all Directors and Board attendees covering areas such as the Boardroom environment, Board reporting and meeting of Board responsibilities. A similar process was completed for the Board Audit, Risk, Nominations and Remuneration Committees. The Chairman met individually with all directors and then presented a report with the conclusions of the exercise to the February 2015 Board. The report concluded that the Board and its Committees were effective and identified areas for development including information technology and the threat of cyber risk, communications with the broader executive and key subsidiaries and changes in subsidiary reporting and interactions with the Board and its Committees.

Individual Non-Executive Directors are evaluated on a one-to-one basis by the Chairman. Executive Directors are evaluated by the Group Chief Executive against agreed performance targets for their areas of responsibility and their own personal performance. The Chairman evaluates the Group Chief Executive's performance while the Deputy Chairman and Senior Independent Director leads the Board evaluation of the Chairman's performance, which also takes into account the views of Executive Directors.

Re-election policy

The Code recommends that all Directors of FTSE 350 Companies should stand for annual re-election. In light of this, the Society's Rules were amended to require that Directors stand for re-election every year. Generally, Non-Executive Directors are not expected to serve more than six years, although this may be extended to nine years in total.

Remuneration

Details relating to Directors' remuneration are contained in the Directors' Remuneration Report set out on pages 56 to 65.

Accountability and audit

Financial reporting

The Directors, after making appropriate enquiries, and on review of internal management reports and completion of the external audit, consider that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, and provide the information necessary for members to assess the Group's performance, business model and strategy. Further details on how this conclusion has been arrived at can be found on page 46 in the Audit Committee Report.

The responsibilities of the Directors in relation to the preparation of the Society's Annual Accounts and a statement that the Society is a going concern are contained in the Statement of Directors' Responsibilities set out on pages 36 to 38.

Risk management and internal control

The Board is responsible for determining the Society's strategy for managing risk and overseeing its systems of internal control which includes reviewing and approving its risk appetite on, at least, an annual basis.

The Executive Directors and senior management are responsible for the operation of an effective Risk Management Framework based on a robust system of internal control. Such systems are designed to manage rather than eliminate the risk of failure to achieve the Society's business objectives. The principal categories of risk confronting the Group are described in greater detail in the Risk Management Report on pages 49 to 55, together with an explanation of the framework adopted by the Group for managing risk.

The Board reviews the effectiveness of the systems of internal control through a combination of processes including:

- Regular reports to the Board by the chairmen of the various Board Committees (see below);
- Presentations to the Board by divisional leaders relating to the strategy and performance of business within each of the divisions, summarising business performance, key business risks, issues and strategies;
- Regular reports to the Board, through the Audit Committee, from the Internal Audit function in respect of their independent audits of risk management processes and effectiveness of internal controls across the Society and its subsidiaries. The Chief Internal Auditor has direct

access to the Chairman of the Audit Committee;

- Regular reports to the Board, through the Board Risk Committee, from the Risk functions on the principal conduct, operational, credit, market, business and regulatory risks facing the Group and the strength of the controls in place to mitigate such risks; and
- Reports to the Board on a quarterly basis presented by the Chief Conduct Risk Officer and the Chief Financial Risk Officer.

The Society has a comprehensive system for reporting financial results to the Board. Each of the divisions prepares monthly results with comparisons against budget. The Board reviews these for the Group as a whole and challenges management, as appropriate, where performance is not in line with expectations.

The Society has a number of central oversight and control functions including Finance, Risk and Compliance that establish and monitor the implementation of business standards across the Group. Each of these functions is subject to review by the Internal Audit function.

The Internal Audit function is responsible for independently reviewing and reporting on the adequacy and effectiveness of internal controls operated by management throughout the Group, thereby helping to evaluate and improve the effectiveness of risk management, regulatory compliance, control and governance processes. Through its programme of work, agreed by the Audit Committee, the Internal Audit function is able to provide assurance on control effectiveness.

The Board is satisfied that during 2014 the Society maintained an adequate system of internal control that met the requirements of the UK Code and good business practice, generally.

Board Committees

The Board has delegated certain matters to Board Committees in order that they can be considered in more detail.

The Committees are:

- The **Audit Committee** – details are contained in the Audit Committee Report on pages 45 to 48.
- The **Board Risk Committee** – details are contained in the Risk Management Report on pages 49 to 55.
- The **Remuneration Committee** and **Non-Executive Directors Remuneration Committee** – details are contained in the Directors' Remuneration Report on pages 56 to 65.
- The **Nominations Committee** – details are contained in the section on 'Appointments to the Board' on page 41 of this report.

The terms of reference of Board Committees are available on the Society's website (www.skipton.co.uk) or from the Secretary, on request.

Board and Committee membership attendance record

The attendance of Directors at scheduled Board meetings and attendance of those who are also members of the Audit Committee, Nominations Committee, Remuneration Committee and Risk Committee, at Committee meetings during the year is set out below:

	Board	Audit Committee	Nominations Committee	Remuneration Committee	Board Risk Committee
Mr M H Ellis	10/10	-	2/2	-	-
Mr P J S Thompson	10/10	7/8	2/2	9/9	-
Mrs C Black	10/10	8/8	2/2	-	-
Ms M Cassoni	10/10	8/8	2/2	-	-
Mr I M Cornelius	10/10	-	-	-	-
Mr D J Cutter	10/10	-	-	-	2/2
Mr R D East	10/10	-	2/2	9/9	6/6
Mr M R Fleet	9/10	-	-	-	-
Mr P R Hales	10/10	-	2/2	-	6/6
Mr G E Picken	10/10	8/8	2/2	-	6/6
Ms H C Stevenson	10/10	-	2/2	9/9	-
Mr R J Twigg	3/3	-	-	-	2/2

The Annual General Meeting (AGM)

Each year the Society gives all eligible members at least 21 days' notice of the AGM. At the meeting, the Chairman and Group Chief Executive address members on the previous year's performance and the main developments in the business. Members have the opportunity to raise questions and put forward their views. All Directors attend the AGM, unless their absence cannot be avoided, and are available for questions both during a 'question and answer' session within the meeting, and on an individual basis before and after the meeting.

All eligible members are encouraged to vote at the AGM, either in person or by voting proxy and the voting form includes a 'vote withheld' option. Members can vote by post, in any of the branches, online at www.skipton.co.uk/agm or at the AGM itself. All votes are returned to independent scrutineers. A poll is called in relation to each resolution at the AGM and the results of the vote are published on the Society's website and in branches.

As a minimum the Society's members at the AGM are asked to vote on the Society's Annual Report and Accounts, election of the Directors, election of the External Auditors and the Report on Directors' Remuneration.

Copies of the full Annual Report and Accounts 2014 are available online at www.skipton.co.uk or on request in branches or by post.

In addition, the Summary Financial Statement is included as part of the AGM magazine, the format of which is aimed at making it informative and easy to read.

Relations with members and other investors

The Society's membership comprises its investors and non-corporate borrowers which is different to the shareholders of a listed company, whose owners may include institutional shareholders. The vast majority of the Society's customers are, therefore, its members and the Society encourages feedback from them on any aspect of the Society's activities and seeks to respond quickly to all enquiries received.

We conduct regular market research with members to evaluate their experience of dealing with the Society and how satisfied they are with their relationship with the Society. In total, we aim to carry out over 20,000 interviews with members each year to help us understand how we can improve the service we provide to them. We also engage with members in numerous other ways, including our Customer Forum. This consists of face-to-face sessions with customers to get their feedback on our strategies and initiatives. Small groups of customers attend each session along with Society representatives. In addition to this, we now have over 4,000 members on our Customer Panel, which we use to gather feedback on a wide range of topics, including new product and proposition development.

Finally, the Society's Executive and Treasury team hold meetings with banks and investors, where appropriate, to update them on the Society's performance and respond to any queries.

On behalf of the Board

M H Ellis
Chairman

24 February 2015

Audit Committee Report

On behalf of the Committee, I am pleased to present this year's Audit Committee Report, which provides an overview of how we, as a Committee, have discharged our responsibilities, setting out the significant issues we have reviewed and concluded on during the year.

The report focuses mainly on the following three areas:

- The role and responsibilities of the Committee;
- The main activities of the Committee during the year; and
- A review of the effectiveness of the Committee

Membership and attendees

The Audit Committee is appointed by the Board and the current members of the Committee are:

Ms Cassoni, Non-Executive Director (Committee Chairman)
Mrs Black, Non-Executive Director
Mr Picken, Non-Executive Director
Mr Thompson, Non-Executive Director

The Committee met eight times during 2014 and the attendance of its members at these meetings is set out on page 43 in the Directors' Report on Corporate Governance. We also held private discussions during the year with the external auditor, KPMG Audit plc ('KPMG'), the Chief Conduct Risk Officer, the Chief Financial Risk Officer and the Chief Internal Auditor, to provide an opportunity for any relevant issues to be raised directly with Committee members.

In addition to its members, the Chairman, Group Chief Executive, Group Finance Director, Chief Conduct Risk Officer and Secretary, Chief Financial Risk Officer, external audit representatives and the Chief Internal Auditor regularly attend meetings, by invitation.

The Board is satisfied that the composition of the Audit Committee contains a Director with relevant, recent financial experience to provide appropriate challenge to management. As Chairman of the Committee, I have held senior finance appointments with a number of large organisations, most recently as Group Finance Director at the John Lewis Group prior to retirement in 2012.

Role and responsibilities of the Committee

The responsibilities of the Committee are delegated by the Board and are set out in its written terms of reference, which are available on our website at www.skipton.co.uk/about-us/governance/board-committees. These are in line with the provisions of the Financial Reporting Council's 'Guidance on Audit Committees' which was last updated in September 2012. Our primary responsibilities are:

- To keep under review the effectiveness of the Society's internal controls, including financial controls and risk management systems;

- To monitor the integrity of the Group's financial reporting process specifically by reviewing, challenging and approving the Group's financial statements, reviewing and approving any formal announcements relating to the Group's financial performance, and reviewing significant reporting judgements and reporting how these were addressed;

- To provide advice, where requested by the Board, on whether the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for members to assess the Group's strategy, business model and performance;

- To provide oversight of the external audit process by monitoring the relationship with the external auditor, agreeing their remuneration and terms of engagement, monitoring their performance, objectivity and independence, ensuring that the policy to provide non-audit services is appropriately applied and making recommendations to the Board on their appointment, re-appointment or removal;

- To review the effectiveness of the Audit Services and Compliance Monitoring functions and review their material findings; and

- To report to the Board how we have discharged our responsibilities.

The minutes of the Audit Committee are distributed to the Board in the month following each meeting and, as Chairman of the Committee, I provide a verbal report to the next Board after each meeting of the Committee.

Activities of the Committee during the year

During 2014 our work fell under three main areas, in line with our responsibilities, as follows:

a) Internal controls and risk

The Group recognises the importance of good systems of internal control in the achievement of its objectives and the safeguarding of its assets. Good internal controls also facilitate the effectiveness and efficiency of operations, help to ensure the reliability of internal and external reporting and assist in compliance with applicable laws and regulations.

The Group operates in a dynamic business environment and, as a result, the risks it faces change continually. Management are responsible for designing the internal control framework to ensure thorough and regular evaluation of the nature and extent of risk and the Group's ability to react accordingly. Management are also responsible for implementing the Board's policies on risk and control, noting that all employees are responsible for internal control as part of their individual objectives.

Further details of the Group's risk management practices are provided in the Risk Management Report on pages 49 to 55.

Through the Committee, the Group's internal audit function ('Audit Services') provides independent assurance to the Board on the effectiveness of the internal control framework. The information received and considered by the Committee during 2014 provided reasonable assurance that there were no material breaches of control and that, overall, the Society maintained an adequate internal control framework that met the principles of the UK Corporate Governance Code.

Audit Services is supported by external advisers who are able to provide specialist service in connection with matters such as Treasury and Credit Risk. The Chief Internal Auditor reports to me, and as a Committee we are responsible for ensuring that Audit Services retains adequate skills and resource levels that are sufficient to provide the level of assurance required. The Committee is satisfied that, throughout 2014, Audit Services had an appropriate level of resources in order to carry out its responsibilities effectively, and that it continues to do so.

The Audit Committee is also responsible for agreeing the annual budget of Audit Services and approves its annual plan of work. This is prepared on a risk based approach by Audit Services, reflecting input from management and the Committee.

We review reports produced by Audit Services and, through Audit Services, track management actions to completion; Audit Services then verifies these periodically after management have reported them as complete. Audit Services provides the Committee with reports on material findings and recommendations and updates on the progress made by management in addressing their findings.

The Committee also has oversight responsibility for the Group's Compliance Monitoring function which provides second line assurance on regulated activities across the Group. The outputs of the Compliance Monitoring function's monitoring activities are reported to the Committee, together with progress updates on management's implementation of the findings. The Compliance Monitoring function's annual plan of work is also approved by the Committee.

During the year, the main issues of internal control we reviewed were as follows:

- the governance framework surrounding the implementation and embedding of new credit risk models introduced to support the Society's strategy to move to a more advanced credit risk approach (the Internal Ratings Based Approach);
- the mortgage sales processes and associated controls within the Group, following the introduction of new legislation in this area (the Mortgage Market Review); and
- a number of specific areas of internal control were discussed including assessment of the adequacy of key processing controls across the Group to ensure these were robust and delivered a quality service to customers.

The Committee also periodically reviews the use of the confidential reporting channel in the Group. Awareness of 'whistle blowing' arrangements is maintained through internal communication and is covered as part of employees' induction and ongoing development.

As part of the external audit process, KPMG also provide us with internal control reports. During the year, they did not highlight any material control weaknesses.

The Committee requires an external 'effectiveness review' of Audit Services at least every five years. A review was carried out during 2014 by an external firm appointed by the Committee. In performing their review, information was gathered from a variety of sources, including interviews with key business stakeholders and the Audit Services team, as well as a review of key documentation covering all aspects of the internal audit process (including file reviews). The review also included an assessment of Audit Services' compliance with the Chartered Institute of Internal Auditors' recommendations on 'Effective Internal Audit in the Financial Services sector', issued in July 2013. The review concluded that the Audit Services function is operating effectively, and provides assurance to the Audit Committee and a wide range of key stakeholders. An action plan to address the recommended areas for further improvement raised within the report will be monitored by the Audit Committee to ensure the internal audit function continues to evolve and meet good practice requirements.

b) Financial reporting

The Committee considers the financial information published in the Group's annual and half year financial statements and considers the accounting policies adopted by the Group, presentation and disclosure of the financial information and, in particular, the key judgements made by management in preparing the financial statements.

The Directors are responsible for preparing the Annual Report and Accounts. At the request of the Board, we considered whether the 2014 Annual Report was fair, balanced and understandable and whether it provided the necessary information for members to assess the Group's performance, business model and strategy. This was assessed in the following ways:

- the Chairman, Group Chief Executive and Group Finance Director were involved from an early stage in agreeing the overall tone and content of the Annual Report;
- all members of the Executive Committee and the Board have been involved in reviewing and commenting on various drafts of the accounts, to help ensure that the final draft is fair, balanced and understandable; and
- verification took place to ensure there was appropriate supporting evidence for the content of the Annual Report.

The Committee is satisfied that, taken as a whole, the 2014 Annual Report is fair, balanced and understandable and includes the necessary information as set out above. It has confirmed this to the Board, whose statement in this regard is set out on page 38.

We pay particular attention to matters we consider to be important by virtue of their impact on the Group's results, and particularly those which involve a high level of complexity, judgement or estimation by management. The key areas of judgement that we considered in reviewing the 2014 financial statements were:

- We have again reviewed the adoption of the going concern assumption for the half year and Annual Accounts, adopting the same, comprehensive approach for both reporting periods. This involves a rigorous consideration, based on reports produced by key risk functions around the business requested by the Committee, of our current and projected liquidity, capital and funding positions together with the potential risks (e.g. business risk, operational risk and conduct risk) which could impact these positions and consideration of potential stress scenarios. Based on this review, we concluded that the adoption of the going concern assumption to prepare the financial statements remains appropriate.

- We considered matters raised during the statutory external audit and, through discussion with senior management of the business and the external auditor, concluded that there were no adjustments required that were material to the financial statements.
- The Committee continues to monitor loan impairment provisions and has considered the impact of forbearance adopted in the mortgage portfolios, as well as various other assumptions contained in the Group's loss provisioning model (such as unemployment and future house prices) on the level of provision made and the relevant disclosure in the accounts. We have examined and challenged the assumptions adopted and, by requesting and scrutinising reports produced by management, are satisfied with the models used to calculate loan impairment provisions for the retail mortgage books and commercial mortgage portfolio. We have also reviewed the carrying value of treasury assets by scrutinising reports produced by the Market and Liquidity Risk function, and consider these to be appropriate.
- In July 2014, Connells Limited purchased the entire share capital of the estate agency business Peter Alan Limited. The accounting for this transaction required an assessment of the fair value of the identifiable net assets acquired, which impacted the resultant goodwill that was generated. Having examined calculations prepared by management, the Committee is satisfied that the fair value of net assets acquired and the level of goodwill arising is appropriately stated in the accounts.
- During the year, the Group sold its entire shareholding in three of its businesses, The Private Health Partnership Limited (and its subsidiaries), Torquil Clark Limited (and its subsidiaries) and Homeloan Management Limited (and its subsidiaries). We have reviewed the disclosures of these disposals within the financial statements and are satisfied that these are appropriate and in line with International Financial Reporting Standards (IFRSs) adopted by the EU.
- As outlined in note 33c) to the accounts, a possible obligation to the Group exists in relation to the inclusion of contractual commission in holiday pay, giving rise to a possibility that employees may claim a shortfall in their holiday pay in prior years. At this stage, no provision has been recognised in the accounts due to the level of uncertainty that exists and as such the Directors have determined that a contingent liability is more appropriate. The Committee has reviewed papers produced by senior management and debated the impact of this issue on the financial statements. We have concurred with the view of the Directors that no provision is currently required and that a contingent liability is more appropriate as we believe that the level of uncertainty still present means the Group is unable to quantify any provision that may arise.
- The Group holds an equity release mortgage book and, as outlined in note 38 to the accounts, a 'no negative equity guarantee' is given to customers under the terms and conditions of the mortgages in this book. Impairment losses recognised in relation to this portfolio are, inter alia, a function of the actual and projected interrelationship between long term house prices and retail price inflation and as a result, judgement is required in determining the appropriate set of assumptions to derive the impairment provision within the accounts.

  During the year, certain assumptions have been revised (principally long term house prices, the long term rate of inflation and an assumed discount for dilapidations) and a further impairment charge of £5.7m has been recognised, bringing the total provision held to £17.5m. The Committee has scrutinised papers prepared by management and concurred with management's view that the revised assumptions are appropriate, taking into account the specific characteristics of this portfolio. The Committee was also presented with the output from an alternative fair valuation methodology undertaken by management, and these results suggested that the impairment provision held is materially appropriate. As a result, we have satisfied ourselves on the impairment provision held and hence the carrying value of this portfolio in the accounts.

c) External auditor

The Committee assesses the effectiveness and independence of the external auditor annually, immediately after the completion of their year end audit, and this is reported to and discussed at a meeting of the Committee in May each year. This assessment is facilitated by Group Finance and is discussed, initially, without the presence of the auditors in the meeting. The assessment is made by reference to the Financial Reporting Council's 'Guidance on Audit Committees (September 2012)' which details what is expected of the Audit Committee to ensure that the annual external audit cycle is effective, and includes consideration of matters such as:

- whether the original audit plan was met;
- openness of communication between the external auditor and senior management; and
- the skills and experience of the audit team.

Based on this, senior management in the Group Finance function prepared a report for the Committee which outlined the principles contained within the above guidance and set out management's view on each principle, whilst at the same meeting the Committee also requested and considered feedback obtained from a survey that had been carried out by KPMG of key business contacts involved with the statutory audit process. The Committee scrutinised these reports and, together with its own experience, formed an opinion as to the effectiveness of the external auditor. During the year, we concluded that the relationship with the external auditor continues to work well and we are satisfied with their effectiveness and independence.

The Committee regularly monitors the Society's relationship with the external auditor and has adopted a framework for ensuring auditor independence and objectivity. This framework defines prohibited non-audit assignments (which includes certain tax-related assignments) and procedures for approval of other non-audit assignments across the Group. All non-audit assignments are required to be pre-approved by designated mandate holders and a limit is in place above which approval can only be given by the Committee; a report detailing any approved expenditure is also sent to each meeting of the Committee. KPMG undertook a number of non-audit related assignments for the Group during 2014. These were conducted in accordance with the framework and are consistent with the professional and ethical standards expected of the external auditor. Details of the fees paid to the external auditor for audit and non-audit services are set out in note 7 to the Annual Accounts and during the year non-audit fees represented 25% of the total Group audit fee (2013: 57%).

The Committee also enhances auditor independence by considering regular rotation of the key external audit partner and during 2014, the previous audit partner was rotated off the audit, having been the responsible partner for five years.

KPMG Audit Plc, or its predecessor firm, has been the Society's auditor since the 1980s. Following Financial Reporting Council (FRC) revisions to the Corporate Governance Code made in September 2012 which recommends FTSE 350 companies put their external audit out to tender at least every 10 years, the Society, as disclosed in the 2013 Annual Report and Accounts, put its audit out to tender in the second half of 2014, having last done so in 2005. The extensive tender process involved meetings between prospective audit firms and senior management of the business, following which management assessed each firm against a number of distinct categories and submitted a report to the Audit Committee who in turn received presentations from the audit firms involved, again scoring each firm against pre-defined specific criteria. Following this process, the Committee decided that KPMG is the most appropriate firm at this time to be the Society's external auditor and will therefore remain in place. The Committee will continue to assess the need for a competitive process on an annual basis as part of its review of the external auditor's effectiveness.

The Committee has also agreed a policy for the employment, by the Group, of former employees of the auditor which is designed to further maintain the auditor's independence.

Effectiveness of the Audit Committee

The effectiveness of the Committee is assessed as part of the annual Board and Committee effectiveness review, further detail on which is contained in the Report on Corporate Governance on pages 39 to 44. The 2014 review, recently completed, concluded that we operated effectively during the year.

Committee members are expected to undertake relevant training as part of their ongoing development and, periodically, the Committee as a whole receives training on current topics such as current sector challenges, regulatory developments, conduct risk issues and financial reporting hot topics to ensure we remain effective in our role.

Marisa Cassoni
Chairman of the Audit Committee

24 February 2015

Risk Management Report

Risk overview

The management of the Group's business and the delivery of the Board's strategy involves the exposure of the Group to a number of potential risks. The Group aims to manage, appropriately, the risks that arise from its activities and the Board promotes a culture and philosophy that reflects an awareness and management of actual and potential risk exposures.

Governance structure

The Group has a formal structure for managing risks which is documented in detailed risk management policies.

The **Board Risk Committee** is responsible for considering and recommending the Group's risk appetite, capital adequacy and liquidity management policies to the Board. It is also responsible for ensuring that the Group maintains an effective risk governance structure to ensure that internal and external risks across the Group are identified, reviewed and managed accordingly. The current members of the Committee are:

Mr East, Non-Executive Director (appointed as Committee Chairman on 1 January 2015)
Ms Stevenson, Non-Executive Director (appointed to the Committee on 1 January 2015)
Mr Picken, Non-Executive Director

Mr Hales stepped down as Committee Chairman on 31 December 2014. Mr Cutter and Mr Twigg served on the Committee when the Committee met in January 2014 and March 2014, but subsequently stood down as members in order to conform with the CRD IV regulations that require that only Non-Executive Directors should be members of the Board Risk Committee.

The Board Risk Committee also has a number of sub-committees, which have day-to-day responsibility for risk management oversight, as follows:

- **The Conduct and Operational Risk Committee (CORC)** is primarily responsible for developing and reviewing the Group's conduct and operational risk management frameworks and monitoring management of the risks arising in these areas. The Committee also recommends changes to the conduct and operational risk appetites and associated policies to the Board Risk Committee. Mr Gibson (Chief Conduct Risk Officer and Secretary) chairs the Committee which comprises senior executives from each of the divisions and the Group Operational Risk and Compliance teams.

- **The Asset and Liability Committee (ALCO)** is primarily responsible for developing and maintaining policies on structural risk management, liquidity, funding and wholesale credit, recommending changes to these policies to the Board Risk Committee, monitoring implementation to ensure that the Group operates within risk limits and that the Society has adequate liquid financial resources to meet its liabilities. Mr Ndawula (Group Finance Director) chairs the Committee which comprises the Group Chief Executive, Commercial Director and senior executives from Treasury, Finance and Risk.

- **The Retail Credit Committee (RCC)** is primarily responsible for developing and maintaining policies for monitoring and controlling the risks to the Group arising from the credit quality of its retail loan books and other assets, recommending changes to these policies to the Board Risk Committee and monitoring implementation to ensure that the Group operates within risk limits. Mr Cutter (Group Chief Executive) chairs the Committee which comprises the Group Finance Director, Commercial Director and senior executives from Risk and the Group's lending businesses.

- **The Model Governance Committee (MGC)** is primarily responsible for the review and approval of Credit Risk models, with the intention to expand this to all key models over time (for example, financial models). Mr Ndawula (Group Finance Director) chairs the Committee, and its members include senior executives from across the operational areas as well as Finance and Credit Risk.

Risk management framework

Through the Group's risk management framework and governance structure, the Group has a formal mechanism for identifying and addressing risks throughout the business. This framework is designed to deliver the corporate plan in line with the Board's overall risk appetite and is based upon the best practice 'three lines of defence' model, as follows:

- First line of defence, being line management within the business which, through the implementation of the organisation's risk framework, identifies, assesses and manages risk.

- Second line of defence, comprising independent Risk functions (Operational, Credit, Market and Liquidity) and related independent Compliance functions. These functions challenge, monitor, guide and support the business in managing its risk exposure. The risk framework includes the four Board Risk Committee sub-committees described above which are responsible for recommending and monitoring the Group's adherence to policy. The independent Risk functions are represented on each of these sub-committees. The Board Risk Committee, headed by a Non-Executive Chairman, is responsible for approving changes to policy, oversight of the risk management framework and monitoring of the business risk profile against the Board approved risk appetite.

- Third line of defence, provided by Audit Services, is designed to provide independent assurance to the Board (via the Board Audit Committee (BAC)) of the adequacy and effectiveness of control systems operating within the first and second lines in identifying and managing risk.

The key risks and uncertainties faced by the Group, which are managed within the framework described above, are set out below.

Business conditions and the economic environment

The Skipton Group is predominantly focused in the UK and is to a large extent exposed to the UK property market. Therefore, the general UK macro-economic environment is a key determinant of the success of the Group. The main drivers that impact the Group include:

- interest rates;
- inflation;
- unemployment; and
- the housing market (volume of transactions and house price inflation).

The Mortgages and Savings division continues to operate in a low interest rate environment and whilst various government initiatives, including the Funding for Lending Scheme (FLS) introduced in 2012, have benefited the business, the future withdrawal of these could increase margin pressures. However, actions taken by the Society during and since the global financial crisis have resulted in the Group achieving a higher interest margin and consequently the Group is well placed to cope with such pressures.

Whilst levels of mortgage arrears have continued to fall throughout 2014, a general downturn in the economy, increasing interest rates or unemployment, would impact the Mortgages and Savings division through an increase in impairment by creating higher levels of arrears and possessions. Whilst the Group's specialist mortgage portfolios of Amber and NYM are likely to be more susceptible to increases in interest rates, these portfolios continue to run off and the improvement in arrears seen in 2014 means that the risk associated with a downturn in the economy is lower this year than it was last.

The results of the Estate Agency division are principally driven by the volume of UK property transactions, particularly second hand property sales. This market is heavily influenced by consumer confidence, driven by the general state of the economy, and level of unemployment and interest rates, together with the availability of mortgages, particularly for first time buyers. A slowdown in the housing market puts pressure on Connells' income levels. However, the Estate Agency division is partially protected against the performance of its core business through its own diversification into complementary businesses such as asset management and lettings.

Skipton Financial Services Limited, a subsidiary specialising in pensions and investment advice, is also exposed to the wider UK economy. Pearson Jones, which also provided these services, was sold on 6 February 2015, subject to regulatory approval and certain other conditions. The gains in the FTSE 100 index, and the Stock Market generally, achieved during 2013 have all been unwound and therefore the Stock Market is now fairly flat compared to the end of 2013. Continued global economic uncertainty may still impact the willingness of some customers to invest in longer term, more risky products.

Credit risk

Credit risk is the risk of suffering financial loss should borrowers or counterparties default on their contractual obligations to the Group.

The Group faces this risk from its lending to:

- individual customers (retail mortgages);
- businesses (through past commercial lending and current debt factoring and invoice discounting; the Society ceased new commercial lending in November 2008); and
- wholesale counterparties (including other financial institutions). Credit risk within our treasury portfolio arises from the investments held by the Group in order to meet liquidity requirements and for general business purposes.

Market background

The Society retains its prudent approach to new lending, so consequently the key driver of credit risk remains a slowdown in the UK economy leading to higher unemployment, deterioration in household finances and falling house prices, all of which would be likely to result in increased arrears and mortgage losses. However, the economy has continued to improve through 2014, although the housing market has slowed to a degree in recent months.

Whilst the wholesale markets are less volatile than during the global financial crisis, the Group remains cautious and has reduced the number of counterparties to whom it lends, as well as the amounts it is willing to lend counterparties, to levels appropriate with the perceived risk of the counterparty.

Risk mitigation

The controlled management of credit risk is critical to the Group's overall strategy. The Group has therefore embedded a comprehensive and robust risk management framework with clear lines of accountability and oversight as part of its overall governance framework. Substantial investment has been made in the management of credit risk as we work towards gaining our Internal Ratings Based (IRB) status, to ensure that the Society has the right processes and controls to monitor, mitigate and manage credit risk within the Group's risk appetite. The RCC provides oversight to the effectiveness of all retail credit management across the Group and the controls in place ensure lending is within the Board approved credit risk appetite. ALCO, through the Wholesale Credit Committee, similarly manages treasury credit exposures.

The establishment of the Model Governance Committee to oversee the IRB models, combined with investment in the Society's credit risk modelling capability, ensures that the Group has the right analytic tools to facilitate the appropriate management of Credit Risk.

Retail mortgage lending to customers

The Group currently lends in the prime residential UK mortgage market, including buy-to-let, through the Society. Skipton International lends in the Channel Islands mortgage markets and to UK expatriates purchasing buy-to-let properties in the UK.

We have established comprehensive risk management processes in accordance with the Board's credit risk appetite which defines a number of limits regarding concentration risk as well as customer and collateral credit quality to which all lending activity must adhere. The Group maintains a low risk approach to new lending and will continue to do so.

The credit decision process utilises automated credit scoring and policy rules within lending policy criteria supported by manual underwriting. All aspects of the credit decision process are subject to regular independent review and development ensuring they support decisions in line with the Board's risk appetite. The Group also has credit exposures through Amber and NYM which comprise residential UK mortgages, including buy-to-let, across prime and non-prime lending markets. In light of the deteriorating economic conditions at the time, we ceased new lending in these portfolios in early 2008.

The Group's collections and recoveries functions aim to provide a responsive and effective operation for the arrears management process. We seek to engage in early communication with borrowers experiencing difficulty in meeting their repayments, to obtain their commitment to maintaining or re-establishing a regular payment plan. We consider forbearance options on a case-by-case basis in line with industry guidance and best practice. The impact of any such forbearance is recognised within our provisioning policy.

Commercial lending to customers and businesses

The Society has a commercial mortgage portfolio which is UK-based and, following a reduction in the Group's risk appetite, was closed to new lending in November 2008. We have retained an appropriately skilled team of people to manage these loans. We consider forbearance options on a case-by-case basis in line with industry guidance and best practice. The impact of any such forbearance is recognised within our provisioning policy.

Other loans

These loans include a number of business and personal loans, and loans made by our factored debt and invoice discounting business, Skipton Business Finance, which continue to be managed by appropriately skilled teams.

Wholesale lending to other financial institutions

Wholesale credit risk arises from the wholesale investments made by the Society's Treasury function, which is responsible for managing this aspect of credit risk in line with Board approved risk appetite and wholesale credit policies. Wholesale counterparty limits are reviewed monthly by the Group Wholesale Credit Committee (a sub-committee of ALCO) based on analyses of counterparties' financial performance, ratings and other market information to ensure that limits remain within our risk appetite.

Deterioration in wholesale credit markets could lead to volatility in the Group's portfolio of available-for-sale assets together with the risk of further impairment within our treasury investments portfolio.

ALCO provides oversight to the effectiveness of wholesale credit risk management.

Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost. The Group has, therefore, developed comprehensive funding and liquidity policies to ensure that it maintains sufficient liquid assets to be able to meet all financial obligations as they fall due and maintain public confidence.

Market background

The secured wholesale funding markets are now far less restricted than a few years ago and building societies including Skipton have successfully issued in the market during the year. The trend for firms to seek longer term wholesale funding and stable retail funds has continued, so has the requirement for banks and building societies to maintain better quality, albeit lower yielding, liquid assets. The new CRD IV Liquidity regulations are in the process of being phased in, namely the Liquidity Coverage ratio and the Net Stable Funding ratio. The Society has already been measuring and monitoring these ratios, and is in a good position for when the regulations come into force in 2015 and 2018 respectively.

Risk mitigation

The Society's Treasury function is responsible for the day-to-day management of the Group's liquidity and wholesale funding. The Board sets the Group's liquidity risk appetite and sets limits over the level, composition and maturity of liquidity and deposit funding balances, reviewing these at least annually. Compliance with these limits is monitored daily by Finance and Risk personnel (i.e. independent of Treasury) and additionally, a series of liquidity stress tests are performed weekly by Risk and formally reported to ALCO, the Board Risk Committee and the Board to ensure that the Group maintains adequate liquidity for business purposes even under stressed conditions.

The Group continues to satisfy both the Individual Liquidity Guidance (ILG) requirement – provided by the PRA for regulatory purposes, and its own internal liquidity risk appetite. Liquidity stress testing is carried out against a number of scenarios including those prescribed by the PRA, considering a wide range of liquidity and economic factors. Early warning indicators are regularly assessed by a variety of functions across the Society to pre-empt potential outflows.

The Group's main source of funding is retail deposits which, at 31 December 2014, accounted for 85.9% (2013: 84.6%) of our total funding. During the year, the Group supplemented its retail funding base and its securitisation issuance in the year by further utilising the Funding for Lending scheme which closes in January 2016.

We have also maintained the quality of the Group's liquidity portfolio and, at 31 December 2014, the proportion of our treasury assets rated A3 or above was 96.7% (2013: 99.0%).

We continue to maintain a close watching brief on the money markets and hold prudent levels of liquidity.

Market risk

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk, including the use of derivatives, foreign currency risk and equity risk.

The Society's Treasury function is responsible for managing the Group's exposure to all aspects of market risk within the operational limits set out in the Group's Treasury policies. ALCO approves the Group's Treasury policies and receives regular reports on all aspects of market risk exposure.

Market risk also exists within the Group's defined benefit pension schemes and is managed by the Trustee of the schemes, working closely with the sponsoring employers – Skipton Building Society and Connells.

Interest rate risk

Interest rate risk is the risk of loss arising from adverse movements in market interest rates. Interest rate risk arises from the mortgages, savings and other financial products that we offer. This risk is managed through the use of appropriate financial instruments, including derivatives, with established risk limits, reporting lines, mandates and other control procedures.

Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics, for example LIBOR and Bank of England Base Rate), are also monitored closely and regularly reported to ALCO. This risk is managed, where appropriate, through the use of derivatives, with established risk limits and other control procedures.

Derivatives are only used to limit the extent to which the Group will be affected by changes in interest rates, foreign exchange rates or other indices which affect fair values or cash flows. Derivatives are therefore used exclusively to hedge risk exposures. The principal derivatives used by the Group are interest rate contracts, commonly known as interest rate swaps, interest rate options and foreign exchange contracts.

The Group's forecasts and plans take account of the risk of interest rate changes and are prepared and stressed accordingly, in line with PRA guidance.

Currency risk

Currency risk is the risk of loss because of changes in foreign exchange rates.

The Group has equity investments in Jade Software Corporation Limited, Wynyard Group Limited and Northwest Investments NZ Limited which are denominated in New Zealand Dollars. The foreign currency fluctuations in relation to these equity investments are not hedged, but are recognised in the Group's translation reserve.

In addition, a number of the Group's businesses undertake transactions denominated in foreign currency as part of their normal business. Any amounts outstanding at the year end are not material.

Equity risk

This is the risk of loss due to movements in equity markets.

Following its flotation in July 2013, the Group holds a 21.7% stake in Wynyard Group Limited, which is listed on the New Zealand Stock Exchange. The Group also has a shareholding in Zoopla Property Group Plc and following its Initial Public Offering on the London Stock Exchange, Connells sold approximately 25% of its shares and retains a 3.9% shareholding. The equity risk in relation to these investments is not material to the Group results. The market values of our shareholdings in Wynyard and Zoopla, based on the share price at 31 December 2014, are £24.5m and £32.2m respectively (carrying value at 31 December 2014 is £13.2m and £32.2m respectively).

Conduct and Operational risk

Conduct risk is the risk of delivering poor or inappropriate outcomes for customers while operational risk is the risk of financial loss or reputational damage arising from inadequate or failed internal processes or systems or human error.

Market background

As a business with a retail franchise in Financial Services, the management of Conduct and Operational Risk is key to the ongoing success of the Group. Central to managing this risk is maintenance of a robust product governance framework to ensure that we develop and market products and services designed to meet the needs of our target market, strong control over providing advice, and efficient administration services.

As well as the core business providing advice on mortgages and general insurance, the Group owns a large estate agency business also providing advice on mortgages and general insurance, and Skipton Financial Services Limited, a subsidiary specialising in pensions and investment advice. Pearson Jones, which also provided these services, was sold on 6 February 2015, subject to regulatory approval and certain other conditions. Alert to the loss of customer trust experienced by Financial Services firms as a result of mis-selling scandals, the Group continues to invest and develop its conduct and operational risk management processes and oversight arrangements.

The Financial Services sector also faces heightened levels of fraud and financial crime, particularly in relation to e-distribution channels, which require increasingly sophisticated controls. We are fully aware of the risk of cyber crime and have developed and enhanced the key controls in place to mitigate these risks.

Risk mitigation

The role of CORC is to ensure that an appropriate framework is in place to manage, control and mitigate the risks that could impact the ability of the Group to meet its business objectives and serve our customers whilst protecting its reputation. The Committee also monitors whether Group businesses are operating within the Board-approved Conduct and Operational risk appetites.

Through the Conduct and Operational risk management framework the Board ensures the management and oversight of the key risk exposures facing the Group in the following risk categories:

- Business Continuity
- Change Management
- Conduct Risk
- Financial Management and Management Information
- Financial Crime (including cyber crime)
- Information Security
- Information Technology
- Legal and Regulatory
- People
- Premises
- Process
- Third Party Relationships

The Group's Conduct and Operational risk management framework sets out the strategy for identifying, assessing and managing such risks. Senior management are responsible for understanding the nature and extent of the impact on each business area and for embedding appropriate controls to mitigate those risks. The framework is updated periodically to take account of changes in business profile, new product development and the external operating environment. CORC provides oversight and assesses the Group's exposure to conduct and operational risks based on both quantitative and qualitative considerations. The crystallisation of risks is captured through the recording and analysis of customer outcomes, operational risk events and operational losses (and near misses) which are used to identify any potential systemic weaknesses in operating processes.

Given the nature of the regulated sectors in which the Group operates, another key conduct and operational risk is the potential failure to maintain ongoing compliance with relevant external regulation across the Group. Each of the regulated businesses either has an established Compliance team, or utilises the Group's central resource, to monitor compliance with existing legislation and consider the impact of new requirements. Oversight is provided by the Society's Compliance function which ensures best practice is adhered to and shared across the Group as appropriate.

Business risk

Business risk is the risk of changes in the environment in which the Group operates or the occurrence of events which damage the franchise or operating economics of the Group's businesses. The Group addresses these risks within its corporate plan which is approved by the Board along with the Group's key strategies. The Board Risk Committee is also provided with the results of stress and scenario tests to ensure progress remains consistent with the Group's risk appetite.

If the Group does not deliver its plans as anticipated, its earnings could grow more slowly or decline. In addition, potential sources of business risk include revenue volatility due to factors such as macro-economic conditions, inflexible cost structures, uncompetitive products or pricing and structural inefficiencies.

Reputational risk

Reputational risk is the risk to earnings, liquidity or capital arising from negative market or public opinion. Management has considered how this might arise and what the impact could be. The consequences would adversely impact the future prospects of the Group and could expose the Group to litigation and financial loss. Reputational risk is inherent across the Group. Senior management manage this risk in the following ways:

- by maintaining and investing in its control structures;
- by a continued focus on customer outcomes;
- by promoting the Society's reputation through marketing and external communications; and
- through the risk management framework which has reputational risk as a key consideration.

Regulatory risk

Regulatory risk arises from a failure or inability of the Group to fully comply with the laws, regulations or codes applicable to the Group. Non-compliance could lead to damage to reputation, public censure, fines and increased prudential requirements. Key changes on the horizon include the results of the FCA's Cash Savings Market Study, the Mortgage Credit Directive which is due to come into force in 2016 and the Bank Recovery and Resolution Directive (BRRD) which includes the Minimum Required Eligible Liabilities requirements. The Group has allocated resource to ensure continued compliance in these and other areas.

Technological risk

The pace of technological development is creating a period of significant change in Financial Services. The Society will continue to invest in its technology provision to provide an excellent level of customer service. Risks in this area include:

Cyber crime – in response to the constantly evolving cyber threat faced by many different types of industry sectors, including Financial Services, the Group continues to focus its efforts on proactively managing the evolving nature of the cyber threat to ensure that the Group continues to protect itself and its customers.

Executing changes – the Society has made, and will continue to make, changes to its products, services and channels to reflect customers' evolving needs and expectations. The Society will ensure that the execution of these changes is carried out in a controlled manner to minimise the risk of system failure.

Customer expectation and demand on digital services – we expect more customers to open and service their accounts through digital channels. The Society has clearly defined plans to ensure its IT resilience and availability can meet this increased demand as it progresses its digital change programme.

Model risk

Model risk is the risk that as a direct result of weaknesses or failures in the design or use of a model a financial loss occurs or a poor business or strategic decision is made.

To mitigate this risk MGC provides a formal forum for managing and assessing model risk in the Society, ensuring that all key models:

- go through a formal review and approval process;
- have a strict change control process;
- undergo a pre-determined model development and validation process; and
- are monitored regularly and reviewed at least annually.

Although over time all key models used by the business will be covered by MGC, at present the focus is on Credit Risk Internal Ratings Based models.

Pension obligation risk

The Group has funding obligations for three defined benefit schemes which are all now closed to new entrants and to future accrual of benefit. Pension risk is the risk that the value of the schemes' assets, together with ongoing contributions, will be insufficient to cover their obligations over time. The return on assets, which includes equities and bonds, will vary with movements in equity prices and interest rates. The projection of the schemes' obligations includes estimates of mortality, inflation and future salary increases, the actual outturn of which may differ from the estimates. The schemes are also exposed to possible changes in pensions legislation.

The following controls are in place to manage the Group's exposure to pension obligation risk:

- The Board regularly reviews the Group's pension risk strategy.
- The Board and the pension scheme Trustee receive professional advice from different actuarial advisers.
- The pension scheme Trustee meets at least quarterly to monitor the investment performance of scheme assets and make investment decisions, liaising with the principal employer in accordance with the scheme rules and taking advice from professional investment consultants.
- The pension scheme Trustee also monitors the pension obligation position (on the Trustee's funding basis).
- The pension obligation position (on an IAS 19 basis) is updated every six months and reported, along with key pension risk metrics, to the Board Risk Committee.

The Group also performs stress testing on the pension scheme liabilities and assets as part of the pension risk metrics for the Board Risk Committee and also in its capital planning methodologies articulated in the Individual Capital Adequacy Assessment Process (ICAAP). Note 29 of this Report and Accounts outlines the steps management have undertaken to manage the Group's pension risk exposure.

Taxation risk

Taxation risk is the risk associated with changes in tax law or in the interpretation of tax law. 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 an additional tax charge. It could also lead to reputational damage or financial penalties. The Group has effective, well-documented and controlled processes in place to ensure compliance with tax disclosure and filing obligations and employs its own tax professionals who take appropriate advice from reputable professional firms when necessary.

The Group takes a responsible approach to the management, governance and oversight of its tax affairs which is documented in a Tax Policy approved by the Board which requires tax risks to be reviewed and assessed as part of the Group's formal governance processes. In 2013 the Group re-adopted the Code of Practice on Taxation for Banks; this requires banks to have proper governance around tax, integrated into business decision making, to establish an appropriate working relationship with HMRC and to undertake tax planning only to support business operations and not to achieve unintended tax advantages. The Group will continue to be co-operative and transparent in its dealings with the tax authorities and has embedded the terms of the Code into its Tax Policy.

Capital management

The Group conducts an ICAAP at least annually, which is approved by the Board. This is used to assess the Group's capital adequacy and determine the levels of capital required to support the current and future risks in the business derived from the corporate plan. The ICAAP addresses all the Group's material risks and includes Board approved stress scenarios which are intended, as a minimum, to meet regulatory requirements. The ICAAP is reviewed by the PRA when setting the Group's Individual Capital Guidance (ICG) requirements.

The Group currently adopts the following approaches to calculate its Pillar 1 minimum capital requirements:

- Standardised approach for mortgages and other lending exposures;
- Comprehensive approach for treasury portfolios; and
- Standardised approach for operational risk.

The Group has also developed a suite of IRB models for the assessment of the credit risk associated with our lending portfolios. The models are now in use and are used, inter alia, to inform our future capital requirements, mortgage pricing decisions and our collection strategies. However, until PRA approval of the models has been received our capital assessment under the standardised approach will continue to form our assessment of our minimum regulatory requirement.

The CRD IV regulatory framework was implemented on 1 January 2014. This introduced significant changes to the calculation of our capital adequacy as well as the introduction of new metrics, for example the leverage ratio. Many of the changes under CRD IV were implemented immediately; others, including the introduction of various capital buffers, are being phased in over the period to 2022. We currently satisfy all of the capital requirements under CRD IV.

To meet the CRD IV Pillar 3 requirements, the Group publishes further information about its exposures and risk management processes and policies on the Society's website www.skipton.co.uk.

Effectiveness of the Board Risk Committee

The effectiveness of the Committee is assessed as part of the annual Board and Committee effectiveness review, further detail on which is contained in the Report on Corporate Governance on pages 39 to 44. The 2014 review, recently completed, concluded that the Committee operated effectively during the year.

Committee members are expected to undertake relevant training as part of their ongoing development and, periodically, the Committee as a whole receives training on current topics such as current sector challenges, regulatory developments, conduct risk issues and developments in financial markets to ensure they remain effective in their role.

R D East

Chairman of Board Risk Committee

24 February 2015

Directors' Remuneration Report

Annual statement from the Chairman of the Remuneration Committee

I am pleased to present the Remuneration Committee's report which sets out details of the pay, bonuses and benefits for the Directors and the Society's Material Risk Takers (MRTs – referred to as Code Staff in previous years) for the year ended 31 December 2014. We constantly strive to maintain the highest standards of transparency and governance in relation to Directors' remuneration and have again this year incorporated the majority of the requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 which now apply to UK listed companies.

The report is presented in two key sections:

- An overview of the Remuneration Policy which was set out in detail and approved at the AGM in April 2014. This policy is unchanged and the overview on pages 57 to 59 serves as a reminder of the key elements of Directors' remuneration policy.
- The Annual Report on Remuneration on pages 60 to 65 explains how we put our policy into practice in 2014 and comments on our approach for 2015.

We are committed to best practice in corporate governance and will, therefore, ask our members to vote, on an advisory basis, on the Directors' Remuneration Report at the forthcoming AGM. A summary of this report will be sent to members, together with the Summary Financial Statement, ahead of that meeting.

Remuneration in 2014

As noted elsewhere in these accounts, the strong performance that we saw in 2013 has continued into 2014, with total Group profit before tax (PBT) increasing to £181.6m (2013: £103.6m), the core Mortgages and Savings division PBT reaching £98.4m (2013: £51.5m) and the CET 1 capital ratio increasing to 16.2% (2013: 14.2%).

Key decisions taken in 2014

- Within the context of strong performance in 2014 and taking into account our approach to risk management the Committee made awards under the Society's annual bonus scheme. The average payment made to the Executive Directors (excluding Mr Twigg) was 47% and to the remaining senior managers in the Senior Leadership scheme was 29% of base salary. In 2014 we introduced an annual bonus scheme for all our people in the Society, having made a discretionary award in 2013. The average payment from this scheme was 5.25% of base salary.
- This year we launched the new Medium Term Incentive scheme (MTI) signalled in our 2013 report. The 2014 MTI operates over a three year performance period ending 31 December 2016 and aligns reward to the achievement of sustainable profit, increased customer satisfaction and growth in customer numbers. Payments for the 2014 – 2016 performance period will not be made until 2017, 2018 and 2019. Half of the amount due will be paid in 2017, one quarter in 2018 and one quarter in 2019. We anticipate that the MTI will run on a rolling annual basis and plan to implement the same scheme in 2015. The limit on our short term and medium term performance pay is the same for each scheme and the overall limit does not exceed 100% of base salary.
- During the year, the Committee has considered the impact of new regulatory changes including the CRD IV regulations, which is an EU legislative package covering prudential rules for banks, building societies and investment firms. The Committee reviewed and agreed the Group companies within scope of the new regulations and approved the list of employees identified as Material Risk Takers (MRTs) in accordance with the European Banking Authority technical standards. MRTs, previously known as Code Staff, are employees whose professional activities have a material impact on the risk profile of the business.
- The Committee has maintained oversight of Group bonus and incentive schemes; approving a Medium Term Incentive Plan (MTIP) for Skipton Financial Services Limited senior managers and approving bonus schemes for the management teams of subsidiaries which were divested in 2014, to ensure value was achieved for the Society through the sale processes.

Conclusion

On behalf of the Committee, I trust you will find this report useful and informative and look forward to your feedback on our ongoing Remuneration Policy. The Committee recommends that members vote in favour of the Directors' Remuneration Report at the forthcoming AGM.

Nimble Thompson
Chairman of the Remuneration Committee

24 February 2015

Directors' Remuneration Policy

Remuneration Policy for Executive Directors

The Board's policy is designed to ensure that Executive Directors' remuneration reflects performance and enables the Group to attract, retain and motivate a sufficient number of high calibre individuals to lead and direct the organisation and deliver continually improving business performance and long term sustainability for our members.

The Directors' Remuneration Report in the 2013 Report and Accounts explained fully our policy on Executive Directors' remuneration. To provide context and to enhance understanding of our 2014 report, we have set out below the key elements of our Executive and Non-Executive Directors' remuneration and how each element links to our overall business strategy.

Element – How element supports our strategy	Operation	Maximum potential value	Performance conditions and assessment
Basic salary • Supports the recruitment and retention of Executive Directors, reflecting their individual roles, skills and contribution.	Basic salary reflects the size of the role and responsibilities, individual performance (assessed annually) and the skills and experience of the individual. In setting appropriate salary levels, the Committee takes into account data for similar positions in comparable organisations. The data is independently commissioned and the Society aims to position Executive Directors competitively within this reference group.	Increases to base salary are determined annually by the Committee taking into account: • Individual performance; • The scope of the role; • Pay levels in comparable organisations; • Pay increases elsewhere within the Group.	None applicable, although we do take account of individual performance when considering base pay increases.
Pension • Supports recruitment and retention of Executive Directors at a cost that can be controlled by the Society.	Generally the Society contributes to a defined contribution pension scheme for the Executive Director. The contribution can instead be paid in cash (which is excluded from bonus calculations) if the Executive Director is likely to be affected by the limits for tax-approved pension saving.	20% of basic salary for Messrs Cutter and Twigg; 8% of basic salary for the other Executive Directors.	None applicable.
Benefits • To attract, retain and provide security for Executive Directors; • Provides a competitive level of benefits to assist Executive Directors to carry out their roles effectively.	A number of benefits are provided to Executive Directors, including a car or car allowance, private medical insurance, life insurance and disability benefits. The Committee reviews benefits from time to time and may make changes, for example to reflect market practice or the needs of the business.	The Society bears the cost of providing benefits, which may vary from year to year.	None applicable.
Short Term Incentive Scheme (STI) • Supports the attraction and retention of Executive Directors; • Supports the development of a high performance culture; • Rewards performance within the context of achieving corporate goals and objectives as set out in the corporate plan.	Performance measures and targets are set on an annual basis and are measured over the financial year. Payment is normally made in cash shortly after performance has been assessed. The Committee has the ability to reduce or defer bonuses in certain circumstances, including: • capital falling below a certain level; • evidence of systemic conduct risk; and • evidence of control failures. If the total annual emoluments earned by an individual are greater than £500,000, or the STI is more than 33% of his or her total remuneration, 40% of the total STI earned is deferred over a three year period. Deferred remuneration is payable in three equal instalments over the three year period. The Committee may reduce or withdraw the payment of a deferred amount in certain circumstances, including failing to maintain a certain level of capital or the Society reporting a pre-tax loss.	The maximum incentive which may be earned for any year across the STI and the MTI is a combined 100% of salary. The Committee determines the overall maximum and the split between the STI and the MTI from year to year. For 2014, the maximum STI opportunity was 50% of salary for all Executive Directors. For each performance measure, the Committee determines a threshold, target and maximum level of performance. No bonus is payable for performance below the threshold level, with varying levels of payout for performance between threshold and maximum. On-target performance generally attracts a bonus of 60% of the maximum.	The performance measures attached to the STI are currently: • Group profit; • Mortgages and Savings division profit; • Team KPIs, including people, customers & conduct, process and financial strength dimensions; • Personal objectives. The measures are assessed independently. The weightings attached to the types of measure and the individual weightings attached to each individual measure may vary from year to year as determined by the Committee.

Element – How element supports our strategy	Operation	Maximum potential value	Performance conditions and assessment
Medium Term Incentive Scheme (MTI) • Encourages the right behaviours in respect of long term, sustainable performance that supports the achievement of strategic goals. • Provides a balance between long and short term rewards in the overall remuneration package for those senior executives eligible to participate.	Payments are based on performance (as determined by performance against agreed corporate plan targets) over rolling three year cycles. The corporate plan targets for each three year performance period are reviewed and agreed by the Board annually. The performance for each three year cycle is based on cumulative performance against the annual targets for the three year cycle. Payments are made over three years so that: • 50% of the incentive earned is paid immediately following completion of the three year performance period; • 25% is deferred for one year; • 25% is deferred for two years. The Committee may reduce or withdraw the payment of a deferred amount in certain circumstances and has the power to reduce or cancel payments due under the MTI if it believes in extreme circumstances that the payments are not appropriate, for example due to failure to maintain certain capital levels, evidence of systemic conduct risk, or evidence of significant control failures or weaknesses.	As noted above an MTI scheme was introduced in 2014, and the maximum incentive which may be earned for any year across the STI scheme and the MTI scheme is a combined 100% of salary (50% STI plus 50% MTI). For each performance measure, the Committee determines a threshold, target and maximum level of performance. No bonus is payable for performance below the threshold level, with varying levels of payout for performance between threshold and maximum. On-target performance generally attracts a bonus of 60% of the maximum.	50% of the award is based on Group profit and 50% of the award is based on customer measures. The measures are assessed independently. Any payment from the MTI is subject to reduction, up to and including the whole payment, based on CET 1 capital levels at the end of each three year cycle. Any payment from the MTI is subject to satisfactory individual performance.

Notes to the table

Performance measures

The performance conditions attached to the STI and MTI schemes have been selected as they support the long term, sustainable success of the Society. The Committee believes that the use of a range of financial and non-financial measures provides a balanced assessment of the overall performance of the Society.

The Committee considers the targets attached to the STI and MTI schemes to be commercially sensitive and will not therefore disclose these at the beginning of the financial years to which they relate. The Committee will, however, disclose the weightings that will be attached to each STI scheme performance measure at the beginning of the financial year to which they relate.

A summary of the targets set and the performance against the targets will be disclosed following the end of the relevant financial year. In setting the target and maximum payments, the Committee considers both the market position and the risk appetite of the Society and sets these levels accordingly. The measures and weightings for the 2014 – 2016 MTI scheme are outlined in the 'Annual Report on Remuneration in 2014' section of this report under the paragraph headed 'Variable pay'.

Remuneration for other employees

All employees of the Society receive a basic salary and benefits consistent with market practice, and are eligible to participate in the Society's annual bonus and pension arrangements.

Members of the Executive Committee and other selected senior managers may be eligible to participate in the STI and/or MTI schemes on the same terms as the Executive Directors, subject to the discretion of the Group Chief Executive and the Committee. The award size for these individuals is typically lower than for the Executive Directors.

The Society introduced in 2014 a variable pay arrangement for all employees, so that everyone employed by the Society has the opportunity to share in the Society's success. The key principles underlying the scheme are aligned with those that apply for senior management.

Committee's discretion in relation to the STI and MTI schemes

As noted above, the Committee has the discretion to reduce or defer payments under the STI and MTI schemes in a number of circumstances. The Committee also has the discretion to cease or amend the operation of either arrangement where this is necessary to ensure the arrangements continue to meet the Committee's overriding remuneration principles. This might include, for example, amending the deferral arrangements to comply with changing regulation.

How the policy supports the Society's strategy

The table below shows how the variable elements of the Remuneration Policy support the Society's strategy.

	Generating profits for the Society…	...in a sustainable way...	…while delivering value to members and treating them fairly….	…and managing risks and processes while complying with regulation
Annual bonus features				
Group profit	•			
Mortgages and Savings division profit	•			
Team KPIs			•	•
Personal objectives		•		
Risk adjustment		•	•	•
Deferral of larger bonuses		•		•
Discretion to reduce/defer payments		•	•	•
Medium Term Incentive features				
Group profit	•			
Customer measures			•	
Multi-year measurement		•		
Risk adjustment		•	•	•
Deferral		•		•
Discretion to reduce/defer payments		•	•	•

Policy on remuneration of Non-Executive Directors

The table below sets out the elements of Non-Executive Directors' remuneration and the policy on how each element is determined.

Element	Approach to determination
Base fees	Reviewed annually based on time commitment and responsibility required for Board and Board Committee meetings. Review takes into account fees paid by comparable Financial Services organisations. Fees set by Non-Executive Directors' Remuneration Committee.
Additional fees	Additional fees are payable for additional responsibilities such as Committee chairmanship or other duties.
Other items	Non-Executive Directors are not eligible to participate in any form of performance pay plans and do not receive pensions or other benefits.

The Remuneration Committee determines the Chairman's fee while the fees of the other Non-Executive Directors are determined by the Non-Executive Directors' Remuneration Committee.

Directors' service contracts and notice periods

The Executive Directors are employed on rolling service contracts which can be terminated by either the Society or the Director giving one year's notice. Unless notice to terminate is given by either party, the contracts continue automatically.

Non-Executive Directors do not have service contracts.

Annual Report on Remuneration in 2014

Executive Directors' remuneration

The total remuneration for Executive Directors in 2014 is set out in the table below:

2014 Audited	**Salary £000**	**Benefits(1) £000**	**Current year annual performance pay(2) £000**	**Pension £000**	**Total £000**	**Prior years' deferred performance pay now released(3) £000**
Mr D J Cutter	408	15	195	81	699	64
Mr I M Cornelius	236	12	111	19	378	21
Mr M R Fleet (note 4)	251	19	115	20	405	23
Mr R J Twigg (note 5)	76	14	46	15	151	27
	971	**60**	**467**	**135**	**1,633**	**135**

2013 Audited	Salary £000	Benefits(1) £000	Current year annual performance pay(2) £000	Pension £000	Total £000	Prior years' deferred performance pay now released(3) £000
Mr D J Cutter	366	16	296	73	751	24
Mr I M Cornelius	215	12	158	17	402	-
Mr M R Fleet	235	65	170	19	489	-
Mr R J Twigg	280	12	206	56	554	-
	1,096	105	830	165	2,196	24

Notes

1. Benefits comprise the provision of a car or car allowance, and private medical insurance contributions. Mr Twigg's 2014 benefits include £11,043 in relation to holiday pay on his transfer to Connells Limited in April 2014. Mr Fleet's 2013 benefits include £44,717 in relation to relocation costs.
2. £77,802 of the 2014 STI bonus has been deferred under the rules of the scheme (2013: £333,172). No amounts relating to the 2014 - 2016 MTI are included in the above figures as payments will be based on performance in 2014, 2015 and 2016 and are not due to be made until 2017, 2018 and 2019. For Mr Cutter and Mr Cornelius a total of £92,002 has been accrued for in 2014. This represents a third of the estimated payment based on current performance. The accrual will be reviewed at the end of each qualifying year and adjusted, as required, based on that year's performance.
3. The Incentive Scheme rules include the requirement to defer over three years a portion of the amount earned by any individual if the total amount earned by that individual is greater than £500,000, or the amount earned under the Incentive Scheme is more than 33% of his or her total remuneration.
4. Mr Fleet left the Society on 31 December 2014. In accordance with our Remuneration Policy, he will receive the STI for the performance year 2014 which he completed and to which he made a significant contribution. He will be paid in lieu for his contractual notice however he has agreed to forgo any remaining pay in lieu of notice in the event of commencing alternative employment within the 12 month notice period.
5. Mr Twigg resigned as a Director of the Society with effect from 7 April 2014 when he took up the role of Finance and Commercial Director at Connells Limited. The reported figures reflect his earnings to that date and a quarter of his annual bonus payment as an Executive Director.
6. Mr Ndawula was appointed as Group Finance Director on 23 February 2015. His remuneration is not disclosed in the table above as he was not a Director in 2014, but details will be included in respect of 2015 onwards.

Basic salary

As indicated in last year's report, in January 2014, we introduced an MTI scheme which reduced the STI available (from 85% to 50% for the Group Chief Executive and from 75% to 50% for the other Executive Directors with the exception of Mr Twigg who remained in the existing STI scheme) but which increased variable pay in the longer term, aligned with medium term sustainable performance. As part of this change in structure to remuneration, and to reflect external benchmarking, the Committee agreed, with effect from 1 January 2014 to increase the Group Chief Executive's base pay by 8.1% and by 4% for the other Executive Directors, with the exception of Mr Twigg, who did not participate in the 2014 MTI due to his planned transfer to Connells Limited.

Our normal annual salary review process for Executive Directors takes place in April each year and the following adjustments were made to the Executive Directors' base salaries effective from 1 April 2014:

	April 2014	January 2014	% increase
Mr D J Cutter	**£410,000**	£400,000	2.5%
Mr I M Cornelius	**£239,795**	£225,180	6.5%
Mr M R Fleet	**£252,642**	£246,480	2.5%
Mr R J Twigg (note 1)	**-**	£281,500	-

Note

1. Mr Twigg resigned as a Director of the Society with effect from 7 April 2014 when he took up the role of Finance and Commercial Director at Connells Limited.

Variable pay

The MTI scheme was introduced in January 2014 to ensure that overall remuneration is competitive and rewards performance appropriately. In order to create the desired balance in overall variable pay between the short and medium term, the Remuneration Committee determined that some value should transfer from the STI scheme to the MTI scheme to achieve an equal balance between the two elements of variable pay (i.e. 50% of variable pay each). For 2014 onwards the target percentage for both STI and MTI is 30% with a maximum of 50% for each scheme (overall variable pay target 60%, maximum 100%).

Short Term Incentive scheme (STI)

The measures, weightings and the resulting payments for the 2014 STI scheme were as follows:

Director	**Target bonus opportunity (% of salary)**	**Maximum bonus opportunity (% of salary)**	**Weighting**				**Bonus awarded**	
			Group profit	**Mortgages & Savings profit**	**Team KPIs**	**Personal objectives**	**% of salary**	**£000**
Mr D J Cutter	30%	50%	30%	30%	20%	20%	**48%**	**195**
Mr I M Cornelius	30%	50%	30%	30%	20%	20%	**47%**	**111**
Mr M R Fleet	30%	50%	30%	30%	20%	20%	**46%**	**115**
Mr R J Twigg (note 1)	11.25%	18.75%	30%	30%	20%	20%	**61%**	**46**

Note

1. Mr Twigg transferred to Connells Limited in April 2014 and the above target and maximum percentages represent 25% of his full year opportunity as an Executive Director in the scheme.

The table below summarises the outcome against the various measures underlying the annual bonus arrangement:

		Performance achieved				
Measure	Weight	Below Threshold	Between Threshold and Target	Target	Between Target and Maximum	Maximum
Group profit	30%				●	
Mortgages and Savings division profit	30%					●
Team KPIs	20%				●	
Personal objectives (average)	20%				●	

Medium Term Incentive scheme (MTI)

Awards from the scheme are based on a three year performance period commencing January 2014 and ending December 2016 with the first payments due in March 2017. Payments are determined on whether the performance objectives have been achieved and consideration of any risk adjustment measures which may need to be applied. The remuneration disclosed for 2014 does not include any amount for the MTI scheme as this scheme has a three year performance period of which 2014 was the first year. Current performance is between target and maximum, but any future payment will depend on performance in 2015 and 2016. The measures and weightings for the 2014 – 2016 scheme are set out in the table below. Current progress towards these objectives is on track to be between target and maximum. If similar progress is maintained over the three year period, the payment due would equate to 44.2% of base salary, half of which would be paid in 2017, one quarter in 2018 and one quarter in 2019.

Measure	Weight
Group profit	50%
Net customer satisfaction	20%
Customer satisfaction for online channel	10%
Net customer growth	20%

Directors' pension benefits

Mr Cutter is a deferred member of the Skipton Building Society Pension & Life Assurance Scheme, which is a defined benefit fund registered with HM Revenue and Customs under the Finance Act 2004. The Scheme was closed to future accrual of benefits on 31 December 2009 and no further member contributions have been made since that date. The value of his benefits in the scheme is set out below.

Audited 2014	**Normal retirement date**	**Members' contribution for the year ended 31 December 2014 £000**	**Accrued pension entitlement at 31 December 2013 £000 pa**	**Accrued pension entitlement at 31 December 2014 £000 pa**	**Value of remuneration for the year ended 31 December 2014 £000**
Mr D J Cutter	**1 January 2027**	**-**	**86**	**88**	**-**

Note: Mr Twigg is also a deferred member of the Skipton Building Society Pension & Life Assurance Scheme; he resigned as a Director of the Society with effect from 7 April 2014 when he took up the role of Finance and Commercial Director at Connells Limited and therefore his pension entitlement as at the end of 2014 is not disclosed as he is no longer a Director. His accrued pension entitlement as at 7 April 2014, the date he resigned as a Director, was £73,077.

Audited 2013	Normal retirement date	Members' contribution for the year ended 31 December 2013 £000	Accrued pension entitlement at 31 December 2012 £000 pa	Accrued pension entitlement at 31 December 2013 £000 pa	Value of remuneration for the year ended 31 December 2013 £000
Mr D J Cutter	1 January 2027	-	84	86	-
Mr R J Twigg	12 February 2030	-	69	70	-

Normal retirement date for members of the scheme is when they reach the age of 65. The scheme rules specify that this is the earliest date at which members are entitled to benefits from the scheme:

- without consent (from the employer or the Trustee of the scheme); and
- without actuarial reduction in the benefits;
- but disregarding any special provisions in the scheme rules relating to a member's entitlement to early payment of their benefits on the grounds of ill health, redundancy or dismissal.

During the year the Directors' accrued pension entitlement was revalued in line with the scheme rules. The value of remuneration shown above is calculated using a modified version of HM Revenue and Customs' tax rules for pension savings, as laid out in the regulations. The additional value earned by the Director during the year due to his membership of the scheme is included in the total remuneration for that Director.

Non-Executive Directors' remuneration

Non-Executive Directors' fees (excluding those of the Chairman) are reviewed annually by the Non-Executive Directors' Remuneration Committee, in line with the policy outlined earlier in the report. The Non-Executive Directors' Remuneration Committee makes recommendations concerning Non-Executive Directors' remuneration to the Board and in 2014 recommended that the basic Non-Executive Director fee and Deputy Chairman fee should be increased by £2,000 to £46,000 and £52,000 respectively with effect from 1 August 2014. The fees for chairing the Board Audit and Board Risk Committees were increased by £500 to £12,500 per annum. The fee for the chair of the Remuneration Committee was increased by £2,000 to £10,000 per annum to reflect the increasing complexity in the role. These fee increases were also effective from 1 August 2014.

The Chairman's fees are reviewed and approved by the Remuneration Committee. Mr Ellis' fee was set at £155,000 per annum when he joined the Board as Chairman on 24 May 2011. An increase to £160,000 per annum was approved by the Remuneration Committee in September 2014 with effect from 1 August 2014.

Audited	**2014**			2013		
	Fees £000	**Committee Chairmanship Fees £000**	**Total £000**	Fees £000	Committee Chairmanship Fees £000	Total £000
Mr M H Ellis (Chairman)	**157**	**-**	**157**	155	-	155
Mr P J S Thompson (Deputy Chairman) (note 1)	**51**	**9**	**60**	45	3	48
Mr C N Hutton (note 2)	**-**	**-**	**-**	28	2	30
Mrs C Black (note 3)	**45**	**-**	**45**	36	-	36
Ms M Cassoni (note 4)	**45**	**12**	**57**	43	10	53
Mr R D East (note 5)	**45**	**-**	**45**	43	-	43
Mr P R Hales (note 6)	**45**	**12**	**57**	43	10	53
Mr G E Picken (note 7)	**70**	**-**	**70**	52	-	52
Ms H C Stevenson (note 8)	**45**	**-**	**45**	36	-	36
	503	**33**	**536**	481	25	506

Notes

1. Mr Thompson was appointed Deputy Chairman and Chairman of the Remuneration Committee on 31 July 2013.
2. Mr Hutton retired as a Director, Deputy Chairman and Chairman of the Remuneration Committee on 30 July 2013.
3. Mrs Black was appointed as a Director on 1 March 2013.
4. Ms Cassoni is the Chairman of the Audit Committee.
5. Mr East was appointed as Chairman of the Board Risk Committee on 1 January 2015.
6. Mr Hales stepped down as the Chairman of the Board Risk Committee on 31 December 2014 and will retire from the Board on 31 March 2015. Mr Hales will join the Board of SFS for the remainder of 2015, subject to regulatory approval.
7. Mr Picken was appointed as a Director of Connells Limited on 19 June 2013, for which he receives an annual fee of £25,000 included in the table above.
8. Ms Stevenson was appointed as a Director on 1 March 2013.

Material Risk Takers (MRTs)

The Remuneration Code includes the principle of proportionality which means that firms are expected to comply with the remuneration requirements of the Code in relation to their size, internal organisation and the nature, scope and complexity of their activities. Accordingly, the Society is grouped in Tier 3 with banks and building societies with total group assets averaging less than £15bn over the last three financial years. In accordance with CRD IV and the new European Banking Authority (EBA) criteria for the identification of Code Staff (now referred to as MRTs), the Society carried out a review to ascertain which Group subsidiary companies fall within scope of the new regulations. The review identified two additional companies falling within the scope of the regulations, namely Skipton Financial Services (SFS) and Skipton International Limited (SIL). SIL is based in the Channel Islands and is regulated by the Guernsey Financial Services Commission. The Board of SIL agreed to follow the UK implementation of the new CRD IV remuneration requirements and to identify Material Risk Takers.

Accordingly, the number of Material Risk Takers has increased to 73 Group wide, due to the additional businesses in scope and also as a result of the broader criteria set by the EBA. The disclosures for the MRTs in the Society are outlined in this report. The disclosures for SFS and SIL are included in the Pillar 3 document available on our website.

The Remuneration Committee is responsible for approving remuneration policies, maintaining oversight of the remuneration of MRTs and for ensuring that remuneration is paid to them in accordance with the relevant provisions of the PRA / FCA Codes.

Remuneration of Material Risk Takers (MRTs)

The basic salary of MRTs is set according to the size of the role and responsibilities, individual performance (assessed annually), salary levels of similar positions in comparable organisations and internal benchmarks. The Society uses a recognised job evaluation mechanism to determine the relative size of roles.

Salaries are reviewed annually and individual increases are awarded based on the individual's performance against personal objectives measured in accordance with the performance management framework.

In the Society, MRTs participate in the Incentive Scheme alongside non-MRT colleagues. Targets set for MRTs are similar to those outlined above for Executive Directors but for MRTs in risk management and internal audit functions, while profit remains an element, an increased weighting (50%) is given to the achievement of non-financial objectives.

The requirement to defer a portion of the bonus if it exceeds 33% of total remuneration, or if total remuneration exceeds £500,000, applies to all participants in the Society's Senior Leadership Bonus Scheme irrespective of whether they are MRTs.

The table below sets out the aggregate remuneration for the Society's MRTs for the year ended 31 December 2014:

2014	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay[1] £000	Total £000	Prior years' deferred performance pay now released £000
Senior management (including Executive Directors)	8	1,964	1,281	3,245	135
Other material risk takers	50	4,384	1,144	5,528	-
	58	**6,348**	**2,425**	**8,773**	**135**

Note

1. Awards for the 2014-2016 MTI scheme are included in the above disclosures at the maximum. MTI scheme awards made each year are paid from three years after the date of the award. Payment is based on the extent to which performance conditions are met overall and can result in zero payments.

History of Group Chief Executive's remuneration

The table below shows the total remuneration of the Group Chief Executive over the last five years, together with the bonus awarded to the Group Chief Executive as a percentage of his maximum possible bonus. The Group Chief Executive's total remuneration in 2014 has decreased due to the reduction in the short term bonus opportunity (from 85% to 50% of base salary). In the longer term this may increase again, depending on performance, but will be capped at 100% in any one performance year.

Year	Total remuneration[1]	Bonus as % of maximum
2014	£699,000	95%
2013	£751,000	94%
2012	£617,000	60%
2011	£482,000	18%
2010	£463,000	25%

Note

1. Total remuneration includes base pay, allowances, benefits and short term incentive pay. MTI is not included in the above figures as payments are subject to a three year performance period.

Comparison to the remuneration of other employees

As outlined earlier in the report, the Group Chief Executive's base salary was increased in January 2014 to reflect the changes in remuneration structure, i.e. the shift between short term and medium term incentive opportunity. His normal annual review in April 2014 resulted in a 2.5% increase in base salary. This compares to an annual average pay award in 2014 of 3.9% for all other Society employees. It should be noted that the Society remuneration comparator relates to Society employees only as this is considered to be the most sensible comparator due to the varying remuneration policies across the other Group subsidiaries.

Statement of implementation of Remuneration Policy in 2015

We anticipate that the implementation of our Remuneration Policy in 2015 will be unchanged from 2014 with regard to the variable pay schemes in operation and our approach to reviewing base pay.

However, subject to meeting our corporate plan expectations in 2015, the Group's average total assets over the last three years will exceed £15bn. This means that, in 2016, we will need to comply with additional PRA and FCA requirements in the governance of remuneration. This is a significant change which will require a close review of our existing remuneration policies and schemes to meet evolving regulatory requirements.

In reviewing our remuneration policies and variable pay schemes for Executive Directors and other senior colleagues, we will take into account member interests, market practice and our existing remuneration principles, including the need to attract and retain key talent within the organisation.

The Committee and its advisers

The Remuneration Committee is responsible for determining, on behalf of the Board, the Remuneration Policy, reviewing its adequacy, effectiveness and compliance with regulatory requirements. The Committee specifically:

- Sets remuneration for the Chairman and the Executive Directors;
- Approves the remuneration policy for senior managers who have a material impact on the Society's risk profile (MRTs);
- Reviews recommendations from the Group Chief Executive for approval of the remuneration for key executives in the Group;
- Agrees the design and overall targets for any short or longer term variable pay schemes applicable to senior executives and MRTs.

The Committee has established clear remuneration principles for the Society and its Group subsidiaries. For the PRA and FCA regulated businesses, the principles, which are reviewed annually, set appropriate standards for remuneration governance, risk management, variable pay structures (and the link to performance) and remuneration for MRTs. The Committee receives an annual report from the Chief Conduct Risk Officer and Secretary on the implications of the remuneration policies within the Group on risk management and compliance with the principles.

The terms of reference of the Remuneration Committee and the remuneration principles are available, on request, from the Secretary.

The Remuneration Committee met nine times during 2014. In discharging its duties, the Committee reviews and takes into account independently produced data in relation to similar Financial Services organisations. Remuneration consultants advising the Committee are independent from the Group.

The Committee currently comprises three Non-Executive Directors, Mr Thompson (Chairman), Mrs Black and Ms Stevenson. Mr East served on the Committee throughout 2014 and he was appointed Chair of the Risk Committee on 1 January 2015. Mrs Black joined the Committee on 1 January 2015. The Chairman, Group Chief Executive, Chief Conduct Risk Officer and Secretary and Chief Human Resources Officer regularly attend meetings by invitation and external advisers are invited to attend meetings as and when appropriate.

A review of external advisers providing support to the Committee will take place in 2015. Consultants from PwC have supported the Committee with the implementation of the CRD IV remuneration rules and the review of Group governance and oversight arrangements.

The Non-Executive Directors' Remuneration Committee, which currently comprises Messrs Ellis (Chairman), Cutter, Cornelius and Ndawula, determines the level of the other Non-Executive Directors' fees.

Statement of voting at 2014 AGM

At the 2014 AGM the Directors' Remuneration Report and the Directors' Remuneration Policy were subject to an advisory vote of members, the results of which were as follows:

	Votes		
Vote	**For**	**Against**	**Withheld**
2013 remuneration report	60,715 (85.6%)	8,424 (11.9%)	1,757 (2.5%)
2013 remuneration policy	60,099 (84.8%)	8,914 (12.5%)	1,888 (2.7%)

Nimble Thompson
Chairman of the Remuneration Committee

24 February 2015

Independent auditor's report to the members of Skipton Building Society only

Opinions and conclusions arising from our audit

1. Our opinion on the Annual Accounts is unmodified

We have audited the Group and Society Annual Accounts of Skipton Building Society for the year ended 31 December 2014 set out on pages 69 to 163. In our opinion 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 December 2014 and of the income and expenditure of the Group and of the Society for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and regulations made under it and, as regards the Group Annual Accounts, Article 4 of the IAS Regulation.

2. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the Annual Accounts, the risks of material misstatement that had the greatest effect on our audit were as follows:

Impairment of loans and advances to customers (£41.4m) (excluding equity release mortgages)

Refer to page 47 (Audit Committee Report), note 1g) (accounting policy) and notes 1u), 16 and 37 (financial disclosures).

The risk

The impairment of loans and advances to customers is estimated by the Directors through the exercise of judgement and use of highly subjective assumptions. Historical information on the Group's loss experience is analysed and adjusted to reflect current circumstances which requires a high degree of judgement. Due to the significance of loans and advances to customers and the related estimation uncertainty, this is considered a key audit risk.

Loans and advances to customers include equity release mortgages, and their carrying value is assessed separately below.

Our response

Our audit procedures included testing the design, implementation and operating effectiveness of key controls over the underwriting, recording and monitoring of loans and advances.

We also tested the methodologies, inputs and assumptions used by the Group in calculating collectively assessed impairments and assessing the adequacy of impairment allowances for individually assessed loans and advances to customers.

We compared the Group's assumptions for both collective and individual impairment allowances to externally available industry, financial and economic data and our own assessments in relation to key inputs such as historical default rates, recovery rates, collateral valuation and economic factors, and considered the sensitivity of these inputs on the assessment of impairment.

For a sample of exposures that were subject to an individual impairment assessment, and focusing on those with the most significant potential impact on the financial statements, we specifically challenged the Group's assumptions on the expected future cash flows, including the value of realisable collateral based on our own understanding and reviewing latest correspondence and valuations.

We also assessed whether the Annual Accounts disclosures adequately reflect the Group's exposure to credit risk.

Equity release mortgages (£234.1m)

Refer to page 47 (Audit Committee Report), notes 1e) and 1u) (accounting policy) and note 38b) (financial disclosures).

The risk

The Directors assess the carrying amount of equity release mortgages, included in loans and advances to customers, by performing a fair valuation of the 'no negative equity guarantee' provided. This fair valuation is assessed collectively with key input assumptions including house price inflation, retail price index, mortality and early redemption rates and the discount factor.

Due to the significant uncertainty in the fair valuations relating to the carrying value of the equity release mortgages and the subjectivity and sensitivity of underlying assumptions, this is considered to be a key audit risk.

Our response

Our audit procedures included testing the methodologies, inputs and assumptions used by the Group in estimating the fair value of the no negative equity guarantee.

We compared the Group's assumptions to externally available industry, financial and economic data and our own assessments in relation to key inputs such as collateral valuation and economic factors, and considered the sensitivity of these inputs on the assessment of the carrying value of the mortgages.

We considered the output of an alternative fair valuation methodology as part of our assessment of the carrying value of the no negative equity guarantee.

We also assessed whether the Annual Accounts disclosures adequately reflect the sensitivities of the assumptions used.

Provisions for liabilities (£32.4m)

Refer to page 47 (Audit Committee Report), note 1u) (accounting policy) and notes 27 and 33 (financial disclosures).

The risk

The recognition and measurement of provisions and the measurement and disclosure of contingent liabilities in respect of potential operational and conduct matters require significant judgement.

Operating in highly regulated sectors and providing a wide range of customer offerings across the Group heightens the risk of compliance issues and of operational litigation and claims to emerge. Due to the significance of potential provisions and the difficulty in assessing and measuring obligations resulting from legal and regulatory judgements, this is considered a key audit risk.

Our response

Our audit procedures included testing the design, implementation and operating effectiveness of key controls over the identification, evaluation and measurement of potential obligations arising from conduct and operational issues.

We considered the Group's assessment of the nature and status of claims and litigation and discussed them with Group senior management including in-house legal and insurance teams. We assessed the legal advice and correspondence with regulators received in connection with legal proceedings, investigations or regulatory matters which the Group is party to.

For all provisions made, we understood and critically assessed the provisioning models and underlying assumptions used. For those underlying assumptions based on historical experience, we assessed whether these remained appropriate and the basis for any adjustments.

We also considered whether the Annual Accounts disclosures of the application of judgement in estimating provisions and contingent liabilities adequately reflected the associated uncertainties.

3. Our application of materiality and an overview of the scope of our audit

The materiality of the Group Annual Accounts as a whole was set at £7.6m. This was determined with reference to a benchmark of Group profit before tax adjusted to exclude the net profit on sale or change in shareholding of subsidiaries, associates and investments, because we consider this to be one of the principal measures used by members in assessing the Group's financial performance. Materiality represents 4.2% of total Group profit before tax and 5.0% after adjustment to exclude the net profit on sale of subsidiaries, associates and investments, profit from discontinued operations and to add back the FSCS levy. We agreed with the Audit Committee to report to it any misstatements we identified through our audit with a value in excess of £0.4m and any other audit misstatements below this threshold that we believed to warrant reporting on qualitative grounds.

Audits for Group reporting purposes were performed by local audit teams at 52 reporting components in three countries covering all of the subsidiaries and the Group's joint ventures and so covered 100% of total Group income, Group profit before tax and total Group assets. The audits undertaken for Group reporting purposes at all these reporting components were performed in accordance with the materiality levels used for local audits, which were set individually. Materiality used at the reporting components ranged from £0.1m to £6.0m.

Detailed Group audit instructions were sent to the auditors of all the components. These instructions covered the significant audit areas that should be covered by these audits (which included the relevant risks of material misstatement detailed above) and set out the information required to be reported back to the Group audit team. The local audit teams attended a Group audit planning meeting and the Group audit team also held regular telephone meetings with the local auditors during the audit.

As well as drawing up the scope, Group audit instructions and exercising overall oversight, the Group audit team performed the audit of the Society itself including work on impairment of loans and advances, valuation of financial instruments and disposal of subsidiaries and investments.

4. Our opinion on other matters prescribed by the Building Societies Act 1986 is unmodified

In our opinion:

- 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 thereunder;
- the information given in the Directors' Report for the financial year for which the Annual Accounts are prepared is consistent with the accounting records and the Annual Accounts; and
- 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.

5. We have nothing to report in respect of the matters on which we are required to report by exception

Under International Standards on Auditing (ISAs) (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the Annual Report that contains a material inconsistency with either that knowledge or the Annual Accounts, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for members to assess the Group's and Society's performance, business model and strategy; or
- the Audit Committee Report does not appropriately address matters communicated by us to the Audit Committee.

Under the Building Societies Act 1986 we are required to report to you if, in our opinion:

- proper accounting records have not been kept by the Society; or
- the Annual Accounts are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.

We have nothing to report in respect of the above responsibilities.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on pages 36 to 38, the Directors are responsible for the preparation of Annual Accounts which give a true and fair view. Our responsibility is to audit, and express an opinion on, the Annual Accounts in accordance with applicable law and ISAs (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of an audit of annual accounts performed in accordance with ISAs (UK and Ireland)

A description of the scope of an audit of annual accounts is provided on our website at www.kpmg.com/uk/auditscopeother2014. This report is made subject to important explanations regarding our responsibilities, as published on that website, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

The purpose of our audit work and to whom we owe our responsibilities

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

Jonathan Holt (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
Leeds

24 February 2015

Income Statements

For the year ended 31 December 2014

	Notes	**Group 2014 £m**	Group 2013 Restated*^ £m	**Society 2014 £m**	Society 2013 Restated* £m
Interest receivable and similar income	2	**442.8**	393.4	**410.6**	365.3
Interest payable and similar charges	3	**(229.5)**	(250.8)	**(233.9)**	(252.5)
Net interest receivable		**213.3**	142.6	**176.7**	112.8
Fees and commissions receivable	4	**402.0**	373.1	**18.7**	23.5
Fees and commissions payable		**(10.2)**	(10.8)	**(1.7)**	(2.0)
Fair value (losses) / gains on financial instruments		**(2.0)**	3.9	**(2.6)**	3.7
Losses on treasury assets	5	**(3.7)**	-	**(3.7)**	-
Income from shares in subsidiary undertakings		**-**	-	**64.0**	30.9
Profit on disposal of subsidiary undertakings	17b)	**1.1**	24.7	**-**	-
Profit on part disposal of equity share investments	17e)	**10.1**	-	**-**	-
Profit on part disposal of associate	17d)	**2.3**	-	**-**	-
Dividend income from equity share investments		**1.1**	1.1	**-**	-
Share of profits from joint ventures		**2.4**	2.2	**-**	-
Share of losses from associate	17d)	**(2.6)**	(0.9)	**-**	-
Other income	6	**3.8**	7.9	**2.6**	3.3
Total income		**617.6**	543.8	**254.0**	172.2
Administrative expenses	7	**(426.7)**	(399.4)	**(83.1)**	(68.6)
Operating profit before impairment losses and provisions		**190.9**	144.4	**170.9**	103.6
Impairment losses on loans and advances to customers	16	**(13.3)**	(21.5)	**(7.5)**	(17.4)
Impairment losses on debt securities	13	**(2.0)**	(1.2)	**(2.0)**	(1.2)
Impairment losses on equity share investments	17e)	**(1.3)**	-	**-**	-
Provisions for liabilities	27	**(17.5)**	(19.0)	**(8.0)**	(8.2)
Provisions against investments in subsidiary undertakings	17a)	**-**	-	**-**	(1.3)
Profit before tax		**156.8**	102.7	**153.4**	75.5
Tax expense	11	**(34.9)**	(26.3)	**(20.2)**	(11.3)
Profit for the financial year from continuing operations		**121.9**	76.4	**133.2**	64.2
Discontinued operation					
Profit from discontinued operation	17b)	**24.8**	0.8	**-**	-
Profit for the financial year		**146.7**	77.2	**133.2**	64.2
Profit for the financial year attributable to:					
Members of Skipton Building Society					
Profit for the financial year from continuing operations		**122.3**	75.3	**133.2**	64.2
Profit for the financial year from discontinued operations		**24.8**	0.8	**-**	-
		147.1	76.1	**133.2**	64.2
Non-controlling interests					
(Loss) / profit for the financial year from continuing operations		**(0.4)**	1.1	**-**	-
		(0.4)	1.1	**-**	-
		146.7	77.2	**133.2**	64.2

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

^ The prior period figures have also been re-presented in accordance with IFRS 5 *Non-current assets held for sale and discontinued operations*, to reflect the disposal of Homeloan Management Limited and its subsidiary companies, which became a discontinued operation during 2014. Further details are provided in note 17b).

Segmental performance of the Group is shown in note 39.

The notes on pages 77 to 161 form part of these Accounts.

Statements of Comprehensive Income

For the year ended 31 December 2014

	Notes	**Group 2014 £m**	Group 2013 Restated* £m	**Society 2014 £m**	Society 2013 Restated* £m
Profit for the financial year		**146.7**	77.2	**133.2**	64.2
Other comprehensive income:					
Items that will not be reclassified to profit or loss:					
Remeasurement losses on defined benefit obligations	29	**(22.8)**	(9.2)	**(11.4)**	(4.5)
Income tax on items that will not be reclassified to profit or loss	32	**4.6**	0.7	**2.3**	0.3
		(18.2)	(8.5)	**(9.1)**	(4.2)
Items that may be reclassified subsequently to profit or loss:					
Available-for-sale investments: valuation gains / (losses) taken to equity	32	**13.5**	28.8	**8.3**	(2.4)
Available-for-sale investments: realised (gains) / losses reclassified to Income Statement	32	**(6.6)**	0.7	**2.2**	0.7
Cash flow hedges: gains taken to equity	32	**4.5**	5.2	**4.5**	5.2
Cash flow hedges: realised losses transferred to Income Statement	32	**2.6**	-	**2.6**	-
Exchange differences on translation of foreign operations	32	**0.1**	(0.5)	**-**	-
Income tax on items that may be reclassified to profit or loss	32	**(2.4)**	(8.3)	**(3.7)**	(1.2)
		11.7	25.9	**13.9**	2.3
Other comprehensive (expense) / income for the year, net of tax		**(6.5)**	17.4	**4.8**	(1.9)
Total comprehensive income for the year		**140.2**	94.6	**138.0**	62.3
Total comprehensive income attributable to:					
Members of Skipton Building Society		**140.6**	93.5	**138.0**	62.3
Non-controlling interests		**(0.4)**	1.1	**-**	-
		140.2	94.6	**138.0**	62.3

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

The notes on pages 77 to 161 form part of these Accounts.

Statements of Financial Position

As at 31 December 2014

	Notes	Group 2014 £m	Group 2013 Restated* £m	Society 2014 £m	Society 2013 Restated* £m
Assets					
Cash in hand and balances with the Bank of England		**1,076.1**	859.4	**1,076.1**	859.4
Loans and advances to credit institutions	12	**365.4**	326.2	**240.5**	195.5
Debt securities	13	**1,152.6**	1,195.5	**1,608.9**	1,717.1
Derivative financial instruments	14	**133.4**	148.8	**139.1**	151.7
Loans and advances to customers	15	**12,836.8**	11,516.9	**10,577.3**	9,205.2
Deferred tax asset	28	**21.7**	18.9	**9.1**	9.7
Investments in group undertakings	17a)	**-**	-	**1,619.6**	1,845.7
Investments in joint ventures		**8.9**	4.2	**-**	-
Investments in associates	17d)	**13.2**	13.4	**-**	-
Equity share investments	17e)	**32.9**	37.1	**-**	-
Property, plant and equipment	18	**64.0**	81.6	**29.9**	30.2
Investment property	19	**22.1**	6.7	**22.0**	27.1
Intangible assets	20	**166.5**	174.2	**1.7**	1.5
Other assets	21	**88.1**	103.8	**11.5**	10.5
Total assets		**15,981.7**	14,486.7	**15,335.7**	14,053.6
Liabilities					
Shares	22	**11,467.5**	10,260.1	**11,467.5**	10,260.1
Amounts owed to credit institutions	23	**789.8**	1,046.3	**880.6**	1,149.4
Amounts owed to other customers	24	**1,143.2**	930.8	**1,485.1**	1,268.9
Debt securities in issue	25	**730.6**	554.7	**7.1**	49.7
Derivative financial instruments	14	**307.3**	287.6	**290.5**	251.6
Current tax liability		**18.3**	9.3	**12.5**	2.7
Other liabilities	26	**101.8**	95.7	**9.7**	8.3
Accruals and deferred income		**41.5**	42.8	**10.7**	8.9
Provisions for liabilities	27	**32.4**	37.3	**6.7**	7.3
Deferred tax liability	28	**12.1**	15.4	**2.4**	5.0
Retirement benefit obligations	29	**73.0**	53.3	**33.6**	24.2
Subordinated liabilities	30	**98.0**	124.4	**98.0**	124.4
Subscribed capital	31	**94.3**	94.1	**94.3**	94.1
Total liabilities		**14,909.8**	13,551.8	**14,398.7**	13,254.6
Members' interests					
General reserve		**1,046.2**	917.3	**939.7**	815.6
Available-for-sale reserve		**26.4**	20.5	**2.6**	(5.6)
Cash flow hedging reserve		**(5.3)**	(11.0)	**(5.3)**	(11.0)
Translation reserve		**5.3**	5.2	**-**	-
Attributable to members of Skipton Building Society		**1,072.6**	932.0	**937.0**	799.0
Non-controlling interests		**(0.7)**	2.9	**-**	-
Total members' interests		**1,071.9**	934.9	**937.0**	799.0
Total members' interests and liabilities		**15,981.7**	14,486.7	**15,335.7**	14,053.6

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

These Accounts were approved by the Board of Directors on 24 February 2015 and were signed on its behalf by:

M H Ellis **Chairman**
D J Cutter **Group Chief Executive**
B Ndawula **Group Finance Director**

The notes on pages 77 to 161 form part of these Accounts.

Financials

Statements of Changes in Members' Interests

For the year ended 31 December 2014

Group	General reserve £m	Available-for-sale financial assets £m	Cash flow hedges £m	Translation of foreign operations £m	Sub total £m	Non-controlling interests £m	Total £m
Balance at 1 January 2014	**917.3**	**20.5**	**(11.0)**	**5.2**	**932.0**	**2.9**	**934.9**
Profit for the financial year	147.1	-	-	-	**147.1**	(0.4)	**146.7**
Other comprehensive income							
Remeasurement losses on defined benefit obligations	(18.2)	-	-	-	**(18.2)**	-	**(18.2)**
Net gains from changes in fair value	-	11.1	3.7	-	**14.8**	-	**14.8**
Available-for-sale: realised gains transferred to profit or loss on sale	-	(5.2)	-	-	**(5.2)**	-	**(5.2)**
Cash flow hedges: realised losses transferred to Income Statement	-	-	2.0	-	**2.0**	-	**2.0**
Exchange differences on translation of foreign operations	-	-	-	0.1	**0.1**	-	**0.1**
Total other comprehensive income (note 32)	**(18.2)**	**5.9**	**5.7**	**0.1**	**(6.5)**	**-**	**(6.5)**
Total comprehensive income for the year	**128.9**	**5.9**	**5.7**	**0.1**	**140.6**	**(0.4)**	**140.2**
Changes in ownership interests:							
Subsidiary share buy-back	-	-	-	-	**-**	(3.2)	**(3.2)**
Balance at 31 December 2014	**1,046.2**	**26.4**	**(5.3)**	**5.3**	**1,072.6**	**(0.7)**	**1,071.9**
Balance at 1 January 2013 (previously published)	844.9	(2.3)	(14.6)	5.7	833.7	1.8	835.5
IFRIC 21 adjustment*	4.8	-	-	-	4.8	-	4.8
Balance at 1 January 2013 (restated)*	849.7	(2.3)	(14.6)	5.7	838.5	1.8	840.3
Profit for the financial year (previously published)	75.2	-	-	-	75.2	1.1	76.3
IFRIC 21 adjustment*	0.9	-	-	-	0.9	-	0.9
Profit for the financial year (restated)*	76.1	-	-	-	76.1	1.1	77.2
Other comprehensive income							
Remeasurement losses on defined benefit obligations	(8.5)	-	-	-	(8.5)	-	(8.5)
Net gains from changes in fair value	-	22.3	3.6	-	25.9	-	25.9
Available-for-sale losses transferred to profit or loss on sale	-	0.5	-	-	0.5	-	0.5
Exchange differences on translation of foreign operations	-	-	-	(0.5)	(0.5)	-	(0.5)
Total other comprehensive income (note 32)	(8.5)	22.8	3.6	(0.5)	17.4	-	17.4
Total comprehensive income for the year (previously published)	66.7	22.8	3.6	(0.5)	92.6	1.1	93.7
IFRIC 21 adjustment*	0.9	-	-	-	0.9	-	0.9
Total comprehensive income for the year (restated)*	67.6	22.8	3.6	(0.5)	93.5	1.1	94.6
Balance at 31 December 2013 (previously published)	911.6	20.5	(11.0)	5.2	926.3	2.9	929.2
IFRIC 21 adjustment*	5.7	-	-	-	5.7	-	5.7
Balance at 31 December 2013 (restated)*	917.3	20.5	(11.0)	5.2	932.0	2.9	934.9

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

Statements of Changes in Members' Interests *(continued)*

For the year ended 31 December 2014

Society	**General reserve £m**	**Available-for-sale financial assets £m**	**Cash flow hedges £m**	**Total £m**
Balance at 1 January 2014	**815.6**	**(5.6)**	**(11.0)**	**799.0**
Profit for the financial year	133.2	-	-	**133.2**
Other comprehensive income				
Remeasurement losses on defined benefit obligations	(9.1)	-	-	**(9.1)**
Net gains from changes in fair value	-	6.6	3.7	**10.3**
Available-for-sale losses transferred to profit or loss on sale	-	1.6	-	**1.6**
Cash flow hedges: realised losses transferred to Income Statement	-	-	2.0	**2.0**
Total other comprehensive income (note 32)	**(9.1)**	**8.2**	**5.7**	**4.8**
Total comprehensive income for the year	**124.1**	**8.2**	**5.7**	**138.0**
Balance at 31 December 2014	**939.7**	**2.6**	**(5.3)**	**937.0**
Balance at 1 January 2013 (previously published)	750.8	(4.3)	(14.6)	731.9
IFRIC 21 adjustment*	4.8	-	-	4.8
Balance at 1 January 2013 (restated)*	755.6	(4.3)	(14.6)	736.7
Profit for the financial year (previously published)	63.3	-	-	63.3
IFRIC 21 adjustment*	0.9	-	-	0.9
Profit for the financial year (restated)*	64.2	-	-	64.2
Other comprehensive income				
Remeasurement losses on defined benefit obligations	(4.2)	-	-	(4.2)
Net (losses) / gains from changes in fair value	-	(1.8)	3.6	1.8
Available-for-sale losses transferred to profit or loss on sale	-	0.5	-	0.5
Total other comprehensive income (note 32)	(4.2)	(1.3)	3.6	(1.9)
Total comprehensive income for the year (previously published)	59.1	(1.3)	3.6	61.4
IFRIC 21 adjustment*	0.9	-	-	0.9
Total comprehensive income for the year (restated)*	60.0	(1.3)	3.6	62.3
Balance at 31 December 2013 (previously published)	809.9	(5.6)	(11.0)	793.3
IFRIC 21 adjustment*	5.7	-	-	5.7
Balance at 31 December 2013 (restated)*	815.6	(5.6)	(11.0)	799.0

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

The notes on pages 77 to 161 form part of these Accounts.

Statements of Cash Flows

For the year ended 31 December 2014

	Notes	**Group 2014 £m**	Group 2013 Restated* £m	**Society 2014 £m**	Society 2013 Restated* £m
Cash flows from operating activities					
Profit before tax from all operations		**181.6**	103.6	**153.4**	75.5
Adjustments for:					
Impairment losses on debt securities	13	**2.0**	1.2	**2.0**	1.2
Impairment losses on loans and advances to customers	16	**13.3**	21.5	**7.5**	17.4
Loans and advances written off, net of recoveries	16	**(13.5)**	(35.2)	**(3.8)**	(23.4)
Provisions against investments in subsidiary undertakings	17a)	**-**	-	**-**	1.3
Depreciation and amortisation	18,19, 20	**15.8**	18.3	**3.3**	3.4
Impairment of investment property and property, plant and equipment	19	**4.7**	1.2	**4.7**	1.2
Impairment of goodwill	20	**3.5**	16.6	**-**	-
Impairment of other intangible assets	20	**0.6**	-	**-**	-
Impairment losses on equity share investments	17e)	**1.3**	-	**-**	-
Income from shares in subsidiary undertakings		**-**	-	**(64.0)**	(30.9)
Dividend income from equity share investments		**(1.1)**	(1.1)	**-**	-
Interest on subscribed capital and subordinated liabilities	3	**12.7**	21.1	**12.7**	21.1
Profit on sale of property, plant and equipment, investment property and intangible assets	6	**(0.3)**	(0.2)	**(0.2)**	(0.3)
Losses on treasury assets	5	**3.7**	-	**3.7**	-
Share of losses / (profits) from joint ventures and associates		**0.2**	(1.3)	**-**	-
Profit on part disposal of associate	17d)	**(2.3)**	-	**-**	-
Profit on part disposal of equity share investments	17e)	**(10.1)**	-	**-**	-
Profit on disposal of subsidiary undertakings	17b)	**(25.8)**	(24.7)	**-**	-
Other non-cash movements		**1.9**	4.7	**10.7**	5.4
		188.2	125.7	**130.0**	71.9
Changes in operating assets and liabilities:					
Movement in prepayments and accrued income		**5.1**	1.0	**(1.2)**	0.4
Movement in accruals and deferred income		**4.3**	(23.4)	**6.6**	(24.9)
Movement in provisions for liabilities		**(4.9)**	(11.1)	**(0.6)**	(3.2)
Movement in fair value of derivatives		**35.1**	(29.3)	**51.5**	2.9
Movement in fair value adjustments for hedged risk		**(35.0)**	13.0	**(30.8)**	9.8
Fair value movements in debt securities	13	**(29.5)**	20.7	**(29.5)**	18.5
Movement in loans and advances to customers		**(1,276.7)**	(964.3)	**(1,336.8)**	(1,028.7)
Movement in shares		**1,190.5**	848.9	**1,190.5**	848.9
Net movement in amounts owed to credit institutions and other customers		**(42.7)**	174.8	**(52.6)**	(91.2)
Net movement in debt securities in issue		**176.9**	(175.7)	**(42.7)**	(10.2)
Net movement in loans and advances to credit institutions		**(41.7)**	24.5	**(46.6)**	29.3
Net movement in other assets		**(2.6)**	7.3	**(1.8)**	5.1
Net movement in other liabilities		**23.3**	12.8	**11.0**	5.0
Income taxes paid		**(31.0)**	(20.2)	**(13.7)**	(7.1)
Net cash flows from operating activities		**159.3**	4.7	**(166.7)**	(173.5)

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

Statements of Cash Flows *(continued)*

For the year ended 31 December 2014

	Notes	**Group 2014 £m**	Group 2013 Restated* £m	**Society 2014 £m**	Society 2013 Restated* £m
Net cash flows from operating activities		**159.3**	4.7	**(166.7)**	(173.5)
Cash flows from investing activities					
Purchase of debt securities	13	**(831.2)**	(767.1)	**(820.5)**	(737.2)
Proceeds from disposal of debt securities		**897.9**	683.6	**952.5**	694.5
Purchase of property, plant and equipment and investment property	18,19	**(14.0)**	(11.6)	**(3.0)**	(1.2)
Purchase of intangible assets	20	**(4.3)**	(7.4)	**(0.7)**	(0.6)
Proceeds from disposal of property, plant and equipment, investment property and intangible assets		**2.1**	5.2	**1.1**	4.0
Dividends received from group undertakings		**-**	-	**64.0**	30.9
Dividends received from equity share investments		**1.1**	1.1	**-**	-
Share options issued	26	**0.2**	-	**-**	-
Proceeds from disposal of equity share investments	17e)	**10.6**	-	**-**	-
Dividends received from joint ventures		**2.7**	1.1	**-**	-
Dividends paid to non-controlling interests	26	**(1.0)**	(1.9)	**-**	-
Purchase of subsidiary undertakings, net of cash acquired	17a)	**(14.8)**	-	**-**	-
Further investment in subsidiary undertakings	17a)	**(10.6)**	(0.2)	**-**	(1.3)
Investment in joint ventures and equity share investments		**(6.1)**	(0.8)	**-**	-
Proceeds from disposal of joint ventures		**0.1**	-	**-**	-
Purchase of other business units	20	**(1.1)**	(0.7)	**-**	-
Cash received from sale of subsidiary undertakings, net of cash disposed of		**64.3**	(0.3)	**-**	-
Cash paid to non-controlling interests on subsidiary share buy-back		**(3.2)**	-	**-**	-
Cash received on flotation of subsidiary		**-**	19.2	**-**	-
Net cash flows from investing activities		**92.7**	(79.8)	**193.4**	(10.9)
Cash flows from financing activities					
Redemption of subordinated liabilities		**(15.0)**	-	**(15.0)**	-
Repurchase of subordinated liabilities	30	**(10.0)**	(91.7)	**(10.0)**	(91.7)
Decrease in loans to subsidiary undertakings	17a)	**-**	-	**226.1**	134.8
Interest paid on subordinated liabilities		**(4.4)**	(12.8)	**(4.4)**	(12.8)
Interest paid on subscribed capital		**(8.3)**	(8.3)	**(8.3)**	(8.3)
Net cash flows from financing activities		**(37.7)**	(112.8)	**188.4**	22.0
Net increase / (decrease) in cash and cash equivalents		**214.3**	(187.9)	**215.1**	(162.4)
Cash and cash equivalents at 1 January		**988.3**	1,176.2	**862.6**	1,025.0
Cash and cash equivalents at 31 December		**1,202.6**	988.3	**1,077.7**	862.6

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

Statements of Cash Flows *(continued)*

For the year ended 31 December 2014

Analysis of the cash balances as shown within the Statement of Financial Position:

	Notes	**Group 2014 £m**	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Cash in hand and balances with the Bank of England		**1,076.1**	859.4	**1,076.1**	859.4
Mandatory reserve deposit with the Bank of England		**(20.2)**	(18.4)	**(20.2)**	(18.4)
		1,055.9	841.0	**1,055.9**	841.0
Loans and advances to credit institutions	12	**146.7**	147.3	**21.8**	21.6
Cash and cash equivalents as at 31 December		**1,202.6**	988.3	**1,077.7**	862.6

The notes on pages 77 to 161 form part of these Accounts.

Notes to the Accounts

1. Accounting policies

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

a) Basis of preparation

The Annual Accounts of the Group and the Society are prepared on a going concern basis (see page 37 of the Directors' Report) and in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and effective at 31 December 2014; and with those parts of the Building Societies (Accounts and Related Provisions) Regulations, 1998, and the Building Societies Act 1986 applicable to building 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, as well as derivatives and certain other liabilities at fair value through 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 pounds.

During the year the Directors have adopted the following new or amended accounting standards and interpretations, all of which are EU endorsed:

- IFRS 10 *Consolidated Financial Statements*, which applies to the consolidated accounts within these financial statements.
- IFRS 11 *Joint Arrangements*, which applies to the consolidated accounts within these financial statements.
- IFRS 12 *Disclosure of Interest in Other Entities*, which applies to the consolidated accounts within these financial statements.
- IAS 27 (revised) *Separate Financial Statements*, which applies to only the Society accounts within these financial statements.
- IAS 28 (revised) *Investments in Associates and Joint Ventures*, which applies to the consolidated accounts within these financial statements.
- *Investment Entities* (amendments to IFRS 10, IFRS 12 and IAS 27).
- Amendments to IAS 32 *Offsetting Financial Assets and Financial Liabilities.*
- Amendments to IAS 36 *Recoverable Amount Disclosures for Non-Financial Assets.*
- Amendments to IAS 39 *Novation of Derivatives and Continuation of Hedge Accounting*.

Note 41 summarises the impact of the above. The Directors have also adopted IFRIC 21 *Levies*, which became EU endorsed during the year, and the impact is summarised in note 1b) below.

b) Change of accounting policy

IFRIC 21 *Levies* clarifies the accounting for government imposed levies within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. It clarifies that the obligating event for the recognition of a liability, in respect of payment of a levy, is the activity that triggers the payment of the levy in accordance with the relevant legislation. While IFRIC 21 was EU endorsed for accounting periods beginning on or after 16 June 2014, the Group has aligned its accounting policy with the principles of IFRIC 21 and has therefore changed its accounting policy with respect to the date at which a liability for the FSCS levy is recognised.

In previous years, in common with others in the industry, the Society recognised a provision on the basis that recognition of the liability was triggered by being a deposit taker at 31 December in the year preceding the scheme year (which commences on 1 April) in which the FSCS levy would be charged. As the FSCS can only raise a levy within its scheme year, then under IFRIC 21 the Society should instead recognise its FSCS provision in the scheme year itself, rather than in the year prior to the scheme year.

1. Accounting policies (continued)

The 2013 comparatives have been restated accordingly. The effect on the comparative figures is shown below.

Income Statement

For the year ended 31.12.13	Group				Society		
	Previously published	IFRIC 21 adjustment	Discontinued operation	**Continuing operations Restated**	Previously published	IFRIC 21 adjustment	**Restated**
	£m	£m	£m	**£m**	£m	£m	**£m**
Provisions for liabilities	(20.6)	1.1	0.5	**(19.0)**	(9.3)	1.1	**(8.2)**
Profit before tax	102.5	1.1	(0.9)	**102.7**	74.4	1.1	**75.5**
Tax expense	(26.2)	(0.2)	0.1	**(26.3)**	(11.1)	(0.2)	**(11.3)**
Profit for the financial year	76.3	0.9	(0.8)	**76.4**	63.3	0.9	**64.2**
Profit for the financial year attributable to members of Skipton Building Society	75.2	0.9	(0.8)	**75.3**	63.3	0.9	**64.2**

The comparative figures in the table above have been restated for the impact of IFRIC 21 and have also been re-presented in accordance with IFRS 5 *Non-current assets held for sale and discontinued operations*, to reflect the disposal of Homeloan Management Limited and its subsidiary companies, which became a discontinued operation during 2014.

Statement of Comprehensive Income

For the year ended 31.12.13	Group			Society		
	Previously published	IFRIC 21 adjustment	**Restated**	Previously published	IFRIC 21 adjustment	**Restated**
	£m	£m	**£m**	£m	£m	**£m**
Profit for the financial year	76.3	0.9	**77.2**	63.3	0.9	**64.2**
Total comprehensive income for the year	93.7	0.9	**94.6**	61.4	0.9	**62.3**
Total comprehensive income attributable to members of Skipton Building Society	92.6	0.9	**93.5**	61.4	0.9	**62.3**

Statement of Financial Position

As at 31.12.13	Group			Society		
	Previously published	IFRIC 21 adjustment	**Restated**	Previously published	IFRIC 21 adjustment	**Restated**
	£m	£m	**£m**	£m	£m	**£m**
Provisions for liabilities	44.5	(7.2)	**37.3**	14.5	(7.2)	**7.3**
Deferred tax liability	13.9	1.5	**15.4**	3.5	1.5	**5.0**
Total liabilities	13,557.5	(5.7)	**13,551.8**	13,260.3	(5.7)	**13,254.6**
General reserve	911.6	5.7	**917.3**	809.9	5.7	**815.6**
Members' interests attributable to members of Skipton Building Society	926.3	5.7	**932.0**	793.3	5.7	**799.0**
Total members' interests	929.2	5.7	**934.9**	793.3	5.7	**799.0**

As the above changes did not have a material effect at the beginning of the preceding period, a restated Statement of Financial Position as at 31 December 2012 has not been presented in these financial statements.

1. Accounting policies (continued)

Statement of Changes in Members' Interests

The impact of the above restatement on the Statement of Changes in Members' Interests is presented on page 72 for the Group and on page 73 for the Society.

Statement of Cash Flows

For the year ended 31.12.13	Group			Society		
	Previously published	IFRIC 21 adjustment	**Restated**	Previously published	IFRIC 21 adjustment	**Restated**
	£m	£m	**£m**	£m	£m	**£m**
Profit before tax	102.5	1.1	**103.6**	74.4	1.1	**75.5**
Movement in provisions for liabilities	(10.0)	(1.1)	**(11.1)**	(2.1)	(1.1)	**(3.2)**

The restatement also impacts a number of the Group's key capital adequacy measures as shown below:

Capital

	As at 01.01.14 Fully loaded			
	Previously published	IFRIC 21 adjustment	Other adjustments	**Restated**
	%	%	%	**%**
Common Equity Tier 1 (CET 1) ratio	14.23	0.11	(0.10)	**14.24**
Tier 1 ratio	14.23	0.11	(0.10)	**14.24**
Total capital ratio	15.67	0.11	(0.71)	**15.07**
Leverage ratio	5.6	0.1	(0.1)	**5.6**

	As at 01.01.14 Transitional			
	Previously published	IFRIC 21 adjustment	Other adjustments	**Restated**
	%	%	%	**%**
Common Equity Tier 1 (CET 1) ratio	14.14	0.11	(0.08)	**14.17**
Tier 1 ratio	15.43	0.11	(0.09)	**15.45**
Total capital ratio	17.14	0.11	(0.52)	**16.73**

The comparative figures in the final two tables above have been restated for the impact of IFRIC 21 and also for revised interpretation of the CRD IV regulations, disclosed under the 'other adjustments' columns, in order that the comparative figures are presented on the same basis as the corresponding numbers as at 31 December 2014. Explanations for the movements are set out in the notes accompanying the capital table in the Strategic Report on page 25.

c) Basis of consolidation

Subsidiary undertakings

Subsidiary undertakings are entities controlled by the Society. Control exists when the Society is exposed, or has rights, to variable returns from its involvement with an entity and has the ability to affect those returns through its power over the entity. In assessing control, only substantive rights (i.e. rights that can be practically exercised) are taken into account. The financial statements of the subsidiary undertakings are included in the results from the date that control commences until the date that control ceases. The Group Accounts consolidate the financial statements of the Society and all its subsidiary undertakings, eliminating intra-group balances.

The results of subsidiary undertakings acquired or disposed of during the year are included in the consolidated Income Statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the accounts of subsidiary undertakings to bring the accounting policies in line with those used by the Group. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Within a number of subsidiary undertakings which have less than 100% ownership, there is an option for non-controlling shareholders to require the Group to buy back their shares at some point in the future. In accordance with IAS 32 *Financial Instruments: Presentation*, the Group recognises the present value of the non-controlling options as a financial obligation, along with recognition of further goodwill on the future purchase of remaining non-controlling interests. Under this accounting policy the Group consolidates 100% of the results of such subsidiary undertakings to reflect the 100% ownership implicit in the recording of the future purchase of the non-controlling interests' remaining shareholdings (that is, the put option liability).

1. Accounting policies (continued)

In accordance with IFRS 10 *Consolidated Financial Statements (2011)*, for business combinations which have taken place from 1 January 2010 onwards, all transactions with non-controlling interests are recorded in equity if there has been no change in control. In accordance with IFRS 3 (2008), *Business Combinations*, goodwill is accounted for only upon the acquisition of a subsidiary undertaking and subsequent changes in the Group's interest are recognised in equity. Any changes in the valuation of an acquired entity where a put option was issued by the Group are credited or charged through the Income Statement. All transaction or acquisition costs are written off to the Income Statement as incurred. Put options issued prior to 1 January 2010 are accounted for in accordance with IAS 27 (2003) and IFRS 3 (2004) and any adjustment to the Group's estimation of the present value of the put option liability results in an adjustment to goodwill.

Non-controlling interests in the net assets of non-100% consolidated subsidiary undertakings are identified separately from the Group's equity therein. Non-controlling interests comprise the amount of those interests at the date of the original business combination and the non-controlling changes in equity since that date. Losses applicable to the non-controlling interests in excess of the non-controlling interests in the subsidiary undertaking's equity are allocated against the interests of the Group unless the non-controlling entity has a binding obligation and is able to make an additional investment to cover those losses.

Unconsolidated structured entities

The Group invests in structured entities that are designed to achieve a specific business purpose. A structured entity is one that has been set up so that any voting rights or similar rights are not the determining factor in deciding which party controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. The principal purpose of structured entities is to provide investors with access to specific portfolios of assets and also provide the investor liquidity through the securitising of financial assets.

A structured entity often has some or all of the following characteristics:

- Restricted activities;
- A narrow and well defined objective;
- Insufficient equity to permit the structured entity to finance its activities without subordinated financial support.

Third party funding entities

The Group invests in structured entities through the purchase of such issued mortgage backed securities, as disclosed in note 13. These structured funding entities are not consolidated into the Group Accounts because the Group does not have the ability to direct the activities of the entities in question and does not control these entities through voting rights, contract, funding agreements or any other means. The Group's involvement is in relation to investment activity only.

Interests in unconsolidated structured entities

The Group's interests in unconsolidated structured entities refer to involvement that exposes the Group to variability of returns from the performance of the structured entities.

Income derived from involvement with unconsolidated structured entities

Interest income is recognised on funding provided to unconsolidated structured entities within interest receivable in the Income Statement.

Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, as well as any related non-controlling interest and other components of equity. Any resulting gain or loss is recognised in the Income Statement.

Joint ventures and associates

A joint venture is an undertaking in which the Group has joint control, and has rights to the net assets of the arrangement.

An associate is a company over which the Group has significant influence and that is neither a subsidiary undertaking nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is neither control nor joint control over those policies.

The results and assets and liabilities of joint ventures and associates are accounted for in these consolidated financial statements using the equity method of accounting. Investments in joint ventures and associates are carried within the Statement of Financial Position at cost, as adjusted by post-acquisition changes in the Group's share of the net assets of the joint venture or associate, less any impairment in the value of individual investments.

1. Accounting policies (continued)

Equity share investments

An equity share investment is an investment in the share capital of a company where the Group does not have significant influence.

Equity share investments are accounted for in these consolidated financial statements as available-for-sale financial assets. As such they are initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in their fair value recognised in equity, except for impairment losses which are recognised in the Income Statement.

Securitisation transactions

The Group has securitised certain loans and advances to customers by the transfer of the beneficial interest in such loans to special purpose vehicles (SPVs). The securitisation enables a subsequent issuance of debt, either by the SPVs or the Society, to investors who gain the security of the underlying assets as collateral. The SPVs are fully consolidated into the Group's Accounts in accordance with IFRS 10.

The transfers of the beneficial interest in these loans to the SPVs are not treated as sales by the Society. The Society continues to recognise these assets within its own Statement of Financial Position after the transfer because it retains the risks and rewards of the portfolio. In the accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the SPVs.

d) 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 cash generating units expected to benefit from the synergies of combination. The impairment test compares the carrying value of goodwill to its associated value in use. The value in use calculations are carried out by discounting the future cash flows of the cash generating unit (see note 20). Future cash flows are ordinarily based upon the corporate plans of the cash generating units for the next five years and assumed growth thereafter for the subsequent 10 years generally in line with long term growth rates. The Group estimates discount rates based upon the weighted average cost of capital which is then adjusted to take account of the market risks associated with each cash generating unit. A 15-year time horizon has been used to reflect that cash generating units are held for the long term.

Goodwill arising on the acquisition of subsidiary undertakings is included in the 'Intangible assets' line within the Statement of Financial Position. Goodwill arising on the acquisition of joint ventures, associates or other businesses is included within the carrying value of the underlying investment within the Statement of Financial Position and tested for impairment in the same way as that described above.

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

Goodwill arising on acquisitions before the transition to IFRS on 1 January 2005 has been retained at its previous UK GAAP amount and is reviewed for impairment at least annually, as above. Goodwill written off to reserves under UK GAAP prior to 1 January 2004 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

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

Computer software, databases, brands and customer contracts

In accordance with IAS 38 *Intangible Assets*, computer software development costs, databases, brands and customer contracts (including directly attributable costs) are recognised as an intangible asset only if all of the following tests are met:

- an asset is created that can be identified (such as software and new processes);
- it is probable that the asset created will generate future economic benefits which will flow to the Group; and
- the development cost of the asset can be measured reliably.

Expenditure incurred to maintain existing levels of performance is recognised as an expense as incurred.

1. Accounting policies (continued)

Computer software licences, databases, brands and customer contracts recognised as intangible assets are initially recognised at cost and subsequently amortised from the date they are available for use using the straight line method over their estimated useful economic lives (unless deemed to have an indefinite economic life), which range from three to 10 years. Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Intangible assets are tested for impairment at each reporting date or when there is an indication of impairment. The Group identifies impairment by comparing the future economic benefit to the Group against the carrying value of the asset.

e) Financial assets

In accordance with IAS 39 *Financial Instruments: Recognition and Measurement*, the financial assets of the Group have been classified into the following four categories:

Available-for-sale

Available-for-sale assets are non-derivative financial assets that are not classified as loans and receivables, at fair value through profit or loss or held to maturity. Available-for-sale assets are initially recognised at fair value plus directly attributable transaction costs, with subsequent changes in their fair value recognised in equity, except for impairment losses which are recognised in the Income Statement. Interest income is recognised in the Income Statement on an effective yield basis. When the assets are derecognised, the gain or loss accumulated in equity is reclassified to the Income Statement.

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

The fair values of available-for-sale assets are based on quoted prices or, if these are not available, fair value valuation techniques developed by the Group. For quoted prices the bid price is used, and fair value valuation techniques 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. The Group's loans and advances to customers, together with certain investment securities and all other liquidity balances are classified as loans and receivables, and are measured at amortised cost using the effective interest method. The effective interest method implies an interest rate which exactly discounts the forecast cash flows of an asset over its expected life back to its carrying value.

In accordance with the effective interest method, directly attributable upfront costs and fees such as cashbacks, mortgage premia paid on acquisition of mortgage books, higher lending charges paid by customers, procuration fees and completion fees are deferred and recognised over the expected life of mortgage assets. Mortgage discounts are also recognised over the expected life of mortgage assets. Historical and forecast mortgage redemption data and management judgement of future performance are used to estimate the expected lives of mortgage assets.

Included in loans and advances to customers of the Society are balances which have been used to secure debt securities issued by the Group's special purpose vehicles, Darrowby No. 1 plc, Darrowby No. 2 plc and Darrowby No. 3 plc, which are each consolidated into the Group Accounts. The beneficial interest in the underlying loans has been transferred to these entities. The loans are retained within the Society's Statement of Financial Position as the Society retains substantially all the risks and rewards relating to the loans.

At fair value through profit or loss

Fair value through profit or loss financial assets are those that are designated on initial recognition as assets to be recognised at fair value and movements in fair value are recognised in the Income Statement.

The Group's derivative financial instruments (both assets and liabilities) and the put option obligation (see note 1n) are classified as at fair value through profit or loss, and are held at fair value in the Statement of Financial Position.

The Group uses derivative financial instruments to hedge its exposure to market risks (for example 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. 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:

- Fair value hedges – Where a derivative financial instrument hedges the changes in fair value of a recognised asset or liability (or portion of a recognised asset or liability), or an unrecognised firm commitment, any gain or loss on the hedging instrument is recognised in the Income Statement. To the extent that there is an effective hedge relationship, the associated hedged items (for example, mortgage assets) are stated at fair value in respect of the hedged risk, with any gain or loss also recognised in the Income Statement. As a result the hedging instrument and hedged items offset each other and reduce profit volatility. Any residual fair value hedge ineffectiveness is also recognised in the Income Statement.

- Cash flow hedges – Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability (or portion of a recognised asset or liability), or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately. Once the forecast transaction has occurred, the cumulative gain or loss recognised in equity is recycled to the Income Statement in the same period in which the underlying transaction affects profit or loss. If the forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss recognised in equity is then recognised immediately in the Income Statement.

The Group discontinues hedge accounting when:

- it is evident from hedge effectiveness testing that a derivative is not, or has ceased to be, highly effective as a hedge;
- the derivative expires, or is sold, terminated or exercised; or
- the underlying item matures or is sold or repaid.

The Group may also decide to cease hedge accounting even though the hedge relationship continues to be highly effective by ceasing to designate the financial instrument as a hedge.

If the derivative no longer meets the criteria for hedge accounting or is de-designated from the hedge relationship, the associated adjustment to the carrying amount of the hedged item or the amount in the cash flow hedging reserve is amortised to the Income Statement over the remaining life of the hedged item.

Certain derivatives are embedded within other non-derivative host financial instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host instrument and where the hybrid instrument is not measured at fair value, the embedded derivative is separated from the host instrument and measured at fair value with changes in fair value of the embedded derivative recognised in the Income Statement. Depending on the classification of the host instrument, the host is then measured in accordance with the relevant accounting policy.

Fair values are obtained from recent market transactions and valuation techniques, including discounted cash flow models and option pricing models, as appropriate. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. No Credit (CVA) or Debit (DVA) Value Adjustments have been made in respect of credit risk in the fair value of the Group's derivative financial instruments as the risk is significantly mitigated as all swaps are cash collateralised. Due to the frequency of the posting of collateral, there is no material exposure from these minimal timing differences which would require CVA or DVA adjustments.

In valuing derivatives used to hedge our mortgage and savings portfolios, the Group has not valued them as one net pool for market risk and credit risk management purposes as allowed under IFRS 13, but has valued each derivative individually.

Interest on derivatives is included within interest receivable where the derivative hedges an asset and within interest expense where the derivative hedges a liability, to align the recognition with its economic purpose. Other gains and losses on all derivatives, hedged items, and on the sale of available-for-sale assets are recognised in the 'Fair value gains on financial instruments' line in the Income Statement, with the exception of cash flow hedging derivatives, where unrealised fair value gains and losses are recognised in the cash flow hedging reserve.

Any derivatives that do not qualify for hedge accounting are held at fair value with changes in fair value recognised in the Income Statement.

Held to maturity

The Group has not classified any assets as held to maturity.

f) Financial liabilities

Borrowings, 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 transaction costs incurred. Borrowings are subsequently measured at amortised cost using the effective interest method. Derivative liabilities, the fair value of the put option obligation and the fair value of the liability of the management incentive scheme are measured at fair value through profit or loss.

Permanent Interest Bearing Shares with no fixed maturity are classified as financial liabilities as opposed to equity instruments since their terms do not permit the Directors discretion to avoid the payment of interest. Permanent Interest Bearing Shares are carried at amortised cost.

1. Accounting policies (continued)

Where financial liabilities are hedged, the Group elects to use the fair value option for those hedged financial liabilities. This designation has been adopted to reduce the volatility that would otherwise exist given that the interest rate risk element of the underlying liabilities in question is economically hedged by derivatives which are also held at fair value through profit or loss.

In applying the fair value option to the Group's financial liabilities, the Group has considered the effect of its own credit risk and considers this not to be material.

g) Impairment of financial assets

Impairment of loans and advances secured on residential property or land

Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession or where fraud or negligence has been identified. Objective evidence of impairment may include indications that the borrower or group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, or the debt being renegotiated to reduce the burden on the borrower. The key drivers influencing this objective evidence predominantly relate to affordability issues driven by unemployment and increased costs of living. Based upon these assessments an individual impairment provision is made in one of two ways. For properties that are either in possession or where sufficient information is available to calculate a specific provision on an account-by-account basis (for example, properties that are on a defined 'watch list'), the provision is calculated as the difference between the existing carrying value and the present value of the estimated future cash flows, discounted at the asset's original effective interest rate. Alternatively, for other individual loans that have reached the point at which an impairment provision is needed but where it is not possible to specifically determine the amount ultimately likely to be received, assumptions are used from groups of loans with similar characteristics, based on historical data including the probability of possession given default and average forced sale discounts, and a provision calculated accordingly against this group of loans.

In addition, a collective impairment provision is made against the remaining portfolio of loans and advances where objective evidence indicates that credit losses have been incurred but not yet identified at the reporting date. The impairment value is calculated by applying various economic factors to pools within our mortgage portfolio that have similar characteristics. These factors take into account the Group's experience of default rates, loss emergence periods, the effect of regional movements in house prices based on a recognised index, and adjustments to allow for ultimate forced sales values and realisation costs. In addition the collective impairment provision takes into account the level of forbearance applied to loans such as payment reductions, term extensions, conversion to interest only and capitalisation of arrears, and reflects the relative performance of each of these pools. The impairment provision also considers macro-economic indicators affecting affordability such as unemployment rates and interest rates.

Impairment provisions are recognised in the Income Statement and reflected in a separate account which is netted against the total carrying value of mortgage assets within the Statement of Financial Position. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is recognised through the Income Statement.

Where a loan is not recoverable, it is written off against the related provision for loan impairment once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the Income Statement.

Impairment of other loans and advances

Individual impairment provisions are made to reduce the value of other impaired loans and advances to the present value of the amount that the Directors consider is likely ultimately to be received, based upon objective evidence.

Impairment of other financial assets

At each reporting date the Group assesses, on an individual security basis, whether there is objective evidence that financial assets held by the Group, except those held at fair value through profit or loss, are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that financial assets are impaired may include default or delinquency by a counterparty, the disappearance of an active market for a security, indications that a counterparty will enter bankruptcy, a significant and prolonged decline in the fair value of a security or evidence of a sovereign debt crisis.

Impairment losses on other financial assets carried at amortised cost are measured as the difference between the carrying value of the asset and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in the Income Statement and reflected as a deduction against the carrying value of the asset. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is recognised through the Income Statement.

1. Accounting policies (continued)

Impairment losses on available-for-sale assets are recognised by transferring the cumulative loss that has been recognised directly in equity to the Income Statement. The cumulative loss that is removed from equity and recognised in the Income Statement is measured as the difference between the acquisition cost, net of any principal repayments and amortisation, and the current fair value, less any impairment loss on that asset previously recognised in the Income Statement.

If, in a subsequent period, the fair value of the asset classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the Income Statement, the impairment loss is reversed through the Income Statement.

h) Derecognition of financial assets and liabilities

Financial assets are derecognised when the contractual rights to receive cash flows have expired or where substantially all the risks and rewards of ownership have been transferred. The Society has not derecognised the loans securing its securitisation issues because substantially all the risks and rewards are retained by the Society as detailed in note 1c). Financial liabilities are derecognised only when the obligation is discharged, cancelled or has expired.

i) Foreign currency transactions

All non-Sterling monetary assets and liabilities are translated at the closing rate of exchange. All exchange differences are taken to the Income Statement as they arise.

Foreign exchange transactions are translated into Sterling using the exchange rates prevailing at the dates of the transactions.

The Income Statements of subsidiary undertakings with non-Sterling functional currencies are translated into Sterling at the monthly average rates for the period, and assets and liabilities are translated at the closing rate of exchange at the reporting date (other than certain non-monetary items that are held at their translated historical cost). Any exchange differences arising on the translation of net assets of overseas subsidiary undertakings are taken to reserves as a separate component of equity and disclosed in the Statement of Comprehensive Income, except to the extent that the translation difference is allocated to the non-controlling interest.

Where a foreign operation is disposed of in its entirety, or partially disposed of such that control is lost, the cumulative amount of translation differences recognised as a separate component of equity is reclassified to the Income Statement as part of the gain or loss on disposal.

j) Taxation

The income tax expense or credit on the profits or losses 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 and disclosed in the Statement of Comprehensive Income.

Current tax is the expected tax payable or receivable on the taxable income or expenditure for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the Statement of Financial Position liability method, which recognises temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary 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, associates and joint arrangements to the extent that it is probable they will not reverse in the foreseeable future. Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which temporary differences reverse, based on tax rates and laws enacted or substantively enacted at the reporting date.

A deferred tax asset is only recognised to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at least annually and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

k) Leases

Where the Group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. The leased asset is recorded within the Statement of Financial Position as an item of property, plant and equipment and is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses. Future instalments under such leases, net of finance charges, are included within payables. Rentals payable are apportioned between the finance element, which is charged to the Income Statement at a constant annual rate, and the amount which reduces the outstanding obligation for future instalments.

1. Accounting policies (continued)

All other leases are accounted for as operating leases and the rental charges are charged to the Income Statement on a straight line basis.

Assets held by the Group on which operating leases are granted are included as items of property, plant and equipment. Rents receivable under operating leases are recognised in the Income Statement on a straight line basis over the term of the lease.

Where leasehold premises cease to be occupied by the Society or its subsidiary undertakings and current market conditions are expected to preclude sub-letting for a rental sufficient to cover the rental costs, a provision is made to cover the expected deficit.

When the Group enters into a sale and leaseback arrangement under an operating lease, if the sale price is at or below fair value, any profit or loss is accounted for in the period of disposal in other income and the operating lease rentals are charged to administrative expenses in the year in which the expenditure is incurred. If the sale price is above fair value, then the excess above the fair value is deferred over the life of the lease.

l) Employee benefits

Defined contribution pension arrangements

Obligations for contributions to defined contribution pension arrangements are recognised as an expense in the Income Statement as incurred.

Defined benefit schemes

The Group operates three funded defined benefit pension schemes administered by a corporate Trustee, the funds of which are separate from those of the Group.

Included within the Statement of Financial Position are the Group's net obligations in respect of the defined benefit pension schemes. The obligation of each scheme is calculated separately by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods.

That benefit is discounted to determine its present value, and the fair value of any scheme assets is deducted. The discount rate is based on the average yield available from long-dated AA-rated corporate bonds. The calculation is performed by a qualified actuary using the projected unit credit method.

Net interest income on the defined benefit obligations comprises interest income on plan assets, less the interest cost on the scheme liabilities, and interest on the effect of the asset ceiling. Net interest income and other expenses relating to the defined benefit pension schemes are recognised in the Income Statement.

Remeasurements of the retirement benefit obligations, which comprise actuarial gains or losses (arising from the differences between previous actuarial assumptions and actual experience), the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest) are recognised in the Statement of Comprehensive Income.

Past and current service costs are recognised immediately in the Income Statement. When a plan is curtailed, the resulting gain or loss on settlement is also recognised immediately in the Income Statement. The Group recognises gains or losses on the settlement of a retirement benefit obligation when the settlement occurs.

Contributions are transferred to the schemes on a regular basis to secure the benefits provided under the rules of the schemes. Pension contributions are assessed in accordance with the advice of a professionally-qualified actuary.

m) Fees and commissions

Other than those accounted for using the 'effective interest method', fees and commissions receivable are generally recognised, net of VAT (where applicable), when all contractual obligations have been fulfilled.

Estate Agency commissions earned on the sales of properties and land and auction income are recognised on the date contracts are exchanged. Property management income is recognised when the cash is received, which reflects the point at which income is earned and contractual obligations have been fulfilled. Insurance commission is recognised upon fulfilment of contractual obligations with a provision for future clawback repayment in the event of early termination by the customer. Mortgage servicing income is recognised on an accruals basis over the period of services rendered.

The recognition of fees and commissions receivable from the sale of third party Regulated Financial Services products is dependent on the market in which the adviser operates and therefore the nature of the advice provided. Revenue is recognised either when the right to consideration has been obtained through fulfilment of performance obligations, or when the provision of advice can be demonstrated by the signing of the initial suitability letter by the customer which demonstrates acceptance of the advice provided. A provision for future clawbacks is made for repayment in the event of early termination by the customer. Ongoing commission income received monthly over the life of a policy is recognised on an accruals basis over the period of

1. Accounting policies (continued)

the service provided, whilst commission receivable in relation to ongoing wealth management on behalf of clients is accrued by reference to the value of work performed.

Revenue from software licence fees is recognised on the transfer of significant risks and rewards of ownership of the licensed software under an agreement between the Group and the customer. Revenue from implementation and consulting services is recognised in proportion to their stage of completion, typically in accordance with the achievement of contract milestones or days expended. Customer support revenue and systems management revenue are recognised on a straight line basis over the period of the service rendered.

Fees and commissions payable are generally recognised on an accruals basis as services are received.

n) Property, plant and equipment

Property, plant and equipment is measured at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of those items.

Depreciation is calculated to write down the cost of items of property, plant and equipment to their estimated residual values over their estimated useful lives as set out below on a straight line basis unless stated otherwise.

Freehold and long leasehold buildings	50 to 100 years
Special purpose freehold head office facilities	40 years
Refurbishment of freehold and long leasehold buildings	five to 10 years
Short leasehold buildings	period of lease
Equipment, fixtures and fittings	two to 10 years
Motor vehicles	25% of net book value

Land is not depreciated. Major items of property, plant and equipment purchased are depreciated on a monthly basis from the date the asset is available for utilisation. Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted where appropriate. In accordance with IAS 36 *Impairment of Assets*, all items of property, plant and equipment are regularly reviewed for indications of impairment. Any impairment identified is charged to the Income Statement.

Subsequent expenditure on items of property, plant and equipment is capitalised only if the subsequent expenditure increases the item's revenue generating capabilities and it is probable that future economic benefits associated with the expenditure will flow to the Group.

Any gain or loss on disposal of an item of property, plant and equipment is recognised in the Income Statement.

o) Segmental reporting

In accordance with IFRS 8 *Operating Segments*, operating segments are identified on the basis of internal reports and components of the Group regularly reviewed by the chief operating decision maker, the Board, to allocate resources to segments and to assess their performance.

Each segment is determined according to distinguishable operating components of the Group that are regularly reviewed by the Board and for which discrete financial information is available. We have not aggregated any of our operating segments for the purpose of financial reporting.

Information regarding the results of each reportable segment is included in note 39.

p) Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash comprises cash in hand and unrestricted loans and advances to credit institutions repayable on demand. Cash equivalents comprise highly liquid unrestricted investments that are readily convertible into cash with an insignificant risk of changes in value with original maturities of less than three months.

The Statements of Cash Flows have been prepared using the indirect method.

q) Investment properties

Properties held by the Group which earn rentals or for capital appreciation are recognised as investment properties at cost less depreciation. The market value of investment properties is disclosed within the Notes to the Accounts, and an internal valuation is carried out annually.

The depreciation policy for investment properties is consistent with the policy for property, plant and equipment. In accordance with IAS 36 *Impairment of Assets*, investment properties are regularly reviewed for indications of impairment. Any impairment identified is charged to the Income Statement.

Rental income from investment property is recognised over the term of the lease and is included in other income. Any gain or loss on disposal of investment property is recognised in the Income Statement.

1. Accounting policies (continued)

r) Financial guarantee contracts

Where the Society has entered into financial guarantee contracts with a Group company, the Society asserts that these are insurance contracts. Therefore, under IAS 39, the Society has elected to apply IFRS 4 *Insurance Contracts*, to such financial guarantee contracts and as a result does not fair value such contracts. Under this election the Group assesses at each reporting date whether a financial liability needs to be recognised in relation to the financial guarantee contracts.

s) Sale and repurchase agreements

Investments and other securities may be lent or sold subject to a commitment to repurchase them (a 'repo'). Such securities are retained within the Statement of Financial Position when substantially all the risks and rewards of ownership remain within the Group, and the liability associated with the cash advanced is included separately within the Statement of Financial Position.

The difference between the sale and repurchase price is accrued over the life of the agreements and recognised within net interest income.

t) Client money

A number of Group companies hold or receive money on behalf of their clients in the course of normal business. These amounts are not represented within the Statement of Financial Position as substantially all the risks and rewards relating to the client money remain with the clients themselves. Such Group companies are subject to client money regulation, and all client money is held in accordance with these regulations as required by the FCA. Client money held by the Group as at 31 December 2014 amounted to £2.4m (2013: £19.4m), and for the Society amounted to £nil (2013: £nil).

u) 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.

The Group also has to make judgements in applying its accounting policies which affect the amounts recognised in the financial statements.

Estimates and judgements are evaluated continually and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The key estimates, assumptions and judgements are set out below:

Effective interest rate

The valuation of assets or liabilities measured at amortised cost is calculated using the effective interest method. The effective interest method imputes an interest rate which discounts the forecast future cash flows of an asset over its expected life back to its carrying value. The most critical factor in calculating the amortised cost of assets and liabilities held by the Group is the expected lives of these assets and liabilities which are determined on the basis of historical data and management judgement.

The impact of a one month increase in the anticipated life of loans and advances to customers would result in a £7.8m (2013: £0.8m) increase in the Group's interest income and a £7.8m (2013: £0.7m) increase in the Society's interest income.

During the year a charge of £4.4m (2013: £1.9m) for the Group and Society were recognised through interest income, following a reassessment of the expected lives of loans and advances to customers.

Impairment of mortgage loans and advances

The Group regularly reviews the performance of its residential loan portfolios to assess the level of impairment. In determining whether an impairment loss should be recorded in the Income Statement, management makes judgements as to whether there is any objective data indicating that there is a measurable impairment loss. Specifically, management regularly assess key assumptions such as the probability of an account going into possession, future levels of unemployment, and the eventual loss incurred in the event of forced sale or write-off.

A critical estimate in calculating the eventual loss incurred in the event of sale is the future level of UK house prices. Based upon the loss provisioning model used by the Group, a 10% fall in house prices compared to the assumptions used (e.g. from say +3% to -7%) would increase the year end residential impairment provision by £3.9m (2013: £4.8m). Other sensitivities include unemployment, where an increase of 1% (e.g. from say 7% to 8%) would increase the loan impairment provision by £1.2m (2013: £2.2m), and where a 10% increase in the expected loss on sales equates to a £2.2m (2013: £3.4m) increase in the loan impairment provision.

The Group also holds an equity release residential mortgage book and the estimates and judgements used in fair valuing the no negative equity guarantee, a separately identifiable embedded derivative accounted for within the residential impairment charge, together with sensitivity disclosures, are outlined in note 38b).

1. Accounting policies (continued)

In respect of commercial mortgage exposures these are individually reviewed on a monthly basis and suitably qualified commercial underwriters objectively assess whether an impairment provision is required.

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 (including the disappearance of an active market), fair value volatility (including any significant reduction in market value), any breach of contract or covenants, the financial stability or any financial difficulties of the counterparty and the country it is resident in (i.e. sovereign debt issues).

Put option obligation

Where the Group acquires a majority shareholding in a subsidiary undertaking, but grants the non-controlling shareholders an option to sell their shares to the Group at some future date, on acquisition the Group estimates the fair value of the total consideration payable in calculating the goodwill arising.

The fair value of both the put option obligation and the associated goodwill recognised are dependent on the following assumptions: an estimate of when the put option will be exercised by the non-controlling shareholders, the market value growth of the obligation and the discount rate used at the reporting date. These assumptions are reviewed on a regular basis by senior management.

Extending the estimated exercise date of all existing put options by one year would result in a reduction in the aggregate put option obligation by £0.3m (2013: £1.5m). A 10% increase in the aggregate market value of these businesses would increase the put option liability by £0.8m (2013: £1.5m).

Management incentive scheme

In 2012 and 2014, senior management of Connells Limited purchased equity shares in that company and at the same time the Group issued options to these shareholders which require the Group to purchase these options at some future dates. In accordance with IFRS 2 *Share-based Payment*, the Group recognises the increase in the fair value of the liability, spread over the vesting period to the dates of exercise. The fair value of this liability is dependent on the following assumptions: an estimate of when the options will be exercised by the non-controlling shareholders, and the forecast profits and cash flows of Connells Limited over the period to exercise.

A 10% increase in the profit before tax of Connells Limited above the amounts forecasted would result in an increase to the fair value of the liability of £3.3m (2013: £1.6m), with a corresponding increase to the Income Statement charge for the year. In addition, the fair value of the liability at 31 December 2014 is based on the assumption that management will exercise their options at the earliest available opportunity under the terms of the scheme; if however management were to exercise their options at the latest opportunity then the fair value of the liability and corresponding charge to the Income Statement would reduce by £1.3m (2013: £1.2m) as at 31 December 2014.

Goodwill

The carrying value of goodwill is assessed against value in use calculations. The key assumptions for the value in use calculations are those regarding cash flows, discount rates and growth rates. These assumptions are reviewed on a regular basis by senior management.

The future cash flows of the cash generating units are based on the latest detailed five year corporate plans available and are sensitive to assumptions regarding the long term growth pattern thereafter. The cash flows reflect management's view of future business prospects at the time of the assessment.

The discount rate used to discount the future expected cash flows is based on the cost of capital assigned to each cost generating unit (see note 20) and can have a significant effect on the valuation of a cost generating unit. The cost of capital is derived from a weighted average cost of capital calculation which incorporates a number of inputs including the risk-free interest rate and a premium to reflect the inherent risk of the business being evaluated. These variables are subject to fluctuations in external markets and economic conditions which are out of management's control and therefore are established on the basis of management judgement.

At 31 December 2014, to the extent that discount rates were to increase by 10%, e.g. from 10% to 11%, the impairment charge would increase by £2.1m (2013: £nil). In addition, a reduction in the long term growth rate assumption from 2.5% to 0% would increase the impairment charge by £1.7m (2013: £nil).

1. Accounting policies (continued)

Fair value of financial instruments

Fair values are determined by the three tier valuation hierarchy as defined within IFRS 13 and Amendments to IFRS 7 *Financial Instruments: Disclosures*, as described in note 38.

The most reliable fair values of financial instruments are quoted market prices in an actively traded market. Where there are no active markets, valuation techniques are used. Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist and other valuation models. Assumptions and market observable inputs used in valuation techniques include forward risk-free and benchmark interest rates, foreign currency exchange rates, equity index prices, expected price volatilities and the retail price index.

Taxation

Judgement is required in determining the provision for Corporation tax. There are a number of transactions for which the final tax determination is uncertain at the reporting date. In these instances a prudent approach is taken.

As outlined in note 1j), deferred tax assets are only recognised to the extent it is probable that future taxable profits will be available against which the asset can be utilised. Based on the Group's detailed five year forecasts, the Directors consider that the carrying value of the Group and Society's deferred tax asset as at 31 December 2014 of £21.7m and £9.1m respectively (2013: £18.9m and £9.7m respectively) is supportable.

Retirement benefit obligations

The schemes expose the Group to actuarial risks such as investment risk, interest rate risk, mortality risk and longevity risk. In conjunction with its actuaries the Group makes key financial assumptions which are used in the actuarial valuation of the defined benefit pension obligation and, therefore, changes to these assumptions have an impact on the pension obligation shown within the Statement of Financial Position and amounts reported in the Income Statement. These assumptions include the inflation and discount rates, life expectancy, commutation allowances and the rate of salary growth; see note 29 for further details on these assumptions.

A decrease in corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to scheme liabilities. This would impact the Statement of Financial Position adversely and may give rise to increased charges in future years' Income Statements. This effect would be partially offset by an increase in the value of the schemes' bond holdings and caps on inflationary increases also exist to protect the schemes against high levels of inflation.

Approximate sensitivities of the principal assumptions are set out in the table below which shows the increase or reduction in the pension obligations that would result. Each sensitivity considers one change in isolation.

Assumption	**Change in assumption**	**Group 2014**	Group 2013	**Society 2014**	Society 2013
		£m	£m	**£m**	£m
Discount rate	+/-0.25% pa	**-/+11.5**	-/+10.8	**-/+5.7**	-/+5.3
Rate of inflation	+/-0.5% pa	**+/-8.3**	+/-10.3	**+/-4.1**	+/-4.4
Rate of salary growth	+/-0.5% pa	**-**	-	**-**	-
Commutation allowance	+/-10% pa	**+/-2.0**	+/-1.6	**+/-0.9**	+/-0.7
Life expectancy	+ 1 year	**+6.6**	+4.7	**+3.3**	+2.3

The average duration of the defined benefit obligation as at 31 December 2014 is 19 years (2013: 20 years).

Other provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, it is probable that the Group will be required to settle that obligation, and the amount can be estimated reliably. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the reporting date, and are discounted to present value where the effect is material. The other provisions made within the Group cover provisions for the cost of surplus properties, commission reclaims and rebates, customer claims and customer compensation.

2. Interest receivable and similar income

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
On financial assets not at fair value through profit or loss:				
On loans fully secured on residential property	**458.5**	427.5	**371.5**	340.8
On other loans:				
To subsidiary undertakings	**-**	-	**59.5**	62.4
Other	**11.2**	11.4	**8.0**	8.8
On debt securities	**27.0**	23.1	**26.8**	22.8
On other liquid assets	**5.3**	4.8	**4.4**	3.9
	502.0	466.8	**470.2**	438.7
On financial assets at fair value through profit or loss:				
Net expense on derivative financial instruments held for hedging assets	**(59.2)**	(73.4)	**(59.6)**	(73.4)
	442.8	393.4	**410.6**	365.3

Included within interest receivable and similar income on debt securities is income from fixed income securities in the Group of £15.4m (2013: £14.8m) and in the Society of £15.3m (2013: £14.6m). Also included within interest receivable and similar income on debt securities is income from available-for-sale assets in the Group of £22.9m (2013: £18.9m) and in the Society of £22.7m (2013: £18.6m).

Included within interest receivable and similar income is interest accrued on impaired financial assets in the Group of £5.1m (2013: £6.6m) and in the Society of £1.3m (2013: £1.4m).

3. Interest payable and similar charges

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
On financial liabilities not at fair value through profit or loss:				
On shares held by individuals	**230.9**	216.2	**230.9**	216.2
On shares held by others	**1.5**	1.5	**1.5**	1.5
On subscribed capital	**8.3**	8.3	**8.3**	8.3
On deposits and other borrowings:				
Subordinated liabilities	**4.4**	12.8	**4.4**	12.8
Subsidiary undertakings	**-**	-	**52.0**	53.0
Wholesale and other funding	**29.4**	30.5	**2.9**	2.7
Other	**(0.1)**	0.1	**-**	-
	274.4	269.4	**300.0**	294.5
On financial liabilities at fair value through profit or loss:				
Net income on derivative financial instruments held for hedging liabilities	**(44.9)**	(18.6)	**(66.1)**	(42.0)
	229.5	250.8	**233.9**	252.5

4. Fees and commissions receivable

	Group 2014	Group 2013 Re-presented^	Society 2014	Society 2013
	£m	£m	£m	£m
Mortgage origination related fees	**18.3**	18.9	**-**	-
Other mortgage related fees	**5.9**	10.8	**5.9**	10.8
General insurance fees	**33.3**	33.8	**3.7**	3.5
Commissions earned on property sales	**145.6**	125.0	**-**	-
Commissions earned on property lettings	**35.1**	27.8	**-**	-
Survey and valuation services	**51.6**	43.0	**-**	-
Financial advice fees	**44.3**	48.5	**-**	-
Other fees and commissions	**67.9**	65.3	**9.1**	9.2
	402.0	373.1	**18.7**	23.5

^ The prior period figures have been re-presented to reflect the disposal of Homeloan Management Limited and its subsidiary companies, which became a discontinued operation during 2014. Further details are provided in note 17b).

5. Losses on treasury assets

Losses on treasury assets arise on the sale of debt securities and similar treasury instruments held at amortised cost, which have been sold in the normal course of business. During the year, the Group disposed of a number of these assets, generating a loss on sale of £3.7m in both the Group and Society (2013: £nil Group and Society).

6. Other income

	Group 2014	Group 2013 Re-presented^	Society 2014	Society 2013
	£m	£m	£m	£m
Property rents receivable	**2.5**	2.5	**1.6**	1.8
Net interest on defined pension obligations (note 29)	**(2.5)**	(2.1)	**(1.1)**	(0.9)
Government grants	**0.2**	0.1	**-**	-
Net profit on sale of property, plant and equipment, investment properties and intangible assets	**0.3**	0.2	**0.2**	0.3
Profit on repurchase of subordinated liabilities	**-**	2.6	**-**	2.6
Other	**3.3**	4.6	**1.9**	(0.5)
	3.8	7.9	**2.6**	3.3

^ The prior period figures have been re-presented to reflect the disposal of Homeloan Management Limited and its subsidiary companies, which became a discontinued operation during 2014. Further details are provided in note 17b).

Other income earned on financial assets held at fair value through profit or loss amounted to £nil (2013: £0.1m) for both Group and Society.

7. Administrative expenses

	Group 2014 £m	Group 2013 Re-presented^ £m	Society 2014 £m	Society 2013 £m
Employee costs:				
Wages and salaries	**241.3**	222.3	**44.7**	41.6
Social security costs	**23.3**	22.2	**4.1**	4.0
Pension costs:				
Defined contribution arrangements (note 29)	**6.3**	5.4	**2.8**	2.5
Defined benefit schemes service costs (note 29)	**-**	0.5	**-**	0.5
Settlement gain (note 29)	**(0.4)**	(0.1)	**-**	(0.1)
	270.5	250.3	**51.6**	48.5
Other administrative expenses	**156.2**	149.1	**47.3**	42.1
Central administrative costs recharged to Group undertakings	**-**	-	**(15.8)**	(22.0)
	426.7	399.4	**83.1**	68.6
Other administrative expenses comprise:				
Depreciation and amortisation (notes 18, 19 and 20)	**14.2**	14.1	**3.3**	3.4
Impairment of goodwill and other intangible assets (note 20)	**4.1**	16.6	**-**	-
Impairment of property, plant and equipment and investment properties (notes 18 and 19)	**4.7**	1.2	**4.7**	1.2
Amounts payable under operating leases	**18.8**	16.9	**6.7**	5.0
Other property and establishment costs	**15.1**	16.7	**5.2**	5.5
Postage and communications	**15.2**	13.4	**3.5**	4.6
IT costs	**6.7**	11.3	**4.9**	7.7
Marketing and advertising	**18.8**	14.0	**4.8**	2.8
Insurance	**5.7**	5.9	**2.0**	2.0
Legal, professional and consultancy	**14.3**	11.7	**7.9**	6.6
Training, recruitment and other employee related costs	**15.5**	9.1	**3.5**	3.0
Costs of management incentive scheme (note 26)	**5.4**	7.7	**-**	-
Other	**17.7**	10.5	**0.8**	0.3
	156.2	149.1	**47.3**	42.1

^ The prior period figures have been re-presented to reflect the disposal of Homeloan Management Limited and its subsidiary companies, which became a discontinued operation during 2014. Further details are provided in note 17b).

Settlement gains of £0.4m (2013: £0.1m) were realised in the Group during the year. The 2014 gain was realised upon the completion of a pension scheme merger and the 2013 gain on the completion of an enhanced pension transfer exercise. In 2013 costs of £0.5m were incurred in providing enhancements for the pension transfer exercise and these are included in pension costs above. Further details are provided in note 29.

7. Administrative expenses (continued)

The remuneration of the external auditor, which is included within legal, professional and consultancy costs above, is set out below (excluding VAT):

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Audit of the Society and Group Annual Accounts	**0.2**	0.2	**0.2**	0.2
Audit of the Group's subsidiary undertakings' accounts pursuant to legislation	**0.4**	0.5	**-**	-
Tax advisory services	**-**	0.1	**-**	-
Audit-related assurance services	**-**	0.1	**-**	0.1
Other assurance services	**0.1**	0.3	**-**	-
	0.7	1.2	**0.2**	0.3

8. Employee numbers

The average number of full and part-time persons employed during the year (including Executive Directors) was as follows:

	Group 2014	Group 2013	**Society 2014**	Society 2013
Principal office	**827**	816	**827**	816
Society branch offices	**695**	672	**695**	672
Subsidiary undertakings	**7,071**	7,212	**-**	-
	8,593	8,700	**1,522**	1,488

9. Directors' emoluments

Directors' emoluments are set out within the Directors' Remuneration Report.

Total Directors' emoluments for 2014 amounted to £2.2m (2013: £2.7m).

10. Related party transactions

A number of transactions are entered into with related parties in the normal course of business; these are detailed below.

Key management personnel

Key management personnel comprises the Executive Directors and Non-Executive Directors, who are responsible for ensuring that the Society and its subsidiary undertakings meet their strategic and operational objectives.

The table below summarises the benefits paid to key management personnel in the year:

	2014 £m	2013 £m
Salary, benefits and annual performance pay	**2.1**	2.5
Employer pension contributions	**0.1**	0.2
	2.2	2.7

The table below sets out the outstanding balances in relation to related party transactions with key management personnel and persons who are connected with key management personnel:

	2014 £m	2013 £m
Mortgage loans outstanding at 31 December	**-**	0.3
Savings balances at 31 December	**1.2**	1.2

Interest receivable and payable on the above accounts during the year was as follows:

	2014 £000	2013 £000
Interest receivable	**3**	7
Interest payable	**15**	26

Loans and savings of key management personnel are at normal commercial rates. There are no provisions for impairment against these loans.

10. Related party transactions (continued)

Directors' loans and transactions

At 31 December 2014 there were outstanding mortgage loans granted in the ordinary course of business amounting in aggregate to £42,000 (2013: £300,000) to one (2013: three) Director or persons who are connected with Directors.

A register is maintained at the Principal Office of the Society which shows details of all loans, transactions and arrangements with Directors and connected persons. A statement for the current financial year of the appropriate details contained in the register will be available for inspection at the Principal Office for a period of 15 days up to and including the Annual General Meeting.

Contributions to pension schemes

During the year, the Group and Society paid contributions of £11.5m (2013: £10.5m) and £5.9m (2013: £4.2m) respectively to pension schemes, which are classified as related parties.

Related party transactions

During the year the Society had the following related party transactions with subsidiary undertakings:

	2014	2013
	£m	£m
Rendering and receiving of services	**7.7**	7.9
Recharges of central costs	**15.8**	22.0
Interest receivable	**59.5**	62.4
Interest payable	**(52.0)**	(53.0)
Other income	**2.4**	2.9
Collateral transferred to securitisation vehicles	**447.0**	-
Purchase of debt securities	**47.0**	-
Repayment of debt securities	**(79.5)**	(95.9)

All the above transactions were entered into on an arm's-length basis. For details of the relationship between the Society and its principal subsidiary undertakings see note 17.

At 31 December 2014 the Society owed subsidiary undertakings £1,332.1m (2013: £1,224.7m) and was owed £1,489.1m (2013: £1,715.2m) by subsidiary undertakings. Interest on Group borrowings is charged at the appropriate market rate.

During the year the Group had the following related party transactions with joint ventures and associates:

	2014	2013
	£m	£m
Services provided to the Group	**2.8**	3.2
Services provided by the Group	**3.1**	4.5

At 31 December 2014 the Group owed joint ventures and associates £0.1m (2013: £0.1m) and was owed £0.2m (2013: £0.5m) by joint ventures and associates.

There are no provisions in respect of sales of goods and services or in respect of outstanding loans to or from related parties at 31 December 2014 (2013: £nil).

11. Tax expense

	Group 2014	Group 2013 Restated*^	**Society 2014**	Society 2013 Restated*
	£m	£m	**£m**	£m
Current tax	**38.6**	19.4	**21.8**	6.2
Deferred tax (note 28)	**(3.7)**	6.9	**(1.6)**	5.1
	34.9	26.3	**20.2**	11.3

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

^ The prior period figures have also been re-presented to reflect the disposal of Homeloan Management Limited and its subsidiary companies, which became a discontinued operation during 2014. Further details are provided in note 17b).

Financials

11. Tax expense (continued)

A reconciliation of the tax expense on profit before tax at the standard UK Corporation tax rate to the actual tax expense is as follows:

	Group 2014 £m	Group 2013 Restated*^ £m	**Society 2014 £m**	Society 2013 Restated* £m
Profit before tax from continuing operations	**156.8**	102.7	**153.4**	75.5
Share of losses / (profits) of joint ventures and associates, net of tax	**0.2**	(1.3)	**-**	-
	157.0	101.4	**153.4**	75.5
Tax calculated at standard UK rate of 21.5% (2013: 23.25%)	**33.8**	23.6	**33.0**	17.6
Effects of:				
Expenses not deductible for tax purposes	**4.2**	6.8	**1.3**	0.8
Adjustment to tax expense in respect of prior periods	**(0.2)**	0.2	**(0.3)**	0.4
Reversal of deferred tax asset previously recognised	**0.3**	3.1	**-**	-
Non-taxable income	**(1.0)**	(6.0)	**(13.8)**	(7.2)
Corporation tax rate change	**0.1**	(0.4)	**-**	(0.3)
Utilisation of tax losses	**(0.6)**	-	**-**	-
Effect of lower tax rates in other jurisdictions (see below)	**(1.4)**	(1.2)	**-**	-
Other	**(0.3)**	0.2	**-**	-
Tax expense	**34.9**	26.3	**20.2**	11.3

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

^ The prior period figures have also been re-presented to reflect the disposal of Homeloan Management Limited and its subsidiary companies, which became a discontinued operation during 2014. Further details are provided in note 17b).

The effective tax rate for the Group from continuing operations for the year ended 31 December 2014 is 22.2% (2013: 25.9%). The major impacts on the effective rate for the year are the costs of the Connells management incentive scheme which are not deductible for tax purposes, together with other non-deductible expenditure; offset by non-taxable income and the impact of lower tax rates on profits made by our Guernsey-based retail banking operation, Skipton International Limited.

The effective tax rate for the Society for the year ended 31 December 2014 is 13.2% (2013: 15.0%). The major impact on the effective rate is the non-taxable dividend income received of £64.0m (2013: £30.9m).

12. Loans and advances to credit institutions

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Repayable on demand:				
Cash and cash equivalents	**85.0**	93.4	**21.8**	21.6
Cash pledged as collateral	**195.2**	130.9	**195.2**	131.1
	280.2	224.3	**217.0**	152.7
In not more than three months:				
Cash and cash equivalents	**61.7**	53.9	**-**	-
Other loans and advances to credit institutions	**-**	24.6	**-**	19.4
	61.7	78.5	**-**	19.4
In more than one year:				
Cash pledged as collateral	**23.5**	23.4	**23.5**	23.4
	23.5	23.4	**23.5**	23.4
Total loans and advances to credit institutions	**365.4**	326.2	**240.5**	195.5
Total included within cash and cash equivalents	**146.7**	147.3	**21.8**	21.6

12. Loans and advances to credit institutions (continued)

At 31 December 2014 £218.7m (2013: £154.3m) of cash has been pledged by the Group and £218.7m (2013: £154.5m) of cash has been pledged by the Society against derivative contracts.

At 31 December 2013, Group and Society loans and advances to credit institutions included £19.6m in reverse repurchase agreements with external counterparties (2014: £nil). Under these agreements both the Group and Society held £20.0m of debt securities. These debt securities were not recognised as the external counterparties retained substantially all the risks and rewards of ownership. The Group was permitted to sell or repledge the debt securities in question but did not do so in the current or prior year.

13. Debt securities

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Gilts	**288.5**	478.8	**288.5**	478.8
Certificates of deposit	**258.4**	62.6	**230.8**	62.6
Fixed rate bonds	**231.4**	170.6	**226.2**	170.6
Floating rate notes	**166.9**	203.7	**156.9**	193.7
Residential mortgage backed securities	**207.4**	261.2	**706.5**	792.8
Commercial mortgage backed securities	**-**	18.6	**-**	18.6
	1,152.6	1,195.5	**1,608.9**	1,717.1
Debt securities have remaining maturities as follows:				
In not more than one year	**425.2**	186.4	**387.4**	181.5
In more than one year	**727.4**	1,009.1	**1,221.5**	1,535.6
	1,152.6	1,195.5	**1,608.9**	1,717.1
Transferable debt securities comprise:				
Listed on a recognised investment exchange	**892.5**	1,129.2	**1,376.4**	1,650.8
Unlisted	**260.1**	66.3	**232.5**	66.3
	1,152.6	1,195.5	**1,608.9**	1,717.1
Market value of listed transferable debt securities	**892.5**	1,130.8	**1,377.4**	1,656.0
Carrying value of securities pledged as collateral under sale and repurchase agreements	**605.3**	505.6	**805.9**	804.2

The Directors consider that the primary purpose of holding debt securities is prudential. The majority of debt securities held are highly liquid assets which are used on a continuing basis in the Group's activities.

Debt securities of the Group, included in the table above, with a carrying value (excluding accrued interest) of £605.3m (2013: £505.6m) have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group has retained substantially all the risks and rewards of ownership.

Included in the Society's residential mortgage backed securities are £381.1m (2013: £460.6m), £71.0m (2013: £71.0m) and £47.0m (2013: £nil) of notes purchased by the Society from the Group's securitisation vehicles, Darrowby No. 1 plc, Darrowby No. 2 plc and Darrowby No. 3 plc respectively.

The Society also holds £87.2m (2013: £6.2m) of securities, included in the table above, which are pledged as collateral with Group subsidiary, Skipton International Limited, in a repurchase agreement. In addition, £113.4m (2013: £292.4m) of securities, which have been issued by the Group's special purpose vehicle Darrowby No. 1 plc, have been pledged by the Society in a repurchase agreement.

The Group's investments in mortgage backed securities, as shown in the table above, represent investments in unconsolidated structured entities, as described in note 1c).

13. Debt securities (continued)

The maximum exposure to losses from unconsolidated structured entities is equivalent to the book value plus accrued interest, determined by the carrying value of these investments less any unrealised gains recognised within the available-for-sale reserve, as shown below.

Group and Society 2014	**Third party funding entities £m**
Carrying value: available-for-sale financial assets	**207.4**
Cumulative unrealised gains recognised in available-for-sale reserve	**(0.3)**
Maximum exposure to loss at 31 December	**207.1**
Total size of unconsolidated structured entities	**207.1**

During the year, the Group and Society received interest income of £3.0m from its investments in unconsolidated structured entities and also incurred an impairment charge of £2.0m in the Income Statement, shown in the 'Impairment losses on debt securities' line. In addition, £0.5m of unrealised losses were recognised through the available-for-sale reserve, as shown in the 'Available-for-sale investments: Valuation gains / (losses) taken to equity' line in the Statement of Comprehensive Income.

No collateral has been received by the Group in respect of the above third party funding entities. The total size of unconsolidated structured entities as shown in the table above is determined by reference to the Group's total notional exposure to the unconsolidated structured entities in question.

The Group did not provide any non-contractual support during the year to unconsolidated structured entities and currently has no intentions to provide any such support. The Group is also not required to absorb losses of any unconsolidated structured entities before other parties, and the Group did not act as a sponsor to any unconsolidated structured entities during the year. The Group would, in general, be regarded as a sponsor of an unconsolidated structured entity if market participants would reasonably associate the entity with the Group.

Movements in debt securities during the year are summarised as follows:

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
At 1 January	**1,195.5**	1,133.9	**1,717.1**	1,694.1
Additions	**831.2**	767.1	**820.5**	737.2
Disposals	**(901.6)**	(683.6)	**(956.2)**	(694.5)
Impairment losses	**(2.0)**	(1.2)	**(2.0)**	(1.2)
Changes in fair value	**29.5**	(20.7)	**29.5**	(18.5)
At 31 December	**1,152.6**	1,195.5	**1,608.9**	1,717.1

Pursuant to the amendments to IAS 39 *Financial Instruments: Recognition and Measurement*, and IFRS 7 *Financial Instruments: Disclosures*, the Group reclassified certain available-for-sale investment securities to the loans and receivables category in 2008. As at 1 July 2008, these financial assets would have met the definition of loans and receivables (if they had not been designated as available-for-sale) as the Group had the intention and the ability to hold them for the foreseeable future or until maturity. As a result these assets were reclassified from being held as available-for-sale to being held as amortised cost.

During 2014, the Group disposed of a number of these reclassified financial assets in the ordinary course of business. Following these disposals, the remaining financial assets that had previously been reclassified were identified as meeting the definition of available-for-sale assets due to the availability of an active market in which these assets could be sold, and so the remaining debt securities, which had a fair value of £14.0m, were reclassified as being held as available-for-sale.

14. Derivative financial instruments

	Group 2014		Society 2014	
	Positive market value	**Negative market value**	**Positive market value**	**Negative market value**
	£m	**£m**	**£m**	**£m**
Derivatives designated as fair value hedges:				
Interest rate swaps	73.9	112.1	74.9	112.3
Index swaps	-	138.2	-	138.2
	73.9	**250.3**	**74.9**	**250.5**
Derivatives designated as cash flow hedges:				
Interest rate swaps	5.2	1.7	6.2	1.7
Basis swaps	-	0.2	-	0.2
	5.2	**1.9**	**6.2**	**1.9**
Other derivatives held at fair value:				
Interest rate swaps	29.9	30.5	33.6	13.5
Index swaps	24.4	-	24.4	-
Investment products – embedded derivatives	-	24.6	-	24.6
	54.3	**55.1**	**58.0**	**38.1**
	133.4	**307.3**	**139.1**	**290.5**

	Group 2013		Society 2013	
	Positive market value	Negative market value	Positive market value	Negative market value
	£m	£m	£m	£m
Derivatives designated as fair value hedges:				
Interest rate swaps	51.1	74.5	51.1	74.6
Index swaps	-	106.3	-	106.3
Currency swaps	6.5	-	6.5	-
	57.6	180.8	57.6	180.9
Derivatives designated as cash flow hedges:				
Interest rate swaps	3.3	4.1	3.4	5.3
Basis swaps	-	1.0	-	1.0
	3.3	5.1	3.4	6.3
Other derivatives held at fair value:				
Interest rate swaps	44.2	58.4	47.0	21.1
Index swaps	43.4	0.3	43.4	0.3
Investment products – embedded derivatives	0.3	43.0	0.3	43.0
	87.9	101.7	90.7	64.4
	148.8	287.6	151.7	251.6

All derivatives that are not accounted for under hedge accounting rules under IAS 39 are measured at fair value through the Income Statement. All derivatives are held for economic hedging purposes.

15. Loans and advances to customers

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Loans fully secured on residential property	**12,153.3**	10,858.3	**10,007.6**	8,646.3
Other loans:				
Loans fully secured on land	**370.9**	400.3	**370.9**	400.3
Other loans	**108.8**	99.0	**0.3**	0.5
Fair value adjustment for hedged risk	**203.8**	159.3	**198.5**	158.1
	12,836.8	11,516.9	**10,577.3**	9,205.2
The remaining maturity of loans and advances to customers from the reporting date is as follows:				
On call and at short notice	**69.2**	66.0	**3.5**	6.7
In not more than three months	**26.9**	21.1	**12.9**	7.6
In more than three months but not more than one year	**64.9**	56.9	**33.5**	30.7
In more than one year but not more than five years	**615.8**	617.7	**388.4**	406.7
In more than five years	**12,118.9**	10,814.3	**10,176.1**	8,786.9
	12,895.7	11,576.0	**10,614.4**	9,238.6
Less: Impairment (note 16)	**(58.9)**	(59.1)	**(37.1)**	(33.4)
	12,836.8	11,516.9	**10,577.3**	9,205.2

The maturity analysis above is based on contractual maturity not expected redemption levels.

At 31 December 2014, loans and advances to customers include £1,212.6m (2013: £1,048.6m) for both the Group and Society which have been used in secured funding arrangements, resulting in the beneficial interest in these loans being transferred to Darrowby No. 1 plc (£516.4m; 2013: £659.4m), Darrowby No. 2 plc (£308.0m; 2013: £389.2m) and Darrowby No. 3 plc (£388.2m; 2013: £nil) which are special purpose vehicles consolidated into the Group Accounts. The carrying value of these loans at the date the beneficial interest was transferred was £2,193.0m (2013: £1,746.0m). All the loans pledged are retained within the Society's Statement of Financial Position as the Society retains substantially all the risk and rewards relating to the loans. These loans secure £808.6m (2013: £724.0m) of funding for the Group.

16. Impairment losses on loans and advances to customers

Group	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans £m	Total £m
At 1 January 2014				
Individual impairment	**29.9**	**5.4**	**1.1**	**36.4**
Collective impairment	**18.6**	**4.1**	**-**	**22.7**
	48.5	**9.5**	**1.1**	**59.1**
Amounts written off during the year, net of recoveries				
Individual impairment	**(11.6)**	**(1.4)**	**(0.4)**	**(13.4)**
Collective impairment	**(0.1)**	**-**	**-**	**(0.1)**
	(11.7)	**(1.4)**	**(0.4)**	**(13.5)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	**2.1**	**2.6**	**0.2**	**4.9**
Collective impairment	**8.4**	**0.5**	**-**	**8.9**
	10.5	**3.1**	**0.2**	**13.8**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	**(0.5)**	**-**	**-**	**(0.5)**
Charge for the year	**10.0**	**3.1**	**0.2**	**13.3**
At 31 December 2014				
Individual impairment	**19.9**	**6.6**	**0.9**	**27.4**
Collective impairment	**26.9**	**4.6**	**-**	**31.5**
	46.8	**11.2**	**0.9**	**58.9**
At 1 January 2013				
Individual impairment	37.8	3.7	20.2	61.7
Collective impairment	9.8	1.3	-	11.1
	47.6	5.0	20.2	72.8
Amounts written off during the year, net of recoveries				
Individual impairment	(14.8)	(1.0)	(19.3)	(35.1)
Collective impairment	(0.1)	-	-	(0.1)
	(14.9)	(1.0)	(19.3)	(35.2)
Income Statement				
Impairment losses on loans and advances				
Individual impairment	7.2	2.7	0.1	10.0
Collective impairment	8.9	2.8	-	11.7
	16.1	5.5	0.1	21.7
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.3)	-	0.1	(0.2)
Charge for the year	15.8	5.5	0.2	21.5
At 31 December 2013				
Individual impairment	29.9	5.4	1.1	36.4
Collective impairment	18.6	4.1	-	22.7
	48.5	9.5	1.1	59.1

16. Impairment losses on loans and advances to customers (continued)

Society	Loans fully secured on residential property £m	Loans fully secured on land £m	Other loans £m	Total £m
At 1 January 2014				
Individual impairment	**7.7**	**5.4**	**0.4**	**13.5**
Collective impairment	**15.8**	**4.1**	**-**	**19.9**
	23.5	**9.5**	**0.4**	**33.4**
Amounts written off during the year, net of recoveries				
Individual impairment	**(2.2)**	**(1.4)**	**(0.1)**	**(3.7)**
Collective impairment	**(0.1)**	**-**	**-**	**(0.1)**
	(2.3)	**(1.4)**	**(0.1)**	**(3.8)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	**0.6**	**2.6**	**(0.1)**	**3.1**
Collective impairment	**4.3**	**0.5**	**-**	**4.8**
	4.9	**3.1**	**(0.1)**	**7.9**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	**(0.4)**	**-**	**-**	**(0.4)**
Charge for the year	**4.5**	**3.1**	**(0.1)**	**7.5**
At 31 December 2014				
Individual impairment	**5.7**	**6.6**	**0.2**	**12.5**
Collective impairment	**20.0**	**4.6**	**-**	**24.6**
	25.7	**11.2**	**0.2**	**37.1**
At 1 January 2013				
Individual impairment	8.5	3.7	19.5	31.7
Collective impairment	6.4	1.3	-	7.7
	14.9	5.0	19.5	39.4
Amounts written off during the year, net of recoveries				
Individual impairment	(3.1)	(1.0)	(19.2)	(23.3)
Collective impairment	(0.1)	-	-	(0.1)
	(3.2)	(1.0)	(19.2)	(23.4)
Income Statement				
Impairment losses on loans and advances				
Individual impairment	2.6	2.7	0.1	5.4
Collective impairment	9.5	2.8	-	12.3
	12.1	5.5	0.1	17.7
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.3)	-	-	(0.3)
Charge for the year	11.8	5.5	0.1	17.4
At 31 December 2013				
Individual impairment	7.7	5.4	0.4	13.5
Collective impairment	15.8	4.1	-	19.9
	23.5	9.5	0.4	33.4

Included in the charge to the Income Statement is the impact of the change in the impairment charge due to the discounting of cash flows by the original effective interest rate. For the Group this amounted to £0.4m (2013: £0.5m); for the Society it amounted to £0.1m (2013: £0.2m).

17. Investments in Group undertakings

a) Subsidiary undertakings

Investments in subsidiary undertakings are recorded at cost.

The net movement in investments in subsidiary undertakings during the year was as follows:

Society	Shares in subsidiary undertakings		Loans to subsidiary undertakings		Total	
	2014	2013	**2014**	2013	**2014**	2013
	£m	£m	**£m**	£m	**£m**	£m
Cost						
At 1 January	**188.2**	186.9	**1,715.2**	1,850.0	**1,903.4**	2,036.9
Additions	**-**	1.3	**26.1**	12.7	**26.1**	14.0
Repayments	**-**	-	**(252.2)**	(147.5)	**(252.2)**	(147.5)
At 31 December	**188.2**	188.2	**1,489.1**	1,715.2	**1,677.3**	1,903.4
Provisions						
At 1 January	**57.7**	56.4	**-**	-	**57.7**	56.4
Provided in the year	**-**	1.3	**-**	-	**-**	1.3
At 31 December	**57.7**	57.7	**-**	-	**57.7**	57.7
Net book value at 31 December	**130.5**	130.5	**1,489.1**	1,715.2	**1,619.6**	1,845.7

In respect of loans provided by the Society to its subsidiary undertakings, limits in place define the maximum amount that can be advanced to each subsidiary and any changes to these limits are required to be pre-approved by the Group Wholesale Credit Committee.

The Society reviews the carrying value of its investments in subsidiary undertakings at each reporting date. During the prior year, the Society invested a further £1.3m in the intermediate holding company Skipton Group Holdings Limited (SGHL) and also provided £1.3m against the carrying value of its investment in SGHL.

17. Investments in Group undertakings (continued)

At 31 December 2014, the Group held a controlling interest in the following principal trading subsidiary undertakings:

Name of subsidiary undertaking	Principal business activity	Percentage of ownership interest 2014	2013
Amber Homeloans Limited	Lending body	**100.0**	100.0
Bailey Computer Services Limited	Provider of IT services (closed during 2014)	**100.0**	100.0
Connells Limited and subsidiary undertakings*	Estate agency and related businesses	**99.6**	99.6
Darrowby No. 1 plc	Funding vehicle	**(See below)**	(See below)
Darrowby No. 2 plc	Funding vehicle	**(See below)**	(See below)
Darrowby No. 3 plc	Funding vehicle	**(See below)**	-
Homeloan Management Limited and subsidiary undertakings	Provider of mortgage services	**-**	100.0
Jade Software Corporation Limited and subsidiary undertakings	Provider of software development services	**56.4**	56.8
North Yorkshire Mortgages Limited	Lending body	**100.0**	100.0
Northwest Investments NZ Limited	Provider of software development services	**100.0**	100.0
Pearson Jones plc	Independent financial adviser	**100.0**	100.0
Skipton Business Finance Limited	Provider of debt factoring services	**100.0**	100.0
Skipton Financial Services Limited	Financial adviser	**100.0**	100.0
Skipton Group Holdings Limited (SGHL)	Intermediate holding company	**100.0**	100.0
Skipton International Limited	Offshore deposit taker and lender	**100.0**	100.0
Skipton Trustees Limited	Provider of will writing services	**100.0**	100.0
The Private Health Partnership Limited	Medical insurance broker	**-**	88.7
Torquil Clark Holdings Limited	Financial adviser	**-**	89.1

* Indicates where an option to purchase non-controlling interests in the future exists.

The Group holds a majority stake in those subsidiary undertakings where a put option exists and the non-controlling shareholders have options that require the Group to purchase the remaining shareholding at some future date. Under IAS 32 *Financial Instruments: Presentation*, and IAS 39 *Financial Instruments: Recognition and Measurement*, these options are designated as 'financial instruments'. As such, the net present value of the estimated future payments under such put options is shown as a financial liability and the Group consolidates 100% of the results of such subsidiary undertakings to reflect the 100% ownership implicit in the obligation to purchase the minority shareholding at some point in the future. In subsequent periods, any adjustment to the Group's estimation of the present value of the liability will result in an adjustment to goodwill (for put options issued prior to 1 January 2010 in accordance with IAS 27 (2003) and IFRS 3 (2004)) or a profit or loss in the Income Statement (for put options issued after 1 January 2010 in accordance with IFRS 3 (2008 revised) and IFRS 10 (2011)). The estimate of the liability is dependent primarily on the forecast performance of the businesses and the estimated timing of the exercise of the option. The change in fair value of the financial liability due to the accretion of the discount of the liability is expensed in the Income Statement.

On 10 July 2014, the non-controlling shareholders of Spaull Limited (also known as the New Homes Group), a subsidiary of Connells Limited, exercised their right to require the Connells group to purchase their minority shareholding. As such, Connells Limited purchased the remaining shareholding in Spaull for £10.2m, increasing its ownership interest from 75% to 100%. The valuation undertaken to determine the price for the transaction generated £6.7m of goodwill. In addition, on 31 December 2014, the remaining put option in Pearson Jones plc was exercised by the non-controlling shareholders, at a cost of £0.4m to Skipton Group Holdings Limited and the valuation undertaken to determine this figure generated £0.4m of goodwill.

At 31 December 2014 the total financial liability for the remaining options detailed above was £7.5m (2013: £13.5m).

In 2012 and 2014, members of Connells Limited senior management purchased equity shares in that company for a total of £1.5m. As a result, the Group's remaining shareholding in Connells is 99.6% (2013: 99.6%). At the same time options were issued that require SGHL to purchase this shareholding at some future dates, with further details provided in note 26.

At 31 December 2014 the total liability for these options was £14.5m (2013: £8.9m).

All the above bodies are incorporated, registered and operate in the United Kingdom except for Skipton International Limited, which is incorporated and registered in Guernsey, and operates in Guernsey, Jersey and the UK; Northwest Investments NZ Limited, which is incorporated, registered and operates in New Zealand; and Jade Software Corporation Limited, which is incorporated and registered in New Zealand, and operates worldwide.

17. Investments in Group undertakings (continued)

The special purpose vehicles (SPVs) Darrowby No. 1 plc, Darrowby No. 2 plc and Darrowby No. 3 plc were formed with only nominal share capital, are funded through loans from the Society and their activities are carried out under the direction of the Society, in line with the programme documentation. The Society is exposed to variable returns from these entities and has the ability to affect those returns in line with the programme documentation and therefore these SPVs pass the test of control under IFRS 10. Consequently they are fully consolidated into the Group Accounts. The Society has no contractual arrangement or intention to provide additional financial or other support to these SPVs.

The remaining subsidiary undertakings are 100% owned except for Jade Software Corporation Limited where the Group holds a 56.4% interest (2013: 56.8%) and no put options exist.

Where the Group does not hold 100% of the share capital of a subsidiary, and no put option exists, the profits or losses attributable to the non-controlling interests of the subsidiary are shown in the Income Statement and the non-controlling interests' share of the total members' interests of the subsidiary is shown in the Statement of Financial Position.

The profit attributable to non-controlling interests as shown in the Income Statement is analysed below:

	2014	2013
	£m	£m
(Loss) / profit for the year attributable to the non-controlling interests of Jade Software Corporation Limited	**(0.4)**	1.9
Loss for the year attributable to the non-controlling interests of Wynyard Group Limited	**-**	(0.8)
Total (loss) / profit for the year attributable to non-controlling interests	**(0.4)**	1.1

The profit attributable to the non-controlling interests of Wynyard Group Limited for 2013 was generated whilst the Group held a controlling interest in Wynyard (and as such Wynyard was accounted for as a subsidiary undertaking of the Group during this time). Following the flotation of Wynyard in July 2013, the Group's shareholding was reduced to 24.5% (and subsequently to 21.7% during 2014) and so Wynyard has been held as an associate investment since this date, as described in note 17d).

The members' interests attributable to the non-controlling interests as shown in the Statement of Financial Position of £(0.7)m (2013: 2.9m) is attributable solely to the non-controlling interests of Jade Software Corporation Limited.

During 2014, Jade carried out an exercise to buy back a proportion of its share capital, which resulted in a decrease in the Group's ownership holding from 56.8% to 56.4%. The transaction resulted in a £3.2m reduction in the non-controlling interests' share of members' interests of the Group, as shown in the Statement of Changes in Members' Interests.

On 30 July 2014, Connells Limited acquired 100% of the share capital and voting rights of the estate agency business Peter Alan Limited and its subsidiary undertakings for a cash consideration of £16.4m. The acquisition also included a team of chartered surveyors and associated staff joining the Connells group and included a long term contract with Principality Building Society to deliver valuation services. The fair value of the net assets acquired was £11.1m and the transaction generated £5.3m of goodwill. The net assets acquired have been incorporated into these financial statements at their values outlined below:

	Book value of assets / (liabilities) acquired	**Fair value adjustments**	**Total**
	£m	**£m**	**£m**
Cash consideration – fair value			**16.4**
Cash	1.6	-	1.6
Property, plant and equipment	1.7	0.4	2.1
Intangible assets	1.6	7.8	9.4
Other assets	1.6	(0.3)	1.3
Liabilities	(1.6)	(1.7)	(3.3)
Net assets	**4.9**	**6.2**	**11.1**
Goodwill			**5.3**

17. Investments in Group undertakings (continued)

The results of Peter Alan have been consolidated using the acquisition method of accounting, and its net assets have been incorporated into these Group Accounts at fair value. Where intangible assets can be separately identified, in accordance with IAS 38, these are recognised within the fair values of the assets acquired. The residual excess of the consideration over the total net assets acquired is recognised as goodwill in the financial statements.

The valuation techniques used for determining the fair value of the intangible assets acquired were as follows:

Brands – The brand fair values were calculated using the relief-from-royalty method. This method considers the discounted cash flows that the Group would otherwise have had to pay as a royalty if it did not own the brand name. By owning the brand, the Group obtains relief from paying these royalties. Management judgement was exercised in determining the royalty rate applied on the cash flows.

Customer relationships and pipeline business – Customer relationships and pipelines were valued using the discounted cash flow method. The expected cash flows arising from each relationship or pipeline were discounted to their present value. Management judgement was used in determining appropriate profit margins and expected profits based on historic performance.

Connells acquired Peter Alan to strengthen its presence in South Wales and effective control was obtained as at the date of acquisition above. The consideration paid exceeds the fair value of the net assets acquired and this premium (goodwill) arises as a result of the expected future economic benefit arising from the purchase, together with the expected economic synergies arising from the combined operations of Connells and Peter Alan.

From the date of acquisition to 31 December 2014, the amount Peter Alan contributed to income was £4.4m and profit before tax was £0.5m.

If Connells had owned Peter Alan throughout 2014, the amount it would have contributed to the Group's income during the year would have been £10.7m and the amount contributed to Group profit before tax would have been £1.1m.

On 16 June 2014, Connells also acquired the assets of the estate agency business Hinckley Real Estates Limited for cash consideration of £0.3m. The transaction resulted in the recognition of intangible assets of £0.3m, which relates to customer contracts obtained as part of the acquisition. On 1 October 2014 Connells acquired the assets of Platinum Estates for consideration of £0.4m, generating intangible assets of £0.4m relating to customer contracts and relationships. Finally, on 9 December 2014 Connells acquired the lettings book of Harrisons Estate Agents for consideration of £0.4m, which was recognised as an intangible asset.

The Group made no further increases to its shareholdings in existing subsidiary undertakings (2013: £0.2m) during the year. However, the reassessment of the expected future payments under the put option agreements resulted in a further £0.2m (2013: £3.3m) of goodwill being recognised; this figure excludes the goodwill generated prior to the exercise of the put options in Spaull Limited and Pearson Jones plc as outlined above.

All the Group's subsidiary undertakings have prepared accounts to 31 December 2014 and their audited results have been included in these Group Accounts.

b) Disposals

During the year, the Group disposed of its entire shareholdings in the following subsidiary undertakings:

Name of subsidiary undertaking	Principal business activity	Effective date of disposal	Profit/ (loss) on disposal £m
Homeloan Management Limited (HML) and its subsidiary companies	Provider of mortgage services	31 May 2014	**24.7**
Torquil Clark Holdings Limited and its subsidiary companies	Financial adviser	30 June 2014	**(1.1)**
The Private Health Partnership Limited and its subsidiary companies	Medical insurance broker	30 June 2014	**2.2**

The deals to sell the subsidiaries above each included a contractual agreement whereby all profits from the effective date of disposal (as shown in the table above) were due to the purchaser rather than to the Group, with completion subsequently occurring after these dates. As a result, the Directors have concluded that the Group was not exposed to variable returns from these subsidiaries since the effective dates of disposal and as such control was lost as at these dates. Therefore, under IFRS 10, the results of the subsidiaries above have been consolidated into the Group's Accounts up to and including the effective dates of disposal.

17. Investments in Group undertakings (continued)

As HML represented the whole of the Mortgage Services division its results are classified as being derived from discontinued operations. HML was not a discontinued operation or classified as held-for-sale as at 31 December 2013 and the comparative Income Statement has been re-presented to show the discontinued operation separately from continuing operations.

An analysis of the contribution made by HML to the Group is shown in the table below:

	5 months to 31.5.2014 £m	12 months to 31.12.2013 £m
Fees and commissions receivable	**24.9**	59.3
Fees and commissions payable	**-**	(0.7)
Administrative expenses	**(24.8)**	(57.2)
Provisions for liabilities	**-**	(0.5)
Profit before tax	**0.1**	0.9
Taxation	**-**	(0.1)
Profit after taxation	**0.1**	0.8
Profit on disposal of discontinued operation	**24.7**	-
Taxation on disposal of discontinued operation	**-**	-
Profit for the period	**24.8**	0.8

An analysis of the cash flows included within the Group Statement of Cash Flows attributable to HML is shown in the table below:

	5 months to 31.5.2014 £m	12 months to 31.12.2013 £m
Net cash flows from operating activities	**5.0**	4.1
Net cash flows from investing activities	**(1.4)**	(2.8)
Net cash flows from financing activities	**-**	-
Net cash flows from discontinued operations	**3.6**	1.3

Consideration of £56.6m was received for the sale of HML and the deal also included contingent consideration, which is dependent on HML's performance in the two years ending 31 December 2016. As a result, any amounts are currently unknown and as we do not have sufficient certainty over these amounts then we have not booked any contingent consideration in the 2014 accounts.

Similarly, the deal to sell PHP also included contingent consideration, which is dependent mainly on the performance of PHP in the year ending 31 December 2014, but is also partly dependent on the performance of one of PHP's subsidiaries in the first six months of 2015. As, again, sufficient certainty does not exist over what this contingent consideration will amount to, we have not booked any contingent consideration in the 2014 accounts.

The disposals of PHP and Torquil Clark are not classified as discontinued operations as neither of these businesses was considered a major line of business of the Group. As such the results of these companies have not been disclosed separately.

c) Joint ventures

At 31 December 2014, the Group held non-controlling interests in the following companies that are classed as joint ventures:

Name of investment	Principal business activity
TM Group (UK) Limited	Property search provider
Cybele Solutions Limited	Conveyancing services
Vibrant Energy Matters Limited	Energy assessor
Home Telecom Limited	Telecommunications services

The Group's combined share of net assets and the Group's combined share of profit after tax for the above joint ventures are as shown within the Statement of Financial Position and Income Statement respectively.

17. Investments in Group undertakings (continued)

d) Associates

At 31 December 2014, the Group held an interest in the following company:

Name of investment	Principal business activity	Percentage of ownership interest 2014	2013
Wynyard Group Limited	Provider of software development services	**21.7**	24.5

Wynyard Group Limited is incorporated in New Zealand.

During the year, our associate holding in Wynyard was diluted from 24.5% to 21.7% following share issues in the year to which we did not subscribe. This deemed part disposal generated a profit of £2.3m for the Group.

As at 31 December 2014 the market value of the Group's shareholding in Wynyard Group Limited was £24.5m (2013: £14.5m), which is based on a quoted share price and is therefore regarded as a Level 1 valuation technique as described in note 38b).

An analysis of the Group's share of Wynyard's assets, liabilities, profit after tax and other comprehensive income is shown in the table below:

	Group 2014 £m	Group 2013 £m
Share of associate's		
Gross assets	**7.7**	7.1
Gross liabilities	**(0.8)**	(0.8)
Fair value adjustment in relation to initial recognition of associate investment	**6.3**	7.1
At 31 December	**13.2**	13.4
Share of associate's		
Income	**2.9**	1.4
Expenditure	**(5.5)**	(2.3)
Taxation	**-**	-
Share of associate's loss after tax	**(2.6)**	(0.9)
Share of associate's other comprehensive income	**-**	-

The associate is recognised within the Group's financial statements using the equity accounting method. As noted above, Wynyard is a listed company and we do not have access to their management accounts. The information above therefore represents the Directors' best estimates of our share of Wynyard's results, assets and liabilities and is based on a publically-available, independently-produced forecast.

e) Equity share investments

At 31 December 2014, the Group held interests in the following companies:

Name of investment	Principal business activity	Percentage of ownership interest 2014	2013
Zoopla Property Group Plc	Property search provider	**3.9**	4.9
Hearthstone Investments Limited	Property fund management	**17.7**	21.0

Both the above investments are held as available-for-sale financial assets.

On 18 June 2014, Zoopla was subject to a flotation and, following flotation, the Group sold a proportion of its shareholding which resulted in the Group's share in Zoopla reducing from 4.9% to 3.9%. This resulted in a gain to the Income Statement of £10.1m (reflected in the 'Profit on disposal of equity share investments' line). This gain had previously been recognised as an unrealised gain (£8.2m of which was recognised in 2013) through the available-for-sale reserve and, following the sale of these shares, has been recycled to the Income Statement. In addition, a further unrealised gain of £4.8m was recognised in the year in respect of the Group's remaining shareholding in Zoopla, based on the quoted share price as at 31 December 2014. This is recognised in the Statement of Comprehensive Income.

The Group's shareholding in Hearthstone was 21.0% at 31 December 2013, and following a number of rights issues during 2014 to which the Group did not subscribe, this holding stood at 17.7% as at 31 December 2014.

17. Investments in Group undertakings (continued)

The movement in the Group's equity share investments during the period is analysed below:

	Group 2014 £m	Group 2013 £m
At 1 January	**37.1**	3.1
Additions	**1.0**	0.8
Disposals	**(10.6)**	-
Impairment recognised in Income Statement	**(1.3)**	-
Gain recognised in Other Comprehensive Income	**6.7**	33.2
At 31 December	**32.9**	37.1

The cost of the Group's investment in Hearthstone was £2.0m when purchased in 2012. Hearthstone continues to develop its business, however this is at a slower rate than previously forecast. Consequently, in the absence of any other observable inputs, the Directors have reviewed the carrying value of this investment, based on a recent indication of the value of the business and have decided to write its value down to £0.7m, which the Directors believe is the best indication of its fair value. As such an impairment charge of £1.3m has been recognised in the Income Statement.

18. Property, plant and equipment

Group	**2014**			2013		
	Land and buildings £m	**Equipment, fixtures and fittings £m**	**Total £m**	Land and buildings £m	Equipment, fixtures and fittings £m	Total £m
Cost						
At 1 January	**93.5**	**92.2**	**185.7**	83.6	100.4	184.0
Acquisitions of subsidiaries	**1.1**	**1.0**	**2.1**	-	-	-
Additions	**4.4**	**9.4**	**13.8**	3.5	7.8	11.3
Disposals	**(0.9)**	**(16.6)**	**(17.5)**	(1.6)	(7.4)	(9.0)
Disposal of subsidiary undertakings	**-**	**(17.7)**	**(17.7)**	-	(0.8)	(0.8)
Transfer to investment property on disposal of subsidiary undertaking	**(22.9)**	**-**	**(22.9)**	-	-	-
Items reclassified in the year	**-**	**-**	**-**	7.8	(7.8)	-
Transfer from investment property	**-**	**-**	**-**	0.2	-	0.2
At 31 December	**75.2**	**68.3**	**143.5**	93.5	92.2	185.7
Depreciation						
At 1 January	**28.9**	**75.2**	**104.1**	22.2	80.4	102.6
Charge for the year – continuing operations	**4.0**	**4.7**	**8.7**	3.9	4.5	8.4
Charge for the year – discontinued operations	**-**	**0.4**	**0.4**	-	1.2	1.2
Impairment	**0.8**	**-**	**0.8**	-	-	-
Disposals	**(0.7)**	**(15.8)**	**(16.5)**	(1.2)	(6.7)	(7.9)
Disposal of subsidiary undertakings	**-**	**(15.4)**	**(15.4)**	-	(0.3)	(0.3)
Transfer to investment property on disposal of subsidiary undertaking	**(2.6)**	**-**	**(2.6)**	-	-	-
Items reclassified in the year	**-**	**-**	**-**	3.9	(3.9)	-
Transfer from investment property	**-**	**-**	**-**	0.1	-	0.1
At 31 December	**30.4**	**49.1**	**79.5**	28.9	75.2	104.1
Net book value at 1 January	**64.6**	**17.0**	**81.6**	61.4	20.0	81.4
Net book value at 31 December	**44.8**	**19.2**	**64.0**	64.6	17.0	81.6

18. Property, plant and equipment (continued)

Society	2014			2013		
	Land and buildings	**Equipment, fixtures and fittings**	**Total**	Land and buildings	Equipment, fixtures and fittings	Total
	£m	**£m**	**£m**	£m	£m	£m
Cost						
At 1 January	**42.8**	**27.3**	**70.1**	40.1	29.3	69.4
Additions	**1.8**	**1.0**	**2.8**	0.6	0.3	0.9
Disposals	**(0.2)**	**(0.2)**	**(0.4)**	(0.1)	(0.3)	(0.4)
Items reclassified in the year	**-**	**-**	**-**	2.0	(2.0)	-
Transfer from investment property	**-**	**-**	**-**	0.2	-	0.2
At 31 December	**44.4**	**28.1**	**72.5**	42.8	27.3	70.1
Depreciation						
At 1 January	**13.5**	**26.4**	**39.9**	11.7	26.5	38.2
Charge for the year	**1.8**	**0.3**	**2.1**	1.5	0.4	1.9
Impairment	**0.8**	**-**	**0.8**	-	-	-
Disposals	**(0.1)**	**(0.1)**	**(0.2)**	-	(0.3)	(0.3)
Items reclassified in the year	**-**	**-**	**-**	0.2	(0.2)	-
Transfer from investment property	**-**	**-**	**-**	0.1	-	0.1
At 31 December	**16.0**	**26.6**	**42.6**	13.5	26.4	39.9
Net book value at 1 January	**29.3**	**0.9**	**30.2**	28.4	2.8	31.2
Net book value at 31 December	**28.4**	**1.5**	**29.9**	29.3	0.9	30.2

The net book value of land and buildings comprises:

	Group 2014	Group 2013	**Society 2014**	Society 2013
	£m	£m	**£m**	£m
Freehold	**40.3**	56.2	**24.3**	25.3
Long leasehold	**1.2**	2.8	**1.0**	1.0
Short leasehold	**3.3**	5.6	**3.1**	3.0
	44.8	64.6	**28.4**	29.3

19. Investment property

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Cost				
At 1 January	**10.7**	17.6	**33.3**	40.2
Additions	**0.2**	0.3	**0.2**	0.3
Disposals	**(1.9)**	(7.0)	**(1.9)**	(7.0)
Transfer from property, plant and equipment on disposal of subsidiary undertaking	**22.9**	-	**-**	-
Transfer to property, plant and equipment	**-**	(0.2)	**-**	(0.2)
At 31 December	**31.9**	10.7	**31.6**	33.3
Depreciation				
At 1 January	**4.0**	6.0	**6.2**	7.6
Charge for the year	**0.5**	0.3	**0.7**	0.9
Impairment	**3.9**	1.2	**3.9**	1.2
Disposals	**(1.2)**	(3.4)	**(1.2)**	(3.4)
Transfer from property, plant and equipment on disposal of subsidiary undertaking	**2.6**	-	**-**	-
Transfer to property, plant and equipment	**-**	(0.1)	**-**	(0.1)
At 31 December	**9.8**	4.0	**9.6**	6.2
Net book value at 1 January	**6.7**	11.6	**27.1**	32.6
Net book value at 31 December	**22.1**	6.7	**22.0**	27.1

All investment property relates to property purchased by the Group or Society and is either unoccupied by the Group or Society, or relates to branches where part of the property is subsequently sub-leased. At 31 December 2013, £20.6m of investment property in the Society was occupied by a Group company, Homeloan Management Limited (HML), and was therefore classed as property, plant and equipment within the Group. Upon the disposal of HML during 2014, this property is now classed as investment property within the Group.

The aggregate estimated market value of investment properties is set out in the table below:

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Market value of investment property	**29.0**	9.0	**28.7**	29.2

The estimated market value of the investment properties has been determined by an appropriately qualified internal valuer in accordance with RICS Appraisal and Valuation Standards and is an indication of fair value. This fair value measurement is categorised as a Level 3 fair value measurement, based on the inputs to the valuation technique used as described in note 38b).

The fair value of the majority of investment properties is estimated using the market valuation approach which uses prices and other relevant information generated by market transactions involving comparable properties. Where comparable transactions may not be available, the Group may also consider a discounted cash flow technique which considers the present value of the net cash flows to be generated from the property, taking into account expected rental growth, void periods and rent-free periods. The expected net cash flows are discounted using risk-adjusted discount rates.

Certain properties are purpose built facilities, for which comparable market transactions are unavailable, and the discounted cash flows do not reflect the value in use to the Group. Therefore, the cost method is considered more appropriate, and reflects the amount that currently would be required to replace the service capacity of such properties.

20. Intangible assets

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Software, databases, brands and customer contracts	**17.3**	18.0	**1.7**	1.5
Goodwill	**149.2**	156.2	**-**	-
	166.5	174.2	**1.7**	1.5

Software, databases, brands and customer contracts	**Group 2014 £m**	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Cost				
At 1 January	**80.1**	81.0	**14.0**	13.4
Acquisition of subsidiary undertakings	**9.4**	0.2	**-**	-
Acquisition of other business assets	**1.1**	0.7	**-**	-
Additions	**4.3**	7.4	**0.7**	0.6
Disposals	**(0.3)**	(2.6)	**-**	-
Disposal of subsidiary undertakings	**(33.8)**	(6.6)	**-**	-
At 31 December	**60.8**	80.1	**14.7**	14.0
Amortisation and impairment				
At 1 January	**62.1**	57.4	**12.5**	11.9
Charge for the year – continuing operations	**5.0**	5.4	**0.5**	0.6
Charge for the year – discontinued operations	**1.2**	3.0	**-**	-
Impairment	**0.6**	-	**-**	-
Disposals	**(0.2)**	(2.3)	**-**	-
Disposal of subsidiary undertakings	**(25.2)**	(1.4)	**-**	-
At 31 December	**43.5**	62.1	**13.0**	12.5
Net book value at 1 January	**18.0**	23.6	**1.5**	1.5
Net book value at 31 December	**17.3**	18.0	**1.7**	1.5

20. Intangible assets (continued)

Goodwill	**Group 2014 £m**	Group 2013 £m
Cost, less amortisation to 1 January 2004		
At 1 January	**182.9**	189.0
Acquisitions of subsidiary undertakings and business units	**5.3**	0.1
Additions and revaluations of put options	**7.3**	3.3
Amounts written off	**-**	(1.5)
Disposal of subsidiary undertakings	**(26.0)**	(8.0)
At 31 December	**169.5**	182.9
Impairment losses		
At 1 January	**26.7**	16.4
Provisions for impairment losses in the year	**3.5**	16.6
Amounts written off	**-**	(1.5)
Disposal of subsidiary undertakings	**(9.9)**	(4.8)
At 31 December	**20.3**	26.7
Net book value at 1 January	**156.2**	172.6
Net book value at 31 December	**149.2**	156.2

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating unit (operating segment) that is expected to benefit from that business combination. The carrying value of goodwill has been allocated as follows:

Operating segment		**Group 2014**	
	Cost of goodwill £m	**Accumulated impairment £m**	**Carrying value £m**
Estate Agency	**141.8**	**2.2**	**139.6**
Financial Advice	**18.8**	**12.8**	**6.0**
Investment Portfolio	**8.9**	**5.3**	**3.6**
Total goodwill	**169.5**	**20.3**	**149.2**

Operating segment		Group 2013	
	Cost of goodwill £m	Accumulated impairment £m	Carrying value £m
Mortgage Services	2.9	2.9	-
Estate Agency	129.6	2.2	127.4
Financial Advice	30.3	13.5	16.8
Investment Portfolio	20.1	8.1	12.0
Total goodwill	182.9	26.7	156.2

Following a revision in future cash flows and based upon the Directors' assessment of recoverable amounts, £3.5m of impairment has been recognised against the Financial Advice division (2013: £0.4m, £10.4m and £2.9m of impairment was recognised against the Estate Agency division, the Financial Advice division and the Investment Portfolio respectively). In 2013, £2.9m of impairment was also recognised against the Mortgage Services division, which is now classified as a discontinued operation.

20. Intangible assets (continued)

The recoverable amounts of the operating segments are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding cash flows, discount rates and growth rates.

The Group prepares cash flow forecasts on the assumption that the subsidiary undertakings within each operating segment are held for long term investment. The cash flows are derived from the most recent corporate plans for the next five years, which take into account the risks inherent in each of the businesses, and cash flows are extrapolated for subsequent years (up to an additional 10 years) based on a long term growth rate of 2.5% (2013: 2.5%) or specific where circumstances dictate.

The corporate plans are based upon the following key drivers:

Operating segment	Key drivers
Estate Agency	Volume of UK property transactions, house price inflation, level of unemployment and interest rates
Financial Advice	Volume of new business, recurring income and FTSE levels
Investment Portfolio	Volume of new business, level of unemployment and interest rates

These key drivers are discussed further in the Risk Management Report on pages 49 to 55.

The Group estimates discount rates based upon the weighted average cost of capital which is then adjusted to take account of the market risks associated with each cash generating unit.

The pre-tax discount rates are as follows:

Operating segment	**Group 2014 %**	Group 2013 %
Estate Agency	**17**	16
Financial Advice	**11**	13-14
Investment Portfolio	**11**	11-14

21. Other assets

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Trade receivables	**25.3**	32.4	**0.6**	0.2
Prepayments	**14.0**	15.5	**9.3**	8.1
Accrued income	**8.2**	11.9	**-**	-
Other	**40.6**	44.0	**1.6**	2.2
	88.1	103.8	**11.5**	10.5

Included within Group other assets above are £34.6m (2013: £34.1m) of undrawn advances to debt factoring clients. These amounts represent the difference between the total of outstanding debts purchased by the Group under recourse agreements and the amounts already advanced to clients in relation to those debts, net of any charges and adjustments. Once recovered, these amounts are paid over to the clients in question and as a result a corresponding creditor is included within other liabilities (see note 26).

21. Other assets (continued)

The ageing of the Group's trade receivables, gross of provision for impairment, at the reporting date was as follows:

	Group 2014		Group 2013	
	£m	**%**	£m	%
Neither past due nor individually impaired	**12.9**	**47.3**	18.7	52.7
Past due but not individually impaired:				
Up to 30 days	**8.5**	**31.3**	9.0	25.4
30 to 120 days	**3.5**	**12.9**	3.8	10.7
Over 120 days	**0.4**	**1.5**	0.9	2.5
	25.3	**93.0**	32.4	91.3
Individually impaired	**1.9**	**7.0**	3.1	8.7
	27.2	**100.0**	35.5	100.0

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

	Group 2014	Group 2013
	£m	£m
At 1 January	**(3.1)**	(4.2)
Provisions made during the year	**(0.2)**	(1.4)
Receivables written off during the year	**1.3**	1.7
Provisions no longer required	**0.1**	0.8
At 31 December	**(1.9)**	(3.1)

The Society has £0.6m (2013: £0.2m) of trade receivables, £0.4m (2013: £nil) of which are neither past due nor impaired. £0.2m of trade receivables in the Society are past due but not individually impaired (2013: £0.2m).

22. Shares

	Group and Society	
	2014	2013
	£m	£m
Held by individuals	**11,337.0**	10,150.3
Other shares	**105.0**	95.8
Fair value adjustment for hedged risk	**25.5**	14.0
	11,467.5	10,260.1
Shares are repayable from the reporting date in the ordinary course of business as follows:		
On demand	**3,873.7**	3,820.6
In not more than three months	**4,901.1**	3,698.9
In more than three months but not more than one year	**1,047.8**	1,343.1
In more than one year but not more than five years	**1,579.3**	1,275.2
In more than five years	**65.6**	122.3
	11,467.5	10,260.1

23. Amounts owed to credit institutions

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Amounts owed to subsidiary undertakings	**-**	-	**91.0**	103.1
Other	**789.8**	1,046.3	**789.6**	1,046.3
	789.8	1,046.3	**880.6**	1,149.4
Amounts owed to credit institutions are repayable from the reporting date in the ordinary course of business as follows:				
Repayable on demand	**32.9**	53.3	**123.7**	156.4
In not more than three months	**574.9**	670.2	**574.9**	670.2
In more than three months but not more than one year	**133.2**	23.1	**133.2**	23.1
In more than one year but not more than five years	**48.8**	297.1	**48.8**	297.1
In more than five years	**-**	2.6	**-**	2.6
	789.8	1,046.3	**880.6**	1,149.4

Amounts owed to credit institutions by the Group and Society includes an amount of £85.1m (2013: £219.0m) of external funding facilitated through the Group's securitisation vehicle Darrowby No. 1 plc. This is secured on debt securities and loans and advances to customers originated by the Group.

At 31 December 2014, £44.0m (2013: £43.4m) of cash collateral has been received by the Group and £47.8m (2013: £43.4m) of cash collateral has been received by the Society against derivative contracts.

24. Amounts owed to other customers

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Amounts owed to subsidiary undertakings	**-**	-	**1,241.1**	1,121.6
Other	**1,143.1**	930.6	**244.0**	147.3
Fair value adjustment for hedged risk	**0.1**	0.2	**-**	-
	1,143.2	930.8	**1,485.1**	1,268.9
Amounts owed to other customers are repayable from the reporting date in the ordinary course of business as follows:				
Repayable on demand	**195.0**	195.7	**99.5**	84.4
In not more than three months	**274.7**	298.9	**101.5**	85.3
In more than three months but not more than one year	**564.6**	352.0	**106.5**	39.6
In more than one year but not more than five years	**108.9**	82.8	**1,177.6**	1,059.6
In more than five years	**-**	1.4	**-**	-
	1,143.2	930.8	**1,485.1**	1,268.9

Amounts owed to subsidiary undertakings includes £2.4m (2013: £nil) of fair value adjustments as a result of applying the fair value option on a loan to a Group undertaking, in line with the accounting policy outlined in note 1f).

25. Debt securities in issue

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Certificates of deposit	**7.0**	8.0	**7.0**	8.0
Floating rate notes	**723.6**	546.8	**0.1**	41.8
Fair value adjustment for hedged risk	**-**	(0.1)	**-**	(0.1)
	730.6	554.7	**7.1**	49.7
Debt securities in issue are repayable from the reporting date in the ordinary course of business as follows:				
In not more than one year	**8.0**	50.8	**7.0**	49.6
In more than one year	**722.6**	503.9	**0.1**	0.1
	730.6	554.7	**7.1**	49.7

Group debt securities in issue include £723.5m (2013: £505.0m) of funding secured on certain loans and advances to customers through the Group's securitisation vehicles, Darrowby No. 1 plc, Darrowby No. 2 plc and Darrowby No. 3 plc.

26. Other liabilities

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Trade payables	**5.2**	6.0	**0.6**	0.5
Tax deducted at source from interest paid	**3.6**	3.3	**3.6**	3.3
Fair value of put option obligation	**7.5**	13.5	**-**	-
Fair value of liability of management incentive scheme	**14.5**	8.9	**-**	-
Debt factoring liabilities	**34.6**	34.1	**-**	-
Other	**36.4**	29.9	**5.5**	4.5
	101.8	95.7	**9.7**	8.3

The debt factoring liabilities of £34.6m (2013: £34.1m) represent the difference between the total of outstanding debts purchased by the Group under recourse agreements and the amounts already advanced to clients in relation to those debts, net of any charges and adjustments. Once recovered, these amounts are paid over to the clients in question.

The movement in the fair value of the put option obligation is summarised below:

	Group 2014 £m	Group 2013 £m
At 1 January	**13.5**	12.0
Unwind of the discount factor	**1.8**	1.5
Revaluation of market values and future exercise dates	**5.4**	1.9
Exercise of put options by non-controlling shareholders	**(10.6)**	-
Dividends paid to non-controlling shareholders	**(1.0)**	(1.9)
Disposal of subsidiary undertakings	**(1.6)**	-
At 31 December	**7.5**	13.5

Financials

26. Other liabilities (continued)

Management incentive scheme

Five members of Connells Limited senior management purchased equity shares in that company in 2012, and during 2014 a further member of Connells Limited senior management purchased equity shares in that company. At the same time, the Group issued options to these shareholders to require SGHL to purchase their shareholdings in Connells Limited at some future dates. Five of the six options remain outstanding at the 2014 year end, with the maximum option length being 10 years from 31 December 2014. In accordance with IFRS 2 *Share-based Payment*, this is a cash-settled scheme in the Group Accounts, with the fair value of the liability being spread over the period to exercise. The fair value of the liability is subsequently remeasured at each reporting date with any changes in fair value recognised in the Income Statement for the year.

The movement in the fair value of the liability of the management incentive scheme is summarised below:

	Group 2014 £m	Group 2013 £m
At 1 January	**8.9**	1.3
Share options issued in the year	**0.2**	-
Movement in fair value of the scheme recognised in the Income Statement	**5.4**	7.7
Share options forfeited in the year	**-**	(0.1)
At 31 December	**14.5**	8.9

27. Provisions for liabilities

	Group 2014 £m	Group 2013 Restated* £m	**Society 2014 £m**	Society 2013 Restated* £m
Provision for the costs of surplus properties	**4.6**	5.3	**0.6**	0.8
Financial Services Compensation Scheme (FSCS)	**4.3**	5.1	**4.3**	4.8
Commission clawbacks / rebates	**5.4**	5.7	**-**	-
Survey and valuation claims	**13.0**	11.4	**-**	-
Customer compensation	**3.4**	6.4	**1.6**	1.7
Other provisions	**1.7**	3.4	**0.2**	-
	32.4	37.3	**6.7**	7.3

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

Movements in provisions during the year were as follows:

Group 2014	**Provision for the costs of surplus properties £m**	**FSCS £m**	**Commission clawbacks / rebates £m**	**Survey and valuation claims £m**	**Customer compensation £m**	**Other provisions £m**	**Total £m**
At 1 January	**5.3**	**5.1**	**5.7**	**11.4**	**6.4**	**3.4**	**37.3**
Charge / (credit) for the year (gross)	**-**	**7.8**	**3.9**	**5.0**	**(1.1)**	**0.6**	**16.2**
Utilised during the year	**(0.7)**	**(8.6)**	**(4.2)**	**(3.4)**	**(1.9)**	**(0.5)**	**(19.3)**
Disposal of subsidiaries	**-**	**-**	**-**	**-**	**-**	**(1.8)**	**(1.8)**
At 31 December	**4.6**	**4.3**	**5.4**	**13.0**	**3.4**	**1.7**	**32.4**

27. Provisions for liabilities (continued)

A reconciliation of the gross charge for provisions for liabilities in the table above to the net charge in the Income Statement is as follows:

Group 2014	**Provision for the costs of surplus properties £m**	**FSCS £m**	**Commission clawbacks / rebates £m**	**Survey and valuation claims £m**	**Customer compensation £m**	**Other provisions £m**	**Total £m**
Charge / (credit) for the year (gross)	**-**	**7.8**	**3.9**	**5.0**	**(1.1)**	**0.6**	**16.2**
PI recoverability asset released during the year	**-**	**-**	**-**	**-**	**1.3**	**-**	**1.3**
Net charge to Income Statement	**-**	**7.8**	**3.9**	**5.0**	**0.2**	**0.6**	**17.5**

The Directors consider that PI insurance recovery is virtually certain, as required by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, when accounting for an expected reimbursement of some or all expenditure required to settle a provision.

Group 2013	Provision for the costs of surplus properties £m	FSCS Restated* £m	Commission clawbacks / rebates £m	Survey and valuation claims £m	Customer compensation £m	Other provisions £m	Total £m
At 1 January	7.9	6.8	5.9	12.1	13.5	2.2	48.4
Reclassified to other liabilities and accruals	-	-	(0.5)	-	-	-	(0.5)
Charge for the year (gross) – from continuing operations	0.9	6.6	5.4	3.1	(3.7)	1.3	13.6
Charge for the year (gross) – from discontinued operations	-	-	-	-	-	0.5	0.5
Utilised during the year	(3.5)	(8.3)	(5.1)	(3.8)	(3.4)	(0.6)	(24.7)
At 31 December	5.3	5.1	5.7	11.4	6.4	3.4	37.3

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

Group 2013	Provision for the costs of surplus properties £m	FSCS Restated* £m	Commission clawbacks / rebates £m	Survey and valuation claims £m	Customer compensation £m	Other provisions £m	Total £m
Charge for the year (gross) from continuing operations	0.9	6.6	5.4	3.1	(3.7)	1.3	13.6
PI recoverability asset released during the year	-	-	-	-	5.4	-	5.4
Net charge to Income Statement from continuing operations	0.9	6.6	5.4	3.1	1.7	1.3	19.0

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

27. Provisions for liabilities (continued)

Society 2014	Provision for the costs of surplus properties	FSCS	Customer compensation	Other provisions	Total
	£m	£m	£m	£m	£m
At 1 January	0.8	4.8	1.7	-	7.3
Charge for the year	-	7.3	0.5	0.2	8.0
Utilised during the year	(0.2)	(7.8)	(0.6)	-	(8.6)
At 31 December	0.6	4.3	1.6	0.2	6.7

Society 2013	Provision for the costs of surplus properties	FSCS Restated*	Customer compensation	Other provisions	Total
	£m	£m	£m	£m	£m
At 1 January	3.4	6.1	1.0	-	10.5
Charge for the year	0.7	6.1	1.4	-	8.2
Utilised during the year	(3.3)	(7.4)	(0.7)	-	(11.4)
At 31 December	0.8	4.8	1.7	-	7.3

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

Provision for the costs of surplus properties

The provision for the costs of surplus properties is expected to reverse over the remaining life of the leases or period to anticipated date of disposal, if sooner.

Financial Services Compensation Scheme

The Society and other subsidiaries pay levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it as described in note 33b).

Following the payment of the 2013/2014 scheme year Management Expense Levy together with the 2014/2015 scheme year Capital Levy in August 2014, the £4.3m provision at the year end relates to the estimated Management Expense Levy for the 2014/2015 scheme year that will be paid in August 2015. The Society's provision does not include management expense levies for any further scheme years, or compensation levies which may arise from any ultimate payout on future claims made under the scheme.

In addition to the annual levies to the FSCS, the Financial Advice division is also subject to one-off levies for particular market events, such as the failure of Keydata and its counterparty Lifemark.

Commission clawbacks / rebates

The commission clawback provision represents an estimate of the repayment of commission to suppliers as a result of cancelled policies sold by the Financial Advice and Estate Agency divisions. These are estimated based upon anticipated cancellation rates.

Survey and valuation claims

A provision is made for professional indemnity claims and potential claims that arise during the normal course of business in relation to surveys and valuations performed by the Group. The provision is based upon the expected level of future professional indemnity claims relating to services provided by the Group. Where a formal letter of claim has been received a provision is made on a case-by-case basis, taking into account the strength of the Group's case, and its history of successfully defending such claims. Where an initial notification has been received, an estimate is made of the proportion of these notifications expected to lead to a formal claim based upon historical trends. A final provision is also made for the estimated level of future claims, taking into account market conditions and a prudent attitude to risk.

The professional indemnity provision is stated at the Directors' best estimate of eventual liability. While the level of future claims is uncertain, the Group has robust processes in place that aim to restrict both the number and magnitude of these.

Due to the nature of the professional indemnity claims it is difficult to indicate approximate payment timescales or claims received in future years. The provision will be utilised as individual claims are settled.

Customer compensation

The customer compensation provision includes provisions for the potential claims on payment protection insurance sold by the Group. The Group has experienced a fall in complaint levels during 2014 and despite uphold rates remaining low, a number of cases are being referred to the Financial Ombudsman Service (FOS), with each MPPI referral incurring a £550 fee. The majority of these provisions are expected to be utilised within the next 12 months.

27. Provisions for liabilities (continued)

Also included within the customer compensation provision is the Directors' best estimate of costs arising from past business reviews (including the costs of remediation) within the Financial Advice division, whereby these reviews initially indicated documentation issues in a number of cases. The provision of £1.3m (2013: £3.8m) is calculated gross of professional indemnity insurance for which a receivable of £1.2m (2013: £2.2m) has been included within other assets.

These reviews are now complete and the amount of the gross provision and the associated professional indemnity insurance recovery have fallen further during 2014, with the amount of remediation likely to be required significantly less than originally estimated. The remaining provision is expected to be utilised within the next 12 months.

28. Deferred tax

Deferred taxes are calculated on temporary differences under the Statement of Financial Position liability method, using the enacted tax rate that is expected to apply when these differences reverse, generally 20% (2013: 20%).

The movement in deferred tax during the year was as follows:	**Group 2014**	Group 2013 Restated*	**Society 2014**	Society 2013 Restated*
	£m	£m	**£m**	£m
At 1 January	**3.5**	18.7	**4.7**	11.3
Income Statement credit / (charge) – from continuing operations (note 11)	**3.7**	(6.9)	**1.6**	(5.1)
Income Statement charge – from discontinued operations	**-**	(0.3)	**-**	-
Items taken directly to Other Comprehensive Income	**3.8**	(8.2)	**0.4**	(1.5)
Acquired on acquisition of subsidiary	**(1.4)**	-	**-**	-
Disposal of subsidiaries	**-**	0.2	**-**	-
At 31 December	**9.6**	3.5	**6.7**	4.7

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

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

Deferred tax assets	**Group 2014**	Group 2013	**Society 2014**	Society 2013
	£m	£m	**£m**	£m
Fixed asset temporary differences	**1.1**	0.9	**-**	-
Pension obligations	**14.6**	11.3	**6.8**	4.9
Provisions for loan impairment	**1.8**	0.8	**0.2**	0.5
Corporation tax losses	**0.3**	0.2	**-**	-
Derivatives and loans	**2.2**	4.3	**2.1**	4.3
Other	**1.7**	1.4	**-**	-
	21.7	18.9	**9.1**	9.7

Deferred tax liabilities	**Group 2014**	Group 2013 Restated*	**Society 2014**	Society 2013 Restated*
	£m	£m	**£m**	£m
Fixed asset temporary differences	**1.9**	2.5	**1.7**	2.1
Derivatives and loans	**1.8**	2.7	**0.7**	1.4
Available-for-sale financial assets	**6.0**	7.2	**-**	-
Other	**2.4**	3.0	**-**	1.5
	12.1	15.4	**2.4**	5.0
Net deferred tax asset	**9.6**	3.5	**6.7**	4.7

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

28. Deferred tax (continued)

The deferred tax (credit) / charge in the Income Statement from continuing operations comprises the following:

	Group 2014	Group 2013 Restated*^	**Society 2014**	Society 2013 Restated*
	£m	£m	**£m**	£m
Fixed asset temporary differences	**(0.9)**	0.6	**(0.4)**	0.3
Provisions	**(0.2)**	(0.2)	**0.4**	(0.1)
Utilisation of tax losses	**-**	4.9	**-**	4.9
Other	**(2.6)**	1.6	**(1.6)**	-
	(3.7)	6.9	**(1.6)**	5.1

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

^ The prior period figures have also been re-presented to reflect the disposal of Homeloan Management Limited and its subsidiary companies, which became a discontinued operation during 2014. Further details are provided in note 17b).

Unrecognised deferred tax relating to trading losses carried forward at 31 December 2014 amounts to £3.9m (2013: £3.4m).

The majority of deferred tax assets are anticipated to be recoverable after one year. The Group's plans indicate that the Group and Society will generate sufficient taxable profits over its five year planning period to absorb the Corporation tax losses included within deferred tax at the reporting date, together with those other temporary differences that are expected to reverse during that period.

29. Pensions

Defined contribution schemes

The amount charged to the Income Statement in respect of contributions to the Group's defined contribution and stakeholder pension arrangements is the contribution payable in the year. The total pension cost charged to the Income Statement from continuing operations amounted to £6.3m for the Group (2013: £5.4m) and £2.8m for the Society (2013: £2.5m).

Defined benefit schemes

The Group sponsors three funded defined benefit arrangements:

- The Skipton Building Society Pension & Life Assurance Scheme (the 'Skipton Scheme');
- The Scarborough Building Society Group Pension and Death Benefits Scheme (the 'Scarborough Scheme'); and
- The Connells (2014) Group Pension Scheme (the Connells (2014) Scheme). This is a new scheme established on 30 April 2014 by the merger of three existing schemes:
    - The Connells Limited Pension & Life Assurance Scheme (the 'Old Connells Scheme');
    - The Sequence (UK) Limited (1997) Pension & Life Assurance Scheme (the 'Sequence 1997 Scheme'); and
    - The Sequence (UK) Limited (South) Staff Pension Scheme (the 'Sequence Staff Scheme').

These are separate trustee administered funds holding the pension scheme assets to meet long term liabilities for current and past employees as follows:

- Skipton Scheme – 709 members
- Scarborough Scheme – 150 members
- Connells (2014) Scheme – 1,148 members

The level of retirement benefit in each scheme is principally based on salary and is linked to changes in inflation up to retirement. For all schemes the level of retirement benefit is based on salary earned in the last years of employment prior to leaving active service (this is known as Career Average Revalued Earnings (CARE)) as follows:

- Skipton Scheme – the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service or, for members employed by Skipton Financial Services Limited, the annual average salary earned in the last five years of employment prior to leaving active service;
- Scarborough Scheme – the highest (prior to 2003) or the average (post 2003) annual salary earned in the last three years of employment prior to leaving active service;
- Connells (2014) Scheme:
    - Old Connells Scheme – the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service;

29. Pensions (continued)

- Sequence 1997 Scheme – the annual average salary earned in the last three years of employment prior to leaving active service;
- Sequence Staff Scheme – the greater of the annual average salary earned in the last three years and the highest annual average salary earned over three consecutive years in the last 10 years of employment prior to leaving active service.

As part of the merger of the three existing pension schemes into the Connells (2014) Scheme, members' benefits in the three existing pension schemes were preserved, hence the three separate benefits sections of the new Connells (2014) Scheme are shown above.

The schemes are all now closed to new members and to the future accrual of benefits, with the exception of the Scarborough Scheme where active members retain a link to salary (capped at 5% per annum). The Scarborough Scheme closed to future accrual of benefits, subject to the exception noted above, on 1 May 2007; the Old Connells Scheme, Sequence 1997 Scheme and Sequence Staff Scheme all closed to future accrual of benefits on 1 January 2009 and the Skipton Scheme closed to future accrual of benefits on 1 January 2010. The Connells (2014) Scheme was open to accrual for one day, on 30 April 2014. Following the closure of all the schemes, all active members left pensionable service and became entitled to deferred benefits.

The schemes are subject to the funding legislation outlined in the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, and Guidance Notes adopted by the Financial Reporting Council, sets out the framework for funding defined benefit occupational pension schemes in the UK.

The Trustee of each scheme is required to act in the best interest of the scheme's beneficiaries. The appointment of the Trustee is determined by the schemes' trust documentation.

Full actuarial valuations were carried out as at the dates set out below in accordance with the scheme funding requirements of the Pensions Act 2004 and the funding of each scheme is agreed between the Group and the Trustee in line with those requirements. This legislation requires the deficit to be calculated using prudent, as opposed to best estimate, actuarial assumptions. The most recent actuarial valuations for each of the schemes showed the following:

Scheme	Valuation date	Deficit £m	Recovery Period	Annual Contribution £m
Skipton	31 March 2014	(11.2)	7 years	0.6
Scarborough	31 December 2013	(8.1)	7 years	0.8
Connells (2014)	30 April 2014	(25.7)	7 years	2.7

Scheme expenses and levies to the Pension Protection Fund are payable by the Group as and when they are due and are accounted for within the Group's administrative expenses.

For the purposes of IAS 19 *Employee Benefits*, the actuarial valuations, which were carried out by a qualified independent actuary, have been updated on an approximate basis to 31 December 2014. There have been no changes in the valuation methodology adopted for this year's disclosures compared to the previous year's disclosures.

The aggregate costs of the three schemes are recognised in accordance with IAS 19. Whilst the Society is the principal employer for the Skipton and Scarborough schemes, current and former employees of other Group companies are also members of these schemes and the Society makes recharges to these subsidiaries in relation to deficit contributions under an internal agreement based on the proportion of active members who were employees at the time of closure to future accrual. These companies are no longer participating employers in the schemes and account for the pension scheme on the basis of the deficit contributions paid by that company. The Society accounts for the difference between the aggregate IAS 19 costs of the scheme and the aggregate contributions paid by the other entities.

29. Pensions (continued)

The main financial assumptions used in the actuarial valuation are as follows:

	Group and Society	
	2014	2013
	%	%
Retail price inflation (RPI)	**3.10**	3.50
Consumer price inflation (CPI)	**1.90**	2.50
Discount rate	**3.55**	4.55
Increases to pension payment:		
in line with RPI, subject to a max of 5% pa	**3.05**	3.30
in line with RPI, subject to a min of 3% and max of 5% pa	**3.60**	3.80
in line with RPI, subject to a max of 2.5% pa	**2.20**	2.40
in line with CPI, subject to a max of 5% pa	**2.00**	2.50
in line with CPI, subject to a min of 3% and max of 5% pa	**3.20**	3.40
in line with CPI, subject to a max of 2.5% pa	**1.60**	2.40
Rate of increase for deferred pensions (in line with CPI, subject to a max of 5% pa)	**1.90**	2.50
Allowance for commutation of pension for cash at retirement	**100% of post A day maximum**	100% of post A day maximum

All the schemes' deferred pensions now accrue inflationary increases based on CPI rather than RPI, unless the scheme rules specifically refer to RPI.

The most significant non-financial assumption is the assumed rate of longevity. For the year ended 31 December 2014, this has been based on mortality rates that are 100% of the S2PMA_L tables for males (or S2PFA_L tables for females) with an allowance for projected improvements in mortality in line with CMI 2014 improvements with a 1% per annum long term rate of convergence. The tables adopted imply the following life expectancy:

	Life expectancy at age 65 (years)	
	2014	2013
Male retiring in the current year	**23.2**	23.5
Female retiring in the current year	**24.3**	24.8
Male retiring in 15 years' time	**24.1**	24.5
Female retiring in 15 years' time	**25.4**	25.9

The table below shows the net pension liability which is recognised within the Statement of Financial Position:

	Group 2014	Group 2013	**Society 2014**	Society 2013
	£m	£m	**£m**	£m
Fair value of plan assets	**171.8**	162.2	**88.0**	81.6
Present value of defined benefit obligations	**(244.8)**	(215.5)	**(121.6)**	(105.8)
Net pension liability	**(73.0)**	(53.3)	**(33.6)**	(24.2)

The present value of scheme liabilities is measured by discounting the best estimate of future cash flows to be paid out by the schemes using the projected unit credit method. The value calculated in this way is reflected in the net liability within the Statement of Financial Position as shown above.

The projected unit credit method is a valuation method in which each potential cash flow from the schemes (e.g. annual pension payment or potential lump sum payment on death) is multiplied by an assumed probability of payment and discounted between the valuation date and the time the payment is needed.

All remeasurements are recognised in the year in which they occur in the Statement of Comprehensive Income. As all remeasurements and assets are recognised, the deficits shown above are those recognised within the Statement of Financial Position.

IAS 19 allows an employer to recognise a surplus as an asset to the extent that it is able to recover a surplus either through reduced contributions in the future or through refunds from the scheme, even if the refunds may only be available at some distant time in the future, such as after the last benefit has been paid. None of the schemes are in surplus as at 31 December 2014.

29. Pensions (continued)

The Group has reviewed the guidance provided by IFRIC 14 and has concluded that it is not necessary to make any adjustments to the IAS 19 figures in respect of an asset ceiling or minimum funding requirement as at 31 December 2014. As the schemes remain in deficit, the asset ceiling has no impact and so a reconciliation is not required.

The table below sets out a reconciliation of the present value of the defined benefit obligation for the year:

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
At 1 January	**215.5**	203.0	**105.8**	101.3
Current service cost	**-**	-	**-**	-
Past service cost	**-**	0.5	**-**	0.5
Interest expense	**9.5**	9.2	**4.7**	4.5
Contributions by employees	**-**	-	**-**	-
Remeasurement losses / (gains) arising from changes in:				
Scheme experience	**2.2**	(0.7)	**1.2**	-
Demographic assumptions	**(5.7)**	(0.5)	**(2.8)**	(0.3)
Financial assumptions	**32.0**	12.7	**16.1**	5.9
Actual benefit payments	**(5.8)**	(5.6)	**(3.4)**	(3.5)
Liabilities extinguished on settlements	**(2.9)**	(3.1)	**-**	(2.6)
At 31 December	**244.8**	215.5	**121.6**	105.8

As outlined above, on 30 April 2014, the three schemes sponsored by the Connells group, the Old Connells, Sequence 1997 and Sequence Staff schemes, were merged into a new pension scheme, the Connells (2014) Scheme, and the three existing schemes wound up.

At the date of the merger, the assets and liabilities of the three merged schemes transferred to the new scheme. This transfer took place at fair value between the individual Connells group companies, such that no settlement gain or loss is reported.

As part of the pension scheme merger and wind up, legislation allows members with small pension pots to take their benefits as a cash lump sum and this has resulted in a settlement gain of £0.4m. This is summarised in the table below:

	Group 2014 £m	Group 2013 £m
Assets discharged on wind up	**(2.5)**	-
Liabilities discharged on wind up	**2.9**	-
Settlement gain on wind up	**0.4**	-

There have been no other settlements, plan amendments or curtailments in the period.

29. Pensions (continued)

The table below sets out the reconciliation of the fair value of scheme assets for the year:

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
At 1 January	**162.2**	157.9	**81.6**	81.2
Interest income	**7.0**	7.1	**3.6**	3.6
Return on plan assets (excluding amounts included in interest income)	**5.7**	2.3	**3.1**	1.1
Contributions by employer	**5.2**	3.5	**3.1**	1.7
Contributions by employees	**-**	-	**-**	-
Benefits paid	**(5.8)**	(5.6)	**(3.4)**	(3.5)
Expenses paid by the schemes	**-**	-	**-**	-
Assets distributed on settlements	**(2.5)**	(3.0)	**-**	(2.5)
At 31 December	**171.8**	162.2	**88.0**	81.6

The actual return on the scheme assets over the year ended 31 December 2014 was as follows:

- Group £12.8m (2013: £9.4m)
- Society £6.7m (2013: £4.7m)

The table below sets out the fair value of the scheme assets by each major category:

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
UK equities	**-**	-	**-**	-
Diversified growth fund (note 1)	**129.6**	127.4	**65.4**	63.4
Property	**-**	-	**-**	-
Corporate bonds	**30.3**	25.3	**16.5**	13.8
Fixed interest bonds	**-**	-	**-**	-
Index linked bonds	**-**	-	**-**	-
Liability driven investments (note 2)	**11.0**	8.7	**5.8**	4.1
Cash	**0.9**	0.8	**0.3**	0.3
	171.8	162.2	**88.0**	81.6

Notes

1. Diversified growth funds target equity-like returns with lower volatility which is achieved through dynamic diversification. Funds are invested in a diversified range of assets, including equities, bonds, property and cash and the allocation between these asset classes is actively managed by a fund manager reflecting the changing correlations and risk characteristics.
2. Liability Driven Investments (LDI) are investments in assets which are expected to behave in a similar manner to liabilities and therefore aim to provide a better match against liability movements than conventional bonds or gilts.

Each of the schemes invests in an LDI fund which aims to provide protection against interest rate and inflation movements.

None of the fair values of the assets shown above include any of the Group's own financial instruments or any property occupied by, or other assets used by the Group. All of the schemes' assets have a quoted market price in an active market with the exception of the Trustees' bank account balance.

It is the policy of the Trustee and the Group to review the investment strategy at the time of each funding valuation. The Trustees' investment objectives and the processes undertaken to measure and manage the risks inherent in the scheme investment strategy are documented in the schemes' Statement of Investment Principle.

29. Pensions (continued)

The table below sets out the amounts which have been recognised within the Income Statement. The service costs, settlements for the year and administrative expenses are recognised in 'administrative expenses', whilst the net interest expense is recognised within 'other income'.

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Service cost:				
Current service cost	**-**	-	**-**	-
Past service cost	**-**	0.5	**-**	0.5
Gains on settlements	**(0.4)**	(0.1)	**-**	(0.1)
Administrative expenses	**-**	-	**-**	-
Net interest expense	**2.5**	2.1	**1.1**	0.9
Total recognised in Income Statement	**2.1**	2.5	**1.1**	1.3

The table below sets out the remeasurements of retirement benefit obligations which have been recognised within the Statement of Comprehensive Income:

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Remeasurements of retirement benefit obligations:				
Actuarial (losses) / gains arising from:				
Experience adjustments	**(2.2)**	0.7	**(1.2)**	-
Demographic assumptions	**5.7**	0.5	**2.8**	0.3
Financial assumptions	**(32.0)**	(12.7)	**(16.1)**	(5.9)
Return on plan assets (excluding amounts included in net interest expense)	**5.7**	2.3	**3.1**	1.1
Total amount recognised in Other Comprehensive Income	**(22.8)**	(9.2)	**(11.4)**	(4.5)

The table below sets out the Group's best estimate of the aggregate contributions expected to be paid to the schemes during the year ending 31 December 2015:

	Group 2015 £m	**Society 2015 £m**
Estimated employer contributions	**4.1**	**1.4**
Estimated employee contributions	**-**	**-**
Estimated total contributions	**4.1**	**1.4**

30. Subordinated liabilities

	Group and Society	
	2014 £m	2013 £m
Subordinated fixed rate notes 2014	**-**	15.2
Subordinated fixed rate notes 2015	**18.1**	18.1
Subordinated fixed rate notes 2017	**10.1**	10.2
Subordinated fixed rate notes 2018	**35.4**	35.5
Subordinated fixed rate notes 2019	**-**	10.1
Subordinated fixed rate notes 2022	**31.2**	31.2
	94.8	120.3
Unamortised discount on issue	**(0.2)**	(0.3)
Fair value adjustment for hedged risk	**3.4**	4.4
	98.0	124.4

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30. Subordinated liabilities (continued)

During 2014, the Society bought back, at par, and cancelled the £10m subordinated fixed rate notes repayable in 2019. Under the new Capital Requirement Regulations, the notes ceased to be eligible for regulatory capital purposes during the year.

All the fixed rate notes are denominated in Sterling. Coupons are paid on a fixed basis annually except for the notes repayable in 2017 where coupons are paid on a fixed basis semi-annually.

All the notes are repayable at maturity or earlier, at the option of the Society. In each case the option for early repayment may only be exercised with the prior consent of the PRA. The note holders' rights are subordinate to those of the depositors and other payables.

All the values in the above table have been calculated using the nominal value plus accrued interest with the exception of the 'Unamortised discount on issue' values which are the difference between the associated face values and current book values.

31. Subscribed capital

	Group and Society	
	2014	2013
	£m	£m
6.875% Permanent Interest Bearing Shares	**47.3**	45.9
8.500% Permanent Interest Bearing Shares	**15.8**	16.0
12.875% Permanent Interest Bearing Shares	**26.3**	26.3
	89.4	88.2
Fair value adjustment for hedged risk	**4.9**	5.9
	94.3	94.1

All Permanent Interest Bearing Shares are unsecured and rank pari passu with each other. They are deferred shares of the Society and rank behind the claims against the Society of all subordinated note holders, depositors, payables and investing members of the Society. These shares are measured at amortised cost.

32. Tax effects relating to each component of other comprehensive income

	Group					
	2014			2013		
	Before-tax amount	**Tax (expense) / benefit**	**Net-of-tax amount**	Before-tax amount	Tax (expense) / benefit	Net-of-tax amount
	£m	**£m**	**£m**	£m	£m	£m
Available-for-sale financial assets	**6.9**	**(1.0)**	**5.9**	29.5	(6.7)	22.8
Cash flow hedges	**7.1**	**(1.4)**	**5.7**	5.2	(1.6)	3.6
Remeasurements of defined benefit obligations	**(22.8)**	**4.6**	**(18.2)**	(9.2)	0.7	(8.5)
Translation of foreign operations	**0.1**	**-**	**0.1**	(0.5)	-	(0.5)
Other comprehensive income	**(8.7)**	**2.2**	**(6.5)**	25.0	(7.6)	17.4

	Society					
	2014			2013		
	Before-tax amount	**Tax (expense) / benefit**	**Net-of-tax amount**	Before-tax amount	Tax benefit / (expense)	Net-of-tax amount
	£m	**£m**	**£m**	£m	£m	£m
Available-for-sale financial assets	**10.5**	**(2.3)**	**8.2**	(1.7)	0.4	(1.3)
Cash flow hedges	**7.1**	**(1.4)**	**5.7**	5.2	(1.6)	3.6
Remeasurements of defined benefit obligations	**(11.4)**	**2.3**	**(9.1)**	(4.5)	0.3	(4.2)
Other comprehensive income	**6.2**	**(1.4)**	**4.8**	(1.0)	(0.9)	(1.9)

33. Other financial commitments and contingent liabilities

a) The Society is obliged under Section 22 of the Building Societies Act 1986 to discharge the liabilities of its subsidiary undertakings incurred prior to 11 June 1996 when this section was repealed. Additionally, the Society has given a legal undertaking agreeing to discharge the liabilities of Skipton International Limited insofar as it is unable to discharge them out of its own assets whilst it remains a subsidiary of Skipton Building Society. Furthermore, the Society has confirmed it will provide continuing support to those subsidiary undertakings that have net liabilities at 31 December 2014 or which rely on it for ongoing funding.

b) 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 Capital Levy. The Management Expenses Levy covers the costs of running the scheme and the Capital Levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it. During 2008 and 2009 claims were triggered against the FSCS in relation to Bradford and Bingley plc, Kaupthing Singer and Friedlander, Heritable Bank plc, Landsbanki Islands hf, London Scottish Bank plc and Dunfermline Building Society and the FSCS is meeting these claims by way of loans received from HM Treasury. The terms of these loans were interest only for the first three years and the FSCS seeks to recover the interest cost, together with ongoing management expenses, by way of annual management levies on members over this period.

In addition to the Management Levies, any capital shortfall is being levied against UK retail deposit holders as a Capital Levy over a three year period which started in 2013/2014. Once the Capital Levies have been paid, the remaining principal on the loans made by HM Treasury to the failed institutions above is expected to be repaid from the realisation of the assets of the institutions in question, which may result in a further shortfall, whilst the Management Expenses Levy is also subject to change. As a result, the Society's ultimate FSCS contribution is uncertain, whilst the Society also has a potential exposure to future levies from further capital losses.

c) In May 2014, a European Court of Justice (ECJ) ruling indicated that, under the European Working Time Directive, 'normal pay' for the purposes of calculating statutory holiday pay should include an element in respect of contractual commission payments, rather than being limited to basic salary. A UK Employment Tribunal is soon to consider the implications for UK employers, applying the principles set out by the ECJ to the Working Time Regulations 1998. A decision is expected in 2015 but had not yet been made by the date of approval of these financial statements. Should the tribunal determine that 'normal pay' includes contractual commission, there is a possibility that employees may seek compensation for a shortfall in their holiday pay in prior years. This gives rise to a possible obligation for the Group but, given the uncertainty of the outcome, the timing of the UK decision and the uncertainty around the scope of any compensation arising, the Group is unable to quantify what, if any, liability may arise.

d) Capital commitments at 31 December for which no provision has been made are as follows:

	Group 2014 £m	Group 2013 £m	**Society 2014 £m**	Society 2013 £m
Contracted but not provided for	**0.3**	1.0	**-**	-

e) Total commitments under non-cancellable operating leases are as follows:

Group	**2014**		2013	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Amounts falling due:				
Within one year	**12.1**	**1.7**	14.4	1.9
Within two to five years inclusive	**30.6**	**2.8**	38.5	3.8
Over five years	**18.3**	**-**	19.7	-
	61.0	**4.5**	72.6	5.7

33. Other financial commitments and contingent liabilities (continued)

Society	2014 Land and buildings £m	2014 Other £m	2013 Land and buildings £m	2013 Other £m
Amounts falling due:				
Within one year	**4.0**	**1.3**	4.3	1.3
Within two to five years inclusive	**11.9**	**2.6**	13.4	3.3
Over five years	**7.0**	**-**	9.4	-
	22.9	**3.9**	27.1	4.6

f) Total amounts receivable under non-cancellable operating sub-leases on land and buildings are as follows:

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Amounts falling due:				
Within one year	**2.3**	0.9	**0.2**	0.3
Within two to five years inclusive	**1.7**	1.9	**0.7**	0.8
Over five years	**0.7**	0.9	**0.5**	0.7
	4.7	3.7	**1.4**	1.8

34. Financial instruments

The Group uses financial instruments to invest liquid asset balances and raise wholesale funding. The Group also uses derivative financial instruments (derivatives) to manage the risks arising from its operations.

The Board has authorised the use of derivatives by the Group to reduce the risk of loss arising from changes in market risks in accordance with Section 9A (4) of the Building Societies Act 1986 and derivatives are used by the Group for economic hedging purposes only. The Group does not run a trading book.

Types of derivatives

The principal derivatives used by the Group are interest rate swaps and foreign exchange contracts 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 used, which are typically used in managing such risks. These risks may also be managed using Statement of Financial Position instruments as part of an integrated approach to risk management.

Type of hedge	Risk	Activity
Interest rate swaps	Sensitivity to changes in interest rates	Fixed rate savings products, funding activities, fixed rate mortgage lending and asset investment
Equity-linked interest rate swaps	Sensitivity to changes in equity indices	Equity-linked investment products
Cross currency swaps and foreign exchange contracts	Sensitivity to changes in foreign exchange rates	Investment and funding in foreign currencies
Basis swaps	Sensitivity to changes in the relationship between interest rates which have similar but not identical characteristics (e.g. LIBOR and Bank of England Base Rate)	Floating rate mortgage lending and asset investment
Index swaps	Interest rates linked to retail price inflation	Equity release mortgages

34. Financial instruments (continued)

Controls over financial instruments

The Group has a formal structure for managing risk, including established risk limits, reporting requirements, mandates and other control procedures. This structure is reviewed regularly by ALCO.

The accounting policies for derivatives are described in note 1 to the Accounts.

Hedge accounting

A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. For each main class of fair value, hedge documentation is produced in accordance with the requirements of IAS 39 *Financial instruments: recognition and measurement*.

A cash flow hedge is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss. Cash flow hedge accounting is used primarily for interest rate swaps taken out to pre-hedge fixed mortgage completions and fixed savings products prior to receipt of funds. Basis swaps used to reduce the Group's exposure to changes in Bank Base Rate are also included within cash flow hedges. The weighted average maturity of interest rate swaps being cash flow hedged at 31 December 2014 was approximately 2.7 years (2013: 2.1 years); the amounts held in the cash flow hedging reserve will be recognised in the Income Statement over this period.

Some hedge accounting ineffectiveness on those fair value and cash flow hedges has occurred, resulting in a charge to the Income Statement of £2.0m (2013: £nil).

35. Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost. It is an inherent part of the Group's business as long term mortgages are funded by short term retail customer balances. Mortgages typically have a contractual maturity date of around 25 years but in practice are frequently repaid early; conversely retail deposits, nominally repayable on demand or with short notice periods, actually remain with the Group beyond their contractual notice. It is this mismatch in the maturity profiles of retail assets and liabilities that creates liquidity risk.

The Group's liquidity policy is designed to ensure the maintenance of sufficient liquid assets to cover statutory, regulatory and operational requirements. This is achieved through maintaining a prudent level of liquid assets, in realisable form, to ensure the Group is able to meet its liabilities as they arise and to absorb potential cash flow requirements created by the maturity mismatches referred to above or by a liquidity stress scenario. ALCO manages liquidity under delegated authority, within risk appetite limits established by the Board, and also monitors the composition of liquidity in line with risk management objectives.

The management of the Group's liquidity is as follows:

- the Board establishes limits over the quantity and quality of the Group's portfolio of liquid assets. The portfolio is managed by the Treasury function, monitored by the Market & Liquidity Risk function and overseen by ALCO under a series of delegated authorities;
- the Group's Market & Liquidity Risk function conducts a series of daily, weekly and monthly stress tests that are designed to ensure that the Group's liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding; and
- under the Regulatory liquidity regime, introduced in 2010, the Group is required to hold highly liquid assets ('buffer liquidity' such as government and supranational debt securities and cash) in excess of the Regulator's Individual Liquidity Guidance (ILG).

There are two key measures that the Group considers key to monitoring its liquidity position:

- buffer liquidity – which analyses daily the amount of high quality liquidity that it is necessary to hold; and
- liquidity stress tests – where, as noted above, the Group models how far its liquid asset holdings would fall under a number of different stress scenarios.

35. Liquidity risk (continued)

The table below analyses the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity. In practice, customer deposits, i.e. shares, amounts owed to credit institutions and amounts owed to other customers, are likely to be repaid later than on the earliest date on which repayment can be required.

Group	2014					
	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Assets						
Cash in hand and balances with the Bank of England	1,076.1	-	-	-	-	**1,076.1**
Loans and advances to credit institutions	280.2	61.7	-	12.1	11.4	**365.4**
Debt securities	-	185.5	239.7	557.9	169.5	**1,152.6**
Derivative financial instruments	-	11.8	13.0	84.9	23.7	**133.4**
Loans and advances to customers	68.9	26.8	64.6	613.0	12,063.5	**12,836.8**
Equity share investments	-	-	-	-	32.9	**32.9**
Trade receivables	12.4	12.9	-	-	-	**25.3**
Total financial assets	**1,437.6**	**298.7**	**317.3**	**1,267.9**	**12,301.0**	**15,622.5**
Liabilities						
Shares	3,873.7	4,901.1	1,047.8	1,579.3	65.6	**11,467.5**
Amounts owed to credit institutions	32.9	574.9	133.2	48.8	-	**789.8**
Amounts owed to other customers	195.0	274.7	564.6	108.9	-	**1,143.2**
Debt securities in issue	-	3.0	5.0	722.6	-	**730.6**
Derivative financial instruments	-	6.4	14.2	99.8	186.9	**307.3**
Trade payables	-	5.2	-	-	-	**5.2**
Fair value of put option obligation	-	1.9	5.6	-	-	**7.5**
Subordinated liabilities	-	-	18.2	45.6	34.2	**98.0**
Subscribed capital	-	-	-	-	94.3	**94.3**
Total financial liabilities	**4,101.6**	**5,767.2**	**1,788.6**	**2,605.0**	**381.0**	**14,643.4**
Net liquidity gap	**(2,664.0)**	**(5,468.5)**	**(1,471.3)**	**(1,337.1)**	**11,920.0**	**979.1**

35. Liquidity risk (continued)

Group	2013					
	Repayable on demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
	£m	£m	£m	£m	£m	£m
Assets						
Cash in hand and balances with the Bank of England	859.4	-	-	-	-	859.4
Loans and advances to credit institutions	224.3	78.5	-	23.4	-	326.2
Debt securities	-	26.5	159.9	840.8	168.3	1,195.5
Derivative financial instruments	-	3.8	34.1	67.4	43.5	148.8
Loans and advances to customers	65.7	21.0	56.6	614.5	10,759.1	11,516.9
Equity share investments	-	-	-	-	37.1	37.1
Trade receivables	13.7	18.7	-	-	-	32.4
Total financial assets	1,163.1	148.5	250.6	1,546.1	11,008.0	14,116.3
Liabilities						
Shares	3,820.6	3,698.9	1,343.1	1,275.2	122.3	10,260.1
Amounts owed to credit institutions	53.3	670.2	23.1	297.1	2.6	1,046.3
Amounts owed to other customers	195.7	298.9	352.0	82.8	1.4	930.8
Debt securities in issue	-	2.2	48.6	503.9	-	554.7
Derivative financial instruments	-	1.7	26.2	127.2	132.5	287.6
Trade payables	-	6.0	-	-	-	6.0
Fair value of put option obligation	-	6.0	7.3	0.2	-	13.5
Subordinated liabilities	-	15.3	-	63.9	45.2	124.4
Subscribed capital	-	-	-	-	94.1	94.1
Total financial liabilities	4,069.6	4,699.2	1,800.3	2,350.3	398.1	13,317.5
Net liquidity gap	(2,906.5)	(4,550.7)	(1,549.7)	(804.2)	10,609.9	798.8

Debt securities in issue include £723.5m (2013: £505.0m) of funding obtained via the Group's securitisation programme carried out through Darrowby No. 1 plc, Darrowby No. 2 plc and Darrowby No. 3 plc. The final maturity dates of these notes are significantly out into the future, however the Group has an option to exercise call options to repurchase the outstanding notes at step-up dates which will occur within the next 1-5 years, and these are expected to be exercised. As a result all such amounts (other than the associated accrued interest) have been shown within 1-5 years in the tables above.

35. Liquidity risk (continued)

The following table is an analysis of gross contractual cash flows payable under financial liabilities:

Group			**2014**		
	Up to 3 months	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Liabilities	**£m**	**£m**	**£m**	**£m**	**£m**
Shares	**8,775.9**	**1,058.1**	**1,688.5**	**75.7**	**11,598.2**
Amounts owed to credit institutions, other customers and debt securities in issue	**1,076.2**	**713.9**	**920.1**	**-**	**2,710.2**
Derivative financial instruments	**17.8**	**53.7**	**125.7**	**276.2**	**473.4**
Trade payables	**5.2**	**-**	**-**	**-**	**5.2**
Fair value of put option obligation	**1.9**	**5.8**	**-**	**-**	**7.7**
Subordinated liabilities	**0.3**	**21.4**	**55.9**	**36.1**	**113.7**
Subscribed capital	**1.6**	**6.3**	**31.7**	**79.3**	**118.9**
	9,878.9	**1,859.2**	**2,821.9**	**467.3**	**15,027.3**

Group			2013		
	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities	£m	£m	£m	£m	£m
Shares	7,519.5	1,343.1	1,319.8	185.4	10,367.8
Amounts owed to credit institutions, other customers and debt securities in issue	1,229.3	564.0	794.8	4.0	2,592.1
Derivative financial instruments	20.2	42.9	91.9	315.2	470.2
Trade payables	6.0	-	-	-	6.0
Fair value of put option obligation	6.9	7.7	0.6	-	15.2
Subordinated liabilities	16.1	3.9	80.1	48.5	148.6
Subscribed capital	1.6	6.3	31.7	79.3	118.9
	8,799.6	1,967.9	2,318.9	632.4	13,718.8

The gross contractual cash flows of debt securities in issue that have been issued as securitisation funding in the tables above have been calculated on the assumption that the call options referred to under the tables on pages 132 and 133 are exercised.

Society			**2014**		
	Up to 3 months	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Liabilities	**£m**	**£m**	**£m**	**£m**	**£m**
Shares	**8,775.9**	**1,058.1**	**1,688.5**	**75.7**	**11,598.2**
Amounts owed to credit institutions, other customers and debt securities in issue	**936.3**	**244.7**	**1,227.2**	**-**	**2,408.2**
Derivative financial instruments	**14.9**	**45.2**	**125.3**	**276.3**	**461.7**
Trade payables	**0.6**	**-**	**-**	**-**	**0.6**
Subordinated liabilities	**0.3**	**21.4**	**55.9**	**36.1**	**113.7**
Subscribed capital	**1.6**	**6.3**	**31.7**	**79.3**	**118.9**
	9,729.6	**1,375.7**	**3,128.6**	**467.4**	**14,701.3**

35. Liquidity risk (continued)

Society	2013				
	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities	£m	£m	£m	£m	£m
Shares	7,519.5	1,343.1	1,319.8	185.4	10,367.8
Amounts owed to credit institutions, other customers and debt securities in issue	1,052.0	436.6	1,033.6	2.6	2,524.8
Derivative financial instruments	16.3	29.3	64.3	315.2	425.1
Trade payables	0.5	-	-	-	0.5
Subordinated liabilities	16.1	3.9	80.1	48.5	148.6
Subscribed capital	1.6	6.3	31.7	79.3	118.9
	8,606.0	1,819.2	2,529.5	631.0	13,585.7

Amounts owed to other customers in the table above include deemed loans from the Group's special purpose vehicles (SPVs) Darrowby No. 1 plc, Darrowby No. 2 plc and Darrowby No. 3 plc which arise from the securitisation transactions carried out through these entities. The gross contractual cash flows arising on these loans have been calculated on the assumption that the call options referred to under the tables on pages 132 and 133 are exercised.

36. Market risk

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk (including the use of derivatives), foreign currency risk and equity risk.

The Group's Treasury function is responsible for managing the Group's exposure to all aspects of market risk within the operational limits set out in the Group's Treasury policy, which is reviewed and recommended by ALCO and approved by the Board. The Group's Market & Liquidity Risk function measures and monitors adherence to the Treasury policy and reports regularly on all aspects of market risk exposure, including interest rate risk, foreign currency risk and equity risk.

a) Interest rate risk

The main market risk faced by the Group is interest rate risk.

The Group uses a number of different metrics to monitor interest rate risk and details of these are set out below.

The Group monitors interest rate risk exposure against limits by determining the effect on the Group's current net notional value of assets and liabilities for a parallel shift in interest rates equivalent to 2% for all maturities, in line with regulatory requirements. Results are compared to Board and Operational limits at least weekly and reported to ALCO and the Board monthly.

Other interest rate risk metrics employed by the Group incorporate earnings-at-risk and market value methodologies, which calculate interest rate risk exposure positions based on 250 historical data observations going back over approximately the last seven years. During the year the earnings-at-risk methodology has been amended to use at least 100 stochastically generated rate paths. All of these approaches employ 95% confidence intervals. The outputs of these advanced interest rate risk measurement methodologies, which are compared to Board and Operational limits at least weekly and reported to ALCO and the Board monthly, are used to guide interest rate risk management decisions.

Although these measures provide valuable insights into the market risk to which the Group is exposed, they need to be viewed in the context of the following limitations:

- historical data is not necessarily a good guide to future events;
- the use of 95% confidence levels, by definition, does not take account of changes that may occur beyond this level of confidence and therefore may not fully take into account extreme events; and
- exposures are calculated on static Statement of Financial Position positions and therefore future changes in the structure of the Statement of Financial Position are ignored.

36. Market risk (continued)

The levels of Group interest rate risk exposures throughout the reporting period, based on measures taken at each month end, were as follows:

	As at 31 December 2014 £m	Average 2014 £m	High 2014 £m	Low 2014 £m	As at 31 December 2013 £m
Static earnings-at-risk	**11.9**	**7.9**	**11.9**	**4.3**	3.9
Historical value-at-risk	**1.4**	**3.3**	**5.2**	**1.4**	1.8
2% parallel interest rate shift	**10.3**	**8.2**	**14.6**	**4.4**	8.6

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

b) Currency risk

Both at the year end and during the year, the Group had no material direct exposure to foreign currency exchange fluctuations. The currency risk appetite of the Group is low and any funding issues denominated in foreign currency are immediately swapped into Sterling.

The Group has equity investments in its subsidiary undertakings Jade Software Corporation Limited and Northwest Investments NZ Limited, and its associate Wynyard Group Limited, which are denominated in New Zealand Dollars. The foreign currency fluctuations in relation to these investments are not hedged, but are recognised in the Group's translation reserve.

In addition, a number of the Group's businesses undertake transactions denominated in foreign currency as part of their normal business. Any amounts outstanding at the year end are not material.

c) Equity risk

This is the risk of loss due to movements in equity markets.

Following its flotation in July 2013, the Group holds a 21.7% stake in Wynyard Group Limited, which is listed on the New Zealand Stock Exchange. The Group also has a shareholding in Zoopla Property Group Plc and following its Initial Public Offering on the London Stock Exchange in June 2014, Connells sold approximately 25% of its shares and retains a 3.9% shareholding. The equity risk in relation to these investments is not material to the Group results. The market values of our shareholdings in Wynyard Group Limited and Zoopla Property Group Plc, based on the share price at 31 December 2014, are £24.5m and £32.2m respectively (carrying values at 31 December 2014 are £13.2m and £32.2m respectively).

d) Other price risk

The Group has a number of savings products outstanding where the return is dependent on the performance of certain equity markets. Derivative contracts to eliminate this exposure are taken out by the Group which exactly match the terms of the savings products and the market risk on such contracts is therefore fully hedged.

37. Credit risk

Credit risk is the risk of suffering financial loss should borrowers or counterparties default on their contractual obligations to the Group.

The Group faces this risk from its lending to:

- individual customers (retail mortgages);
- businesses (through past commercial lending and current debt factoring / invoice discounting); and
- wholesale counterparties (including other financial institutions). Credit risk within our treasury portfolio arises from the investments held by the Group in order to meet liquidity requirements and for general business purposes.

Changes in the credit quality and the recoverability of loans and amounts due from counterparties influence the Group's exposure to credit risk. The Group's strategy is to maintain a cautious approach to credit risk and new lending. Adverse changes in the credit quality of counterparties, collateral values or deterioration in the wider economy, including rising unemployment, changes in interest rates, deterioration in household finances and any contraction in the UK property market leading to falling property values, could affect the recoverability and value of the Group's assets and influence its financial performance. An economic downturn and falls in house prices and commercial property values would affect the level of impairment losses.

37. Credit risk (continued)

The controlled management of credit risk is critical to the Group's overall strategy, and there has been substantial investment in the Credit Risk function during the year. The Group has therefore embedded a comprehensive risk management framework with clear lines of accountability and oversight as part of its overall governance framework.

The Group has processes and policies to monitor, control, mitigate and manage credit risk within the Group's credit risk appetite. The Retail Credit Committee and the Group Wholesale Credit Committee provide oversight to the effectiveness of all credit management across the Group and the controls in place ensure lending is within the Board approved credit risk appetite. The reporting structure ensures timely and accurate reporting of all substantive risk matters to the Board and Board Risk Committee. The Board receives monthly updates on the credit risk profile of the Group.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, except for loans and advances to customers where a fair value adjustment for hedged risk of £203.8m (2013: £159.3m) is included.

Retail mortgage lending to customers

The Group currently lends in the prime residential UK mortgage market, including buy-to-let, through the Society, and by Skipton International Limited in the Channel Islands and to a limited extent in the UK. The Board's credit risk appetite defines a number of limits regarding customer and collateral credit quality to which all lending activity must adhere.

The credit decision process utilises automated credit scoring and policy rules with lending policy criteria supporting manual underwriting. All aspects of the credit decision process are subject to regular independent review and development ensuring they support decisions in line with the Board's credit risk appetite.

The Group also has credit exposures through Amber Homeloans Limited and North Yorkshire Mortgages Limited which comprise residential UK mortgages, including buy-to-let, across prime and non-prime lending markets. These portfolios closed to new customer origination and lending in 2008 and are managed by adherence to clear policies in relation to mortgage servicing and credit management. The performance of these portfolios has continued to improve over the reporting period.

Commercial lending to customers and businesses

The Society's commercial mortgage portfolio was closed to new lending in November 2008. We have retained a team of people to manage and monitor the performance of these loans.

Other lending

These loans principally comprise loans made by our factored debt and invoice discounting business, Skipton Business Finance, which continue to be managed by appropriately skilled teams.

Wholesale lending to other financial institutions

Wholesale credit risk arises from the wholesale investments held by the Society's Treasury function, which is responsible for managing this aspect of credit risk in line with Board approved credit risk appetite and wholesale credit policies. Wholesale counterparty limits are reviewed monthly by the Group Wholesale Credit Committee based on analyses of counterparties' financial performance, ratings and other market information to ensure that limits remain within our risk appetite. We regularly review and closely monitor the number of counterparties to whom we will lend, and for those counterparties whom we have lent to, we have reviewed both the amount and duration of any limits.

A deterioration in wholesale credit markets could lead to volatility in the Group's portfolio of available-for-sale assets together with the risk of further impairment within our treasury investments portfolio.

ALCO provides oversight to the effectiveness of wholesale credit risk management.

37. Credit risk (continued)

a) Credit risk - loans and advances to customers

The table below shows the mix of the Group and Society's loans and advances to customers at the reporting date:

Loans and advances to customers	Group				Society			
	2014		2013		**2014**		2013	
	£m	**%**	£m	%	**£m**	**%**	£m	%
Total residential mortgages	**12,200.1**	**96.1**	10,906.8	95.5	**10,033.3**	**96.3**	8,669.8	95.5
Commercial mortgages*	**382.1**	**3.0**	409.8	3.6	**382.1**	**3.7**	409.8	4.5
Other lending:								
Debt factoring loans	**63.8**	**0.5**	58.9	0.5	**-**	**-**	-	-
Other loans	**45.9**	**0.4**	41.2	0.4	**0.5**	**-**	0.9	-
Gross balances	**12,691.9**	**100.0**	11,416.7	100.0	**10,415.9**	**100.0**	9,080.5	100.0
Impairment provisions	**(58.9)**		(59.1)		**(37.1)**		(33.4)	
Fair value adjustment for hedged risk	**203.8**		159.3		**198.5**		158.1	
	12,836.8		11,516.9		**10,577.3**		9,205.2	

* Also known as loans fully secured on land.

i) Residential mortgages

The majority of loans and advances to customers are secured on UK residential properties and are geographically diverse.

The Group's portfolio of loans fully secured on residential property includes the Society, Skipton International Limited, which lends in the Channel Islands and to a limited extent in the UK, and the specialist mortgage lending in Amber Homeloans Limited and North Yorkshire Mortgages Limited. The credit risk appetite explicitly considers geographic regions to manage concentration risk.

The tables below provide further information on types of lending and geographical split.

Lending analysis	Group				Society			
	2014		2013		**2014**		2013	
	£m	**%**	£m	%	**£m**	**%**	£m	%
Prime:								
Residential	**8,991.4**	**73.8**	7,567.4	69.3	**8,072.1**	**80.4**	6,739.0	77.8
Buy-to-let	**2,146.0**	**17.6**	2,081.5	19.1	**1,851.4**	**18.5**	1,772.7	20.4
Self build	**67.1**	**0.5**	84.7	0.8	**23.8**	**0.2**	33.1	0.4
Fast track	**86.0**	**0.7**	125.0	1.1	**86.0**	**0.9**	125.0	1.4
Self certified	**613.8**	**5.0**	589.8	5.4	**-**	**-**	-	-
Sub-prime:								
Residential	**60.8**	**0.5**	105.9	1.0	**-**	**-**	-	-
Buy-to-let	**53.7**	**0.4**	62.0	0.6	**-**	**-**	-	-
Self build	**0.5**	**-**	0.6	-	**-**	**-**	-	-
Self certified	**180.8**	**1.5**	289.9	2.7	**-**	**-**	-	-
	12,200.1	**100.0**	10,906.8	100.0	**10,033.3**	**100.0**	8,669.8	100.0

The definitions of prime and sub-prime have been updated during the year to be consistent with our regulatory loan book data reporting, which has resulted in £136.7m of balances, previously regarded as sub-prime as at 31 December 2013, being reclassified from sub-prime to prime during the year.

37. Credit risk (continued)

Geographical analysis	Group				Society			
	2014		2013		**2014**		2013	
	£m	**%**	£m	%	**£m**	**%**	£m	%
North	**463.0**	**3.8**	414.4	3.8	**418.9**	**4.2**	366.4	4.2
Yorkshire	**1,221.8**	**10.0**	1,127.5	10.3	**1,120.6**	**11.2**	1,017.9	11.8
East Midlands	**834.1**	**6.8**	733.0	6.7	**736.6**	**7.3**	628.2	7.2
East Anglia	**770.2**	**6.3**	681.2	6.2	**675.1**	**6.7**	575.7	6.6
London	**1,381.6**	**11.3**	1,293.1	11.9	**1,141.6**	**11.4**	1,018.2	11.7
South East	**2,291.1**	**18.9**	2,031.5	18.7	**1,958.2**	**19.6**	1,657.0	19.2
South West	**1,063.9**	**8.7**	936.2	8.6	**949.6**	**9.5**	806.8	9.3
West Midlands	**732.9**	**6.0**	634.8	5.8	**634.1**	**6.3**	524.9	6.1
North West	**1,296.9**	**10.6**	1,156.0	10.6	**1,135.4**	**11.3**	982.8	11.3
Wales	**250.9**	**2.1**	212.1	1.9	**191.2**	**1.9**	147.6	1.7
Scotland	**1,099.1**	**9.0**	969.1	8.9	**1,038.0**	**10.3**	902.7	10.4
Northern Ireland	**57.1**	**0.5**	68.5	0.6	**34.0**	**0.3**	41.6	0.5
Channel Islands	**737.5**	**6.0**	649.4	6.0	**-**	**-**	-	-
	12,200.1	**100.0**	10,906.8	100.0	**10,033.3**	**100.0**	8,669.8	100.0

Loan-to-value information on the Group's residential loan portfolio is set out as follows:

Indexed loan-to-value analysis	Group				Society			
	2014		2013		**2014**		2013	
	£m	**%**	£m	%	**£m**	**%**	£m	%
<70%	**6,832.4**	**56.1**	5,073.1	46.5	**6,098.4**	**60.8**	4,520.3	52.1
70% - 80%	**2,749.7**	**22.5**	2,115.2	19.4	**2,250.6**	**22.4**	1,798.8	20.7
80% - 90%	**1,802.5**	**14.8**	2,103.0	19.3	**1,321.1**	**13.2**	1,611.2	18.6
90% - 100%	**590.7**	**4.8**	1,026.2	9.4	**299.0**	**3.0**	552.1	6.4
>100%	**224.8**	**1.8**	589.3	5.4	**64.2**	**0.6**	187.4	2.2
	12,200.1	**100.0**	10,906.8	100.0	**10,033.3**	**100.0**	8,669.8	100.0

The indexed loan-to-value is updated on a quarterly basis to reflect changes in the Halifax house price index which is applied to the portfolio on a regional basis. The new lending policy is currently a maximum loan-to-value ratio of 90% for residential mortgages and 75% for buy-to-let lending.

At 31 December 2014, the average indexed loan-to-value of Group residential mortgages was 50.3% (2013: 52.9%) and for Society residential mortgages was 47.8% (2013: 49.6%).

The table below provides further information on residential loans and advances by payment due status:

Indexed loan-to-value analysis	Group				Society			
	2014		2013		**2014**		2013	
	£m	**%**	£m	%	**£m**	**%**	£m	%
Neither past due nor individually impaired	**11,859.8**	**97.2**	10,485.3	96.1	**9,921.2**	**99.0**	8,528.7	98.4
Individually impaired:								
Low risk	**95.7**	**0.8**	160.8	1.5	**54.9**	**0.5**	74.6	0.8
High risk	**236.1**	**1.9**	241.9	2.2	**54.5**	**0.5**	60.8	0.7
Possessions	**8.5**	**0.1**	18.8	0.2	**2.7**	**-**	5.7	0.1
	12,200.1	**100.0**	10,906.8	100.0	**10,033.3**	**100.0**	8,669.8	100.0

Low risk accounts in the table above relate to loans with an indexed loan-to-value of less than or equal to 70%. High risk accounts relate to loans with an indexed loan-to-value of more than 70%.

Financials

37. Credit risk (continued)

During the year, the methodology for determining arrears reporting within this section of the accounts has been revised in order to align arrears reporting with the industry standard. Arrears, i.e. those accounts that are individually impaired, are now reported here by reference to the equivalent number of months' worth of repayments that a customer's repayments are overdue, whereas previously they were reported by reference to the arrears balance as a percentage of the total outstanding balance. This change in methodology is a key driver of the movement since 31 December 2013 in the low risk and high risk individually impaired figures in the table above.

Where appropriate for customers, the Group applies a policy of forbearance. This may be applied where the actual or apparent financial stress of the customer is considered to be short term with a potential to be recovered. Forbearance may involve arrears capitalisation, a reduction in the monthly payment (known as a concession), a conversion to interest only or a mortgage term extension. These strategies are undertaken in order to achieve the best outcome for both the customer and the business through dealing with arrears at an early stage. Possession balances represent loans against which the Group has taken ownership of properties pending their sale. Possession is generally only considered as a last resort once all other options for the customer have been exhausted. As at 31 December 2014 the balance of residential loans where the property in question has been taken into possession represents 0.1% of total outstanding loans for the Group (2013: 0.2%), and under 0.1% of total outstanding loans for the Society (2013: 0.1%). The Group does not occupy repossessed properties for business use, or use assets acquired in its operations. All customer accounts are monitored to ensure that these strategies remain appropriate.

The table below provides further information on residential mortgages at 31 December 2014 by the type of account renegotiations applied to customers over the last two years. For clarity, this table includes all accounts where we have renegotiated terms during the last two years where the customer has encountered payment difficulties, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms.

Group 2014		**Capitalisation**	**Reduced payment**	**Transfer to interest only**	**Term extension**	**Total renegotiations**	
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**%**
Neither past due nor individually impaired	**11,859.8**	4.8	43.0	33.9	26.8	**108.5**	**0.9**
Individually impaired:							
Low risk	**95.7**	-	14.1	4.5	1.9	**20.5**	**21.4**
High risk	**236.1**	0.8	19.5	4.9	2.2	**27.4**	**11.6**
Possessions	**8.5**	-	0.4	0.5	-	**0.9**	**10.6**
	12,200.1	**5.6**	**77.0**	**43.8**	**30.9**	**157.3**	**1.3**
Collective impairment	**(26.9)**	-	-	-	-	**-**	**-**
Individual impairment	**(19.9)**	(0.3)	(1.9)	(0.9)	(0.2)	**(3.3)**	**16.6**
	12,153.3	**5.3**	**75.1**	**42.9**	**30.7**	**154.0**	**1.3**

Group 2013		Capitalisation	Reduced payment	Transfer to interest only	Term extension	Total renegotiations	
	£m	£m	£m	£m	£m	£m	%
Neither past due nor individually impaired	10,485.3	14.2	101.7	59.0	117.2	292.1	2.8
Individually impaired:							
Low risk	160.8	2.3	12.3	7.0	4.6	26.2	16.3
High risk	241.9	3.9	15.3	12.0	4.8	36.0	14.9
Possessions	18.8	0.1	1.1	0.7	-	1.9	10.1
	10,906.8	20.5	130.4	78.7	126.6	356.2	3.3
Collective impairment	(18.6)	(0.1)	(0.2)	(0.2)	(0.1)	(0.6)	3.2
Individual impairment	(29.9)	-	(2.0)	(1.4)	(0.7)	(4.1)	13.7
	10,858.3	20.4	128.2	77.1	125.8	351.5	3.2

37. Credit risk (continued)

Society 2014	**£m**	**Capitalisation £m**	**Reduced payment £m**	**Transfer to interest only £m**	**Term extension £m**	**Total renegotiations £m**	**%**
Neither past due nor individually impaired	**9,921.2**	4.3	38.2	18.5	19.6	**80.6**	**0.8**
Individually impaired:							
Low risk	**54.9**	-	11.3	3.2	1.5	**16.0**	**29.1**
High risk	**54.5**	0.8	10.7	2.9	1.6	**16.0**	**29.4**
Possessions	**2.7**	-	0.1	0.3	-	**0.4**	**14.8**
	10,033.3	**5.1**	**60.3**	**24.9**	**22.7**	**113.0**	**1.1**
Collective impairment	**(20.0)**	-	-	-	-	**-**	**-**
Individual impairment	**(5.7)**	(0.3)	(0.9)	(0.5)	(0.1)	**(1.8)**	**31.6**
	10,007.6	**4.8**	**59.4**	**24.4**	**22.6**	**111.2**	**1.1**

Society 2013	£m	Capitalisation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renegotiations £m	%
Neither past due nor individually impaired	8,528.7	13.4	91.8	36.0	95.7	236.9	2.8
Individually impaired:							
Low risk	74.6	2.3	10.0	4.7	3.2	20.2	27.1
High risk	60.8	3.9	8.3	5.1	2.6	19.9	32.7
Possessions	5.7	0.1	0.2	0.6	-	0.9	15.8
	8,669.8	19.7	110.3	46.4	101.5	277.9	3.2
Collective impairment	(15.8)	(0.1)	(0.2)	(0.1)	(0.1)	(0.5)	3.2
Individual impairment	(7.7)	-	(1.1)	(0.7)	(0.4)	(2.2)	28.6
	8,646.3	19.6	109.0	45.6	101.0	275.2	3.2

The factors considered by the Group in determining the level of individual impairment to be made are outlined in note 1g) to the accounts.

A collective impairment allowance is made against performing loans where objective evidence indicates that it is likely that credit losses have been incurred but not yet identified at the reporting date. This impairment allowance is calculated by applying various economic factors to our mortgage portfolio exposures and incorporates the relative credit risk assessment of the account renegotiation categories shown above.

Individual assessments are made of all mortgage loans where objective evidence indicates that losses are likely or the property is in possession, or where fraud or negligence has been identified.

The collateral held consists predominantly of residential properties. The use of such collateral is in line with terms that are usual and customary to standard lending activities.

Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In subsequent periods, the fair value is updated by reference to market prices or indices of similar assets.

Some properties in the Group's mortgage book are in negative equity, which increases the possibility of the Group incurring a loss if the property is taken into possession. However, one of the economic factors used to calculate impairment allowances, the Halifax house price index, has improved during the year, and so the number of properties in negative equity has reduced. For the majority of the Group's loans, the Group holds excess collateral however this cannot be used to offset those instances where the loan amount exceeds the collateral held. The fair value of collateral in the table below is therefore calculated, on an individual loan basis, as the lower of the value of the property and the outstanding loan amount. It does not reflect the overall value of properties against which the loans are secured.

37. Credit risk (continued)

Fair value of capped collateral held	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Not individually impaired	**11,789.6**	10,400.9	**9,852.7**	8,463.0
Impaired	**326.8**	389.9	**108.5**	133.6
Possessions	**7.6**	15.9	**2.1**	4.3
	12,124.0	10,806.7	**9,963.3**	8,600.9

The fair value of residential property used to derive the figures in the table above is determined by reference to a recognised house price index (the Halifax house price index). Movements in this index to the reporting date are applied to all properties in the portfolio on a regional basis.

ii) Commercial mortgages

The commercial mortgage portfolio (also known as loans fully secured on land) is currently closed to new business. An analysis of loans secured on commercial property by industry type and geography is provided below:

	Group and Society			
	2014		2013	
	£m	**%**	£m	%
Leisure and hotel	**45.3**	**11.9**	48.7	11.9
Retail	**13.3**	**3.5**	14.9	3.6
Nursing / residential homes	**19.1**	**5.0**	20.2	4.9
Offices	**11.1**	**2.9**	12.1	3.0
Commercial investment and industrial units	**281.7**	**73.7**	301.5	73.6
Miscellaneous	**11.6**	**3.0**	12.4	3.0
	382.1	**100.0**	409.8	100.0

The comparative figures in the table above have been revised following a reclassification during the year of certain properties with a total balance of £8.5m from the miscellaneous category into the leisure and hotel category.

Geographical analysis	Group and Society			
	2014		2013	
	£m	**%**	£m	%
North	**19.2**	**5.0**	20.5	5.0
Yorkshire	**34.0**	**8.9**	36.2	8.8
East Midlands	**27.2**	**7.1**	28.4	6.9
East Anglia	**14.8**	**3.9**	16.1	3.9
London	**87.0**	**22.8**	92.8	22.7
South East	**75.5**	**19.7**	81.0	19.8
South West	**45.5**	**11.9**	49.3	12.0
West Midlands	**26.7**	**7.0**	29.6	7.2
North West	**39.0**	**10.2**	41.3	10.1
Wales	**7.5**	**2.0**	8.1	2.0
Scotland	**5.7**	**1.5**	6.5	1.6
	382.1	**100.0**	409.8	100.0

37. Credit risk (continued)

Loan-to-value information on the Group's commercial mortgage portfolio is set out as follows:

Loan-to-value analysis	Group and Society			
	2014		2013	
	£m	**%**	£m	%
<70%	**238.5**	**62.4**	268.4	65.5
70% - 80%	**38.3**	**10.0**	51.1	12.5
80% - 90%	**30.8**	**8.1**	31.1	7.6
90% - 100%	**21.3**	**5.6**	18.5	4.5
>100%	**53.2**	**13.9**	40.7	9.9
	382.1	**100.0**	409.8	100.0

At 31 December 2014 the average loan-to-value of commercial mortgages was 56.7% (2013: 56.3%). The comparative figure has been revised from the figure previously presented in order to be presented on the same basis as the corresponding figure as at 31 December 2014 which, following a significant revaluation exercise on higher value commercial properties carried out over the last few years, is now calculated based on the latest external valuation of the properties in question, rather than against the IPD (Investment Property Databank Ltd) commercial property index previously used. This has resulted in an increase in loans with a loan-to-value of more than 100% in the above table, which is reflected within our impairment model and the associated provision held.

The table below provides further information on commercial mortgages and advances by payment due status:

	Group and Society			
	2014		2013	
	£m	**%**	£m	%
Neither past due nor individually impaired	**375.3**	**98.2**	395.1	96.4
Individually impaired:				
Low risk	**0.8**	**0.2**	3.0	0.7
High risk	**6.0**	**1.6**	11.7	2.9
	382.1	**100.0**	409.8	100.0

Low risk accounts in the table above relate to loans with an indexed loan-to-value of less than or equal to 70%. High risk accounts relate to loans with an indexed loan-to-value of more than 70%.

During the period, the methodology for determining arrears reporting for this section of the accounts has been revised, as described on page 140. In addition, as outlined above, the methodology for calculating loan-to-value information has been revised since 2013 and the comparative figures in the table above have been presented on the same basis as the current year numbers.

Where appropriate for customers, the Group applies a policy of forbearance. This may be applied where the actual or apparent financial stress of the customer is considered to be short term with a potential to be recovered. Forbearance may involve arrears capitalisation, a reduction in the monthly payment (known as a concession), a conversion to interest only or a mortgage term extension. These strategies are undertaken in order to achieve the best outcome for both the customer and the business through dealing with arrears at an early stage. Possession balances represent loans against which the Group has taken ownership of properties pending their sale. Possession is generally only considered as a last resort once all other options for the customer have been exhausted. All customer accounts are monitored to ensure that these strategies remain appropriate.

37. Credit risk (continued)

The table below provides further information on commercial mortgages at 31 December 2014 by the type of account renegotiations applied to customers over the last two years. For clarity, this table includes all accounts where we have renegotiated terms during the last two years where the customer has encountered payment difficulties, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms.

Group and Society 2014		**Capitalisation**	**Reduced payment**	**Transfer to interest only**	**Total renegotiations**	
	£m	**£m**	**£m**	**£m**	**£m**	**%**
Neither past due nor individually impaired	**375.3**	1.7	-	19.7	**21.4**	**5.7**
Individually impaired:						
Low risk	**0.8**	-	-	0.7	**0.7**	**87.5**
High risk	**6.0**	1.0	0.3	-	**1.3**	**21.7**
	382.1	**2.7**	**0.3**	**20.4**	**23.4**	**6.1**
Collective impairment	**(4.6)**	-	-	(2.0)	**(2.0)**	**43.5**
Individual impairment	**(6.6)**	(0.8)	(0.1)	(0.6)	**(1.5)**	**22.7**
	370.9	**1.9**	**0.2**	**17.8**	**19.9**	**5.4**

Group and Society 2013		Capitalisation	Reduced payment	Transfer to interest only	Total renegotiations	
	£m	£m	£m	£m	£m	%
Neither past due nor individually impaired	395.1	1.8	-	21.4	23.2	5.9
Individually impaired:						
Low risk	3.0	0.1	-	1.9	2.0	66.7
High risk	11.7	-	-	8.2	8.2	70.1
	409.8	1.9	-	31.5	33.4	8.2
Collective impairment	(4.1)	-	-	(0.2)	(0.2)	4.9
Individual impairment	(5.4)	-	-	(2.8)	(2.8)	51.9
	400.3	1.9	-	28.5	30.4	7.6

A collective impairment allowance is made against performing loans where objective evidence indicates that it is likely that credit losses have been incurred but not yet identified at the reporting date. This impairment allowance is calculated using third party valuation indices which are discounted further to assume a forced sale value in addition to default propensity modelling.

Individual impairment provisions are made to reduce the value of commercial mortgages to the present value of the amount that the Directors consider is ultimately likely to be received, based upon objective evidence.

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

37. Credit risk (continued)

An analysis of capped collateral, where the collateral is capped to the lower of the value of the property and the amount outstanding on an individual loan basis, is shown below:

Fair value of capped collateral held	**Group and Society**	
	2014	2013
	£m	£m
Not individually impaired	**363.4**	386.6
Individually impaired	**5.8**	12.3
	369.2	398.9

The fair value of commercial property used to derive the figures in the table above is determined by reference to the latest external valuation of the properties in question.

iii) Other lending

	Group			
	2014		2013	
	Gross	**Impairment**	Gross	Impairment
	£m	**£m**	£m	£m
Factored debt and invoice discounting	**63.8**	**(0.7)**	58.9	(0.7)
Other loans	**45.9**	**(0.2)**	41.2	(0.4)
	109.7	**(0.9)**	100.1	(1.1)

	Society			
	2014		2013	
	Gross	**Impairment**	Gross	Impairment
	£m	**£m**	£m	£m
Other loans	**0.5**	**(0.2)**	0.9	(0.4)

The balances of those assets within our factored debt and invoice discounting business which are individually impaired amount to £3.2m (2013: £3.0m). The factors considered in determining whether these assets are impaired include the existence of objective evidence to doubt ultimate recoverability of the Group's net exposure due to client insolvency.

The balances of those assets within other loans which are individually impaired amounts to £0.2m (2013: £0.4m) in both Group and Society. The factors considered in determining whether these assets are impaired include the existence of objective evidence that the customer is unable to honour their obligations as they fall due.

The majority of these loans have an original maturity of less than one year. As at 31 December 2014, there are £0.3m (2013: £0.4m) of these loans for Group and £nil (2013: £nil) for Society which are past due but not individually impaired.

b) Credit risk – debt securities and loans and advances to credit institutions

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.

Collateral held for treasury assets is determined by the nature of the instrument. Loans and debt securities are generally unsecured with the exception of asset backed securities which are secured by pools of financial assets.

As at 31 December 2014, £2.5m (2013: £9.9m) of the Group's treasury portfolio exposure was either past due or impaired. A provision of £2.5m (2013: £6.0m) is held against the impaired assets in question. There are no assets that would otherwise be past due had the terms not been renegotiated (2013: £5.7m). In assessing the potential impairment of its treasury assets, the Group considers, amongst other factors, objective evidence of deterioration in the counterparty's financial health, the normal volatility in valuation, as well as industry and sectoral performance.

As at 31 December 2014, 96.7% (2013: 99.0%) of the Group's treasury investment assets (including cash in hand and balances with the Bank of England) were rated A3 or better. The Group continues to have no exposure to emerging markets and only limited exposure to non-investment grade debt.

37. Credit risk (continued)

The table below provides further details of the credit ratings of the Group's treasury investment portfolio:

Rating	2014 £m	2014 %	2013 £m	2013 %
Aaa	**430.5**	**16.6**	436.9	18.4
Aa1	**1,419.0**	**54.7**	1,366.7	57.4
Aa2	**147.8**	**5.7**	143.1	6.0
Aa3	**152.9**	**5.9**	131.6	5.5
A1	**83.8**	**3.2**	22.1	0.9
A2	**245.1**	**9.5**	149.7	6.3
A3	**28.7**	**1.1**	106.9	4.5
Baa1	**84.6**	**3.3**	18.8	0.8
Ca	**-**	**-**	1.6	-
Unrated:				
Building societies	**1.7**	**-**	1.7	0.1
Other	**-**	**-**	2.0	0.1
	2,594.1	**100.0**	2,381.1	100.0

The Group also monitors exposure concentrations against a variety of criteria including industry sector / asset class and country of risk.

Industry sector / asset class	2014 £m	2014 %	2013 £m	2013 %
Cash in hand and balances with the Bank of England	**1,076.1**	**41.5**	859.4	36.1
Loans and advances with banks and building societies	**365.4**	**14.1**	326.2	13.7
Gilts	**288.5**	**11.1**	478.8	20.1
Certificates of deposit	**258.4**	**10.0**	62.6	2.6
Fixed rate bonds	**231.4**	**8.9**	170.6	7.2
Floating rate notes	**166.9**	**6.4**	203.7	8.6
Residential mortgage backed securities	**207.4**	**8.0**	261.2	10.9
Commercial mortgage backed securities	**-**	**-**	18.6	0.8
	2,594.1	**100.0**	2,381.1	100.0

Geographical exposure	2014 £m	2014 %	2013 £m	2013 %
UK	**2,091.7**	**80.7**	1,987.5	83.5
Rest of Europe	**354.9**	**13.7**	286.7	12.0
North America	**86.8**	**3.3**	36.3	1.5
Australasia	**60.7**	**2.3**	70.6	3.0
	2,594.1	**100.0**	2,381.1	100.0

c) Credit risk – derivative financial instruments

A credit exposure could arise in respect of derivative contracts entered into by the Group if the counterparty was unable to fulfil its contractual obligations. The Group address the risks associated with these activities by monitoring counterparty credit exposure and requiring additional collateral to be posted or returned as necessary. The only form of collateral accepted by the Group is cash. Derivatives are transacted under International Swaps and Derivatives Association (ISDA) Master Agreements. No Credit (CVA) or Debit (DVA) Value Adjustments have been made in respect of credit risk in the fair value of the Group's derivative financial instruments as the risk is significantly mitigated as all swaps are cash collateralised. Credit Support Annexes (CSAs) executed with certain counterparties in conjunction with the ISDA Master Agreement require collateral to be posted regularly, as required by specific terms and conditions of the arrangements. Due to the frequency of the posting of collateral, there is no material exposure from these minimal timing differences which would require CVA or DVA adjustments.

37. Credit risk (continued)

Netting arrangements do not necessarily result in an offset of Statement of Financial Position assets and liabilities, as transactions are usually settled on a gross basis. The Group's legal documentation for derivative transactions does grant legal rights of set-off for those transactions with the same counterparty. Accordingly the credit risk associated with such contracts is reduced to the extent that negative mark to market valuations on derivatives will offset positive mark to market values on derivatives, subject to an absolute exposure of zero.

38. Fair values

a) Classification and measurement

The table below summarises the classification of the carrying amounts of the Group's financial assets and liabilities:

	2014			
	Amortised cost	**Held at fair value as available-for-sale assets**	**Fair value through profit or loss**	**Total**
	£m	**£m**	**£m**	**£m**
Cash in hand and balances with the Bank of England	1,076.1	-	-	**1,076.1**
Loans and advances to credit institutions	365.4	-	-	**365.4**
Debt securities	1.7	1,150.9	-	**1,152.6**
Derivative financial instruments	-	-	133.4	**133.4**
Loans and advances to customers	12,854.3	-	(17.5)	**12,836.8**
Equity share investments	-	32.9	-	**32.9**
Trade receivables	25.3	-	-	**25.3**
Total financial assets	**14,322.8**	**1,183.8**	**115.9**	**15,622.5**
Other non-financial assets				**359.2**
Total assets				**15,981.7**
Shares	11,467.5	-	-	**11,467.5**
Amounts owed to credit institutions and other customers	1,933.0	-	-	**1,933.0**
Debt securities in issue	730.6	-	-	**730.6**
Derivative financial instruments	-	-	307.3	**307.3**
Trade payables	5.2	-	-	**5.2**
Fair value of put option obligation	-	-	7.5	**7.5**
Subordinated liabilities and subscribed capital	192.3	-	-	**192.3**
Total financial liabilities	**14,328.6**	**-**	**314.8**	**14,643.4**
Other non-financial liabilities				**266.4**
Total liabilities				**14,909.8**

38. Fair values (continued)

	2013			
	Amortised cost	Held at fair value as available-for-sale assets	Fair value through profit or loss	Total
	£m	£m	£m	£m
Cash in hand and balances with the Bank of England	859.4	-	-	859.4
Loans and advances to credit institutions	326.2	-	-	326.2
Debt securities	143.0	1,052.5	-	1,195.5
Derivative financial instruments	-	-	148.8	148.8
Loans and advances to customers	11,528.7	-	(11.8)	11,516.9
Equity share investments	-	37.1	-	37.1
Trade receivables	32.4	-	-	32.4
Total financial assets	12,889.7	1,089.6	137.0	14,116.3
Other non-financial assets				370.4
Total assets				14,486.7
Shares	10,260.1	-	-	10,260.1
Amounts owed to credit institutions and other customers	1,977.1	-	-	1,977.1
Debt securities in issue	554.7	-	-	554.7
Derivative financial instruments	-	-	287.6	287.6
Trade payables	6.0	-	-	6.0
Fair value of put option obligation	-	-	13.5	13.5
Subordinated liabilities and subscribed capital	218.5	-	-	218.5
Total financial liabilities	13,016.4	-	301.1	13,317.5
Other non-financial liabilities				234.3
Total liabilities				13,551.8

b) Valuation of financial instruments carried at fair value

The Group holds certain financial assets and liabilities at fair value, grouped into Levels 1 to 3 of the fair value hierarchy (see below).

Valuation techniques

Fair values are determined using the following fair value hierarchy that reflects the significance of the inputs in measuring fair value:

Level 1

The most reliable fair values of financial instruments are quoted market prices in an actively traded market. The Group's Level 1 portfolio mainly comprises gilts, fixed rate bonds and floating rate notes for which traded prices are readily available.

Level 2

These are valuation techniques for which all significant inputs are taken from observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed when no active market exists and quoted prices are available for similar instruments in active markets. Where discounting techniques are used in arriving at derivative fair values, management have chosen to use LIBOR rather than Overnight Index Swaps (OIS). This will be reviewed when derivative clearing is introduced and there is currently no material difference. No Credit (CVA) or Debit (DVA) Value Adjustments have been made in respect of credit risk in the fair value of the Group's derivative financial instruments as the risk is significantly mitigated because all swaps are cash collateralised. Examples of Level 2 instruments are certificates of deposit and interest rate swaps.

When considering the credit quality of instruments and their sensitivity to changes in market rates, the Market and Liquidity Risk function make use of quoted prices available for other similar instruments.

Basis swaps are valued using discounted cash flow models, including observable market data, either by our internal Treasury function or by our external counterparties.

38. Fair values (continued)

Level 3

These are valuation techniques for which one or more significant input is not based on observable market data.

Valuation techniques include net present value by way of discounted cash flow models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, similar market products, foreign currency exchange rates and equity index prices. Critical judgement is applied by management in utilising unobservable inputs including expected price volatilities, expected mortality rates and prepayment rates, based on industry practice or historical observation. 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.

Transfers between different levels of the fair value hierarchy

The Group makes transfers between the different levels of the fair value hierarchy where the inputs used to measure the fair value of the financial instruments in question no longer satisfy the conditions required to be classified in a certain level within the hierarchy. This could occur, for example, where a listed company whose share price is used as a basis for fair value measurement becomes de-listed, and so the share price is no longer shown in a recognised listing and therefore cannot be classified as a Level 1 input.

The following tables provide an analysis of financial assets and liabilities held within the Group Statement of Financial Position at fair value, grouped into Levels 1 to 3 of the fair value hierarchy.

Group	2014			
	Quoted prices in active markets (Level 1)	Valuation techniques using observable inputs (Level 2)	Valuation techniques using significant unobservable inputs (Level 3)	Total
	£m	£m	£m	£m
Financial assets				
Financial assets held at fair value as available-for-sale:				
Debt securities	892.5	258.4	-	**1,150.9**
Equity share investments	32.2	-	0.7	**32.9**
Financial assets at fair value through profit or loss:				
Embedded derivatives within loans and advances to customers	-	-	(17.5)	**(17.5)**
Derivative financial instruments	-	116.0	17.4	**133.4**
	924.7	**374.4**	**0.6**	**1,299.7**
Financial liabilities				
Financial liabilities at fair value through profit or loss:				
Derivative financial instruments	-	130.3	177.0	**307.3**
Fair value of put option obligation	-	-	7.5	**7.5**
	-	**130.3**	**184.5**	**314.8**
	924.7	**244.1**	**(183.9)**	**984.9**

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38. Fair values (continued)

Group	2013			
	Quoted prices in active markets (Level 1) £m	Valuation techniques using observable inputs (Level 2) £m	Valuation techniques using significant unobservable inputs (Level 3) £m	Total £m
Financial assets				
Financial assets held at fair value as available-for-sale:				
Debt securities	989.9	62.6	-	1,052.5
Equity share investments	-	-	37.1	37.1
Financial assets at fair value through profit or loss:				
Embedded derivatives within loans and advances to customers	-	-	(11.8)	(11.8)
Derivative financial instruments	-	110.9	37.9	148.8
	989.9	173.5	63.2	1,226.6
Financial liabilities				
Financial liabilities at fair value through profit or loss:				
Derivative financial instruments	-	128.9	158.7	287.6
Fair value of put option obligation	-	-	13.5	13.5
	-	128.9	172.3	301.1
	989.9	44.6	(109.0)	925.5

Certain index swaps, included within derivative financial liabilities in the tables above and originally stated as Level 2 and reported as such in 2013, have now been reclassified as Level 3 due to the use of estimated redemption rates as inputs, which are considered unobservable. As a result, Level 3 more appropriately reflects the basis of these fair values and the 2013 comparatives have therefore been restated accordingly.

38. Fair values (continued)

The table below analyses the movements in the Level 3 portfolio during the year:

Group			**2014**		
	Equity share investments £m	**Embedded derivatives £m**	**Derivative financial instruments £m**	**Fair value of put option obligation £m**	**Total £m**
At 1 January	**37.1**	**(11.8)**	**(120.8)**	**(13.5)**	**(109.0)**
(Loss) / credit recognised in Income Statement	**-**	**(5.7)[1]**	**(38.8)[2]**	**0.1[3]**	**(44.4)**
Gain recognised in Other Comprehensive Income	**12.2[4]**	**-**	**-**	**-**	**12.2**
Impairment	**(1.3)[5]**	**-**	**-**	**-**	**(1.3)**
Revaluation of market values	**-**	**-**	**-**	**(7.3)**	**(7.3)**
Dividends paid to non-controlling shareholders	**-**	**-**	**-**	**1.0**	**1.0**
Additions	**1.0**	**-**	**-**	**-**	**1.0**
Disposals	**(10.6)**	**-**	**-**	**1.6**	**(9.0)**
Exercise of put options by non-controlling shareholders	**-**	**-**	**-**	**10.6**	**10.6**
Transfer to Level 1 portfolio	**(37.7)**	**-**	**-**	**-**	**(37.7)**
At 31 December	**0.7**	**(17.5)**	**(159.6)**	**(7.5)**	**(183.9)**

Notes

1. Included in the 'Impairment losses on loans and advances to customers' line in the Income Statement.
2. Included in the 'Fair value (losses) / gains on financial instruments' line in the Income Statement. As noted below, the majority of these derivatives are held to hedge the Group's equity release mortgage book and a gain, largely offsetting the above amount, was recognised through the same line in the Income Statement in respect of the underlying mortgages that are being hedged. However some hedge ineffectiveness resulted during the year and this resulted in an overall charge to the Income Statement of £2.0m.
3. Included in the 'Interest payable and similar charges' line in the Income Statement and arises from the unwind of the liability and changes to exercise dates.
4. Included in the 'Available-for-sale investments: valuation gains / (losses) taken to equity' line in the Statement of Comprehensive Income.
5. Included in the 'Impairment losses on equity share investments' line in the Income Statement.

Group			2013		
	Equity share investments £m	Embedded derivatives £m	Derivative financial instruments £m	Fair value of put option obligation £m	Total £m
At 1 January	3.1	(3.5)	(114.6)	(12.0)	(127.0)
Loss recognised in Income Statement	-	(8.3)[1]	(6.2)[2]	(0.1)[3]	(14.6)
Gain recognised in Other Comprehensive Income	33.2[4]	-	-	-	33.2
Revaluation of market values	-	-	-	(3.3)	(3.3)
Dividends paid to non-controlling shareholders	-	-	-	1.9	1.9
Additions	0.8	-	-	-	0.8
At 31 December	37.1	(11.8)	(120.8)	(13.5)	(109.0)

Notes

1. Included in the 'Impairment losses on loans and advances to customers' line in the Income Statement.
2. Included in the 'Fair value (losses) / gains on financial instruments' line in the Income Statement. The majority of these derivatives are used to hedge the Group's equity release mortgage book and the overall impact of the change in fair value of these derivatives on the Income Statement was nil, due to the associated hedged item included within loans and advances to customers as described below.
3. Included in the 'Interest payable and similar charges' line in the Income Statement and arises from the unwind of the liability and changes to exercise dates.
4. Included in the 'Available-for-sale investments: valuation gains / (losses) taken to equity' line in the Statement of Comprehensive Income.

38. Fair values (continued)

Equity share investments

The Group's equity share investments represent a 3.9% (2013: 4.9%) holding in Zoopla Property Group Plc and a 17.7% (2013: 21.0%) holding in Hearthstone Investments Limited.

On 18 June 2014, Zoopla was subject to a flotation and, following flotation, the Group sold a proportion of its shareholding which resulted in the Group's share in Zoopla reducing from 4.9% to 3.9%. This resulted in a gain to the Income Statement of £10.1m (reflected in the 'Profit on disposal of equity share investments' line). This gain had previously been recognised as an unrealised gain (£8.2m of which was recognised in 2013) through the available-for-sale reserve and, following the sale of these shares, has been recycled to the Income Statement. In addition, a further unrealised gain of £4.8m has been recognised in respect of the Group's remaining shareholding in Zoopla, based on the quoted share price at 31 December 2014 as the Directors consider that this represents the best assessment of the fair value of the remaining shareholding. The cumulative balance recognised in the available-for-sale reserve as at 31 December 2014 in respect of Zoopla, gross of taxation, is £29.8m (2013: £33.2m).

As a result of the flotation, the fair value of Zoopla can now be determined by reference to a quoted share price in an active market and this therefore represents a Level 1 fair value measurement. Accordingly the Group has reflected a transfer from Level 3 to Level 1 of the fair value hierarchy in respect of its holding in Zoopla, as shown in the table on the previous page.

The cost of the Group's investment in Hearthstone was £2.0m when purchased in 2012. Hearthstone continues to develop its business, however this is at a slower rate than previously forecast. Consequently, the Directors have reviewed the carrying value of this investment, based on a recent indication of the value of the business and have decided to write its value down to £0.7m, which the Directors believe is the best indication of its fair value.

The Directors believe that it is appropriate to hold the Group's investment in Hearthstone at cost less impairment as, in the absence of any observable inputs or other relevant information, the fair value of the company cannot be reliably measured.

In the absence of any other reliable information regarding Hearthstone, the Directors do not consider that any reasonably possible alternative valuation assumptions exist.

Embedded derivatives

The Group holds an equity release mortgage book under the terms of which the Group is required to provide a 'no negative equity guarantee' to its customers. This guarantee means that the Group's maximum return is limited to the value of the customer's property on redemption.

In accordance with the accounting policy as described in note 1e), this guarantee is accounted for as an embedded derivative as the characteristics and risks of the guarantee are not closely related to the economic characteristics and risks of the underlying mortgage. The guarantee is impacted by the interaction of a number of factors, not all of which also impact on the performance of the underlying equity release book. These factors include future expected house prices, future expected interest rates, mortality rates and estimated redemption profiles. As a result the embedded derivatives are bifurcated from the underlying mortgage book and measured at fair value, with any changes in fair value recognised within the impairment charge in the Income Statement. As certain of these inputs are not market observable, the fair value of the embedded derivatives is regarded as a Level 3 valuation technique.

The following table outlines the impact of reasonably possible alternative assumptions of certain inputs outlined above:

Assumption	Change to current assumption	**Group 2014** (Decrease) / increase in impairment provision £m	Group 2013 (Decrease) / increase in impairment provision £m
Future change in house prices	+/-10% in any one year*	**(7.2) / 9.6**	(6.6) / 8.9
Redemption rates	+/-1% pa	**(1.9) / 2.2**	(1.2) / 1.4

* For example, a 7% fall or 13% increase in house prices compared to a base case assumption of a 3% increase.

38. Fair values (continued)

Derivative Financial instruments

The majority of the derivative financial instruments included in the tables on page 151 comprise index swaps which are used to hedge the Group's equity release mortgage book (with the exception of the no negative equity guarantee described above, i.e. the embedded derivative, for which the Group holds no natural hedging instrument). Derivatives hedging equity release mortgages are valued using discounted cash flow models using market observable benchmark rates consistent with accepted economic methodologies for pricing financial instruments, and, as the cash flows from the derivatives are intended to match the cash flows from the underlying mortgage assets, also include estimated redemption profiles that are based on historical data and reviewed periodically to ensure forecasts remain broadly in line with actual data.

These redemption profiles are not market observable, therefore these derivatives are categorised as Level 3 financial instruments within the fair value hierarchy.

Two of the index swaps described above contain contractual 'boundaries', within which any change in fair value of the swaps will be offset by a corresponding but opposite change in the value of the associated hedge relationship within loans and advances to customers. These boundaries exist in order to alleviate risk to the counterparty. If these boundaries are crossed, then hedge ineffectiveness and therefore Income Statement volatility could arise and this resulted in an Income Statement charge of £2.0m during the year (2013: £nil), which is included in the 'Fair value (losses) / gains on financial instruments' line in the Income Statement. In addition, as described above, certain inputs into the valuation of these swaps are not market observable and, as at 31 December 2014, the effect on the fair value of these swaps of reasonably possible alternative valuation assumptions of certain of these inputs is outlined below:

Assumption	Change to current assumption	**Group 2014 Increase / (decrease) in liability £m**	Group 2013 Increase / (decrease) in liability £m
Retail price index	+/-1% pa	**6.3 / (6.3)**	4.8 / (4.8)
Redemption rates	+/-1% pa	**(16.7) / 20.7**	(7.6) / 9.5

As can be seen, the valuation of these swaps is very sensitive to the underlying assumptions such as redemption rates, however changes in the fair value of these swaps are generally offset to a significant degree by changes in the fair value of the associated hedge relationship within loans and advances to customers.

Fair value of put option obligation

Key inputs into the calculation of the fair value of the put option obligation include an estimate of the market value of the non-controlling shareholding and an estimate of when the put option will be exercised by the non-controlling shareholders. As these inputs are based on the judgement of senior management, the valuation of the put option obligation is considered to be a Level 3 valuation technique. The impact of reasonably possible alternative valuation assumptions for the fair value of the put option obligation are shown in note 1u) to the financial statements.

38. Fair values (continued)

c) Fair values of financial assets and liabilities not carried at fair value

The tables below summarise the carrying values and fair values of those financial assets and liabilities not presented within the Statement of Financial Position at fair value.

	Group 2014		Society 2014	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Cash in hand and balances with the Bank of England	1,076.1	1,076.1	1,076.1	1,076.1
Loans and advances to credit institutions	365.4	365.4	240.5	240.5
Debt securities	1.7	1.7	500.8	501.8
Loans and advances to customers	12,854.3	12,779.5	10,594.8	10,549.4
Trade receivables	25.3	25.3	0.6	0.6
	14,322.8	**14,248.0**	**12,412.8**	**12,368.4**
Financial liabilities				
Shares	11,467.5	11,492.7	11,467.5	11,492.7
Amounts owed to credit institutions	789.8	788.6	880.6	879.4
Amounts owed to other customers	1,143.2	1,143.6	1,485.1	1,485.6
Debt securities in issue	730.6	738.6	7.1	7.0
Trade payables	5.2	5.2	0.6	0.6
Subordinated liabilities and subscribed capital	192.3	204.3	192.3	204.3
	14,328.6	**14,373.0**	**14,033.2**	**14,069.6**

	Group 2013		Society 2013	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Cash in hand and balances with the Bank of England	859.4	859.4	859.4	859.4
Loans and advances to credit institutions	326.2	326.2	195.5	195.5
Debt securities	143.0	144.6	674.6	679.8
Loans and advances to customers	11,528.7	11,482.5	9,217.0	9,272.9
Trade receivables	32.4	32.4	0.2	0.2
	12,889.7	12,845.1	10,946.7	11,007.8
Financial liabilities				
Shares	10,260.1	10,338.6	10,260.1	10,338.6
Amounts owed to credit institutions	1,046.3	1,044.6	1,149.4	1,147.7
Amounts owed to other customers	930.8	934.1	1,268.9	1,269.2
Debt securities in issue	554.7	564.7	49.7	49.4
Trade payables	6.0	6.0	0.5	0.5
Subordinated liabilities and subscribed capital	218.5	210.1	218.5	210.1
	13,016.4	13,098.1	12,947.1	13,015.5

Key considerations in the calculation of fair values of those financial assets and liabilities not presented on the balance sheet at fair value are set out below unless there is no significant difference between carrying value and fair value.

38. Fair values (continued)

Loans and advances to customers

For fixed rate and 'tracker' mortgage products, the Group has estimated the fair value of these products using discounted cash flows, and has applied relevant current market product rates as discount rates in order to also incorporate an element of future expected credit losses. Incurred losses have also been included. Fixed rate and tracker mortgages have been discounted using current market product rates that are specific to the particular market to which they relate.

Market prices will generally have moved since the fixed or tracker rate was taken out, therefore the valuation of these products will change reflecting upwards or downwards movements in market rates. The valuation includes information and expectations regarding estimated redemption profiles, which are regularly reviewed and updated in light of experience.

As these redemption profiles are not considered to be observable by the market, then the fair value of loans and advances to customers is considered to be derived by using Level 3 valuation techniques.

For standard variable rate mortgage products, the interest rate on such products is equivalent to a current market product rate and as such the Group considers the discounted future cash flows of these mortgages to be equal to their carrying value.

Shares

Savings products at variable rates are at current market rates and therefore the Group regards the fair value to be equal to the carrying value.

The fair value of fixed rate savings products has been determined using discounted cash flows, discounted using a combined yield curve of cash and swap term rates.

Changes in market prices since the product was taken out will result in increases or decreases in the fair value of the fixed rate savings products. Penalties for early withdrawal on notice accounts are such as to suggest a negligible early withdrawal rate and none has therefore been applied; as a result the valuation of shares is considered to be a Level 2 valuation technique.

Amounts owed to credit institutions

Balances in this category with re-pricing dates greater than six months are valued using discounted cash flows which use only observable market inputs consisting of the combined yield curve of cash and swap term rates, discounted using this same yield curve, as their rates are now considered 'off-market'. The Group considers balances with re-pricing dates of less than six months to be at current rates and these therefore have a carrying value materially the same as fair value. All inputs to this valuation technique are market observable and as such they are categorised within Level 2 of the fair value hierarchy.

Amounts owed to other customers

As with the above category, the Group considers that balances with re-pricing dates of less than six months are at current rates and thus have a fair value equal to their carrying value. All remaining longer term balances are fair valued using discounted cash flows which use the combined yield curve of cash and swap term rates, discounted using this same yield curve. Again, these are therefore considered to be Level 2 valuation techniques.

Debt securities in issue

Where securities are actively traded in a recognised market, with readily available and quoted prices, these have been used to value the securities. These securities are therefore regarded as having Level 1 fair values. Where such prices are not available, discounted cash flows are used, again using only market observable inputs consisting of a combined yield curve of cash and swap term rates, together with adjustments for credit risk derived from similar instruments issued by the Group where an actively quoted price is readily available. As such, these securities are categorised as having Level 2 fair values.

Subordinated liabilities and subscribed capital

Where prices are quoted for instruments in actively traded markets, these prices have been used in the valuation. As a result, these instruments are categorised as having Level 1 fair values. Where these prices are not available, valuations have been derived from discounted cash flows which utilise a combined yield curve of cash and swap term rates, adjusted for credit risk for similar instruments of the same maturity. These inputs are considered to be observable market inputs and therefore the resulting valuations are categorised as Level 2.

d) Fair values of non-financial assets and liabilities not carried at fair value

The fair values of certain non-financial assets and liabilities that are not carried at fair value are also disclosed in these financial statements. These relate to investments in associates (see note 17d) and investment property (see note 19). Relevant disclosures are made of the valuation techniques used in estimating these fair values, together with the resulting categorisation of these valuation techniques within the fair value hierarchy, within these particular notes.

39. Group segmental reporting

The Group's operating results are regularly reviewed by the Board (the chief operating decision maker) in the following reportable segments. Each segment offers different products and services and is managed on a divisional basis in line with the Group's management and internal reporting structure. The divisions are:

- Mortgages and Savings – principally the Society, but also includes specialist mortgage businesses Amber Homeloans Limited and North Yorkshire Mortgages Limited and deposit taking and mortgage lending in the Channel Islands and the UK through Skipton International Limited. The division also includes the Group's special purpose vehicles formed to acquire funds from wholesale markets, Darrowby No. 1 plc, Darrowby No. 2 plc and Darrowby No. 3 plc, and the intermediate holding company Skipton Group Holdings Limited.
- Estate Agency – including property sales, survey and valuations, conveyancing, lettings, asset management and mortgage broking carried out through the Connells group.
- Financial Advice – provision of financial advice through Skipton Financial Services (SFS) and, prior to its disposal in 2014, Torquil Clark Limited, together with Pearson Jones plc which has been sold since the year end subject to regulatory approval and certain other conditions.
- Investment Portfolio – includes a small number of trading companies that do not fall within the core operating segments.
- Mortgage Services – mortgage administration services, principally Homeloan Management Limited and its subsidiaries, which became a discontinued operation during the year on its disposal.

These segments reflect how internal reporting is provided to management and how management allocate resources and assess performance.

Transactions between the segments are on normal commercial terms and conditions. The accounting policies of the reportable segments are consistent with the Group's accounting policies.

No geographical analysis is presented because substantially all of the Group's activities are conducted within the UK. Of the total external income, £33.0m (2013: £55.7m) was generated outside the UK.

A more detailed breakdown of the allocation of goodwill to each segmental area is given within note 20.

39. Group segmental reporting (continued)

2014

	Mortgages and Savings £m	Estate Agency £m	Financial Advice £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Continuing operations £m	Dis-continued operations £m	Inter-divisional adjustments relating to discontinued operations £m	Total £m
Interest receivable and similar income	440.4	0.7	0.1	3.3	(1.7)	442.8	-	-	442.8
Interest payable and similar charges	(229.8)	-	-	(1.5)	1.8	(229.5)	-	-	(229.5)
Fees and commissions receivable	18.9	325.3	45.4	25.3	(12.9)	402.0	24.9	(2.5)	424.4
Fees and commissions payable	(6.7)	(1.7)	(8.8)	(0.8)	7.8	(10.2)	-	2.5	(7.7)
Fair value losses on financial instruments	(2.0)	-	-	-	-	(2.0)	-	-	(2.0)
Losses on treasury assets	(3.7)	-	-	-	-	(3.7)	-	-	(3.7)
(Loss) / profit on disposal of subsidiary undertakings	-	-	(1.1)	2.2	-	1.1	24.7	-	25.8
Profit on part disposal of associate	-	-	-	2.3	-	2.3	-	-	2.3
Profit on part disposal of equity share investments	-	10.1	-	-	-	10.1	-	-	10.1
Dividend income from equity share investments	-	1.1	-	-	-	1.1	-	-	1.1
Share of profits / (losses) from joint ventures and associates	-	2.4	-	(2.6)	-	(0.2)	-	-	(0.2)
Other income	1.8	(0.7)	-	1.9	0.8	3.8	-	(0.6)	3.2
Total income	**218.9**	**337.2**	**35.6**	**30.1**	**(4.2)**	**617.6**	**49.6**	**(0.6)**	**666.6**
Employee and pension costs	(53.8)	(176.0)	(24.6)	(16.1)	-	(270.5)	(14.8)	-	(285.3)
Depreciation, amortisation and impairment of property, plant and equipment and investment property	(8.2)	(8.4)	(0.6)	(1.7)	-	(18.9)	(1.6)	-	(20.5)
Other administrative expenses	(35.5)	(79.2)	(8.6)	(6.8)	(7.2)	(137.3)	(8.4)	0.6	(145.1)
Operating profit / (loss) before impairment losses and provisions	**121.4**	**73.6**	**1.8**	**5.5**	**(11.4)**	**190.9**	**24.8**	**-**	**215.7**
Impairment losses / provisions for liabilities	(23.0)	(10.4)	(0.4)	(0.3)	-	(34.1)	-	-	(34.1)
Profit / (loss) before tax	**98.4**	**63.2**	**1.4**	**5.2**	**(11.4)**	**156.8**	**24.8**	**-**	**181.6**
Taxation	(20.8)	(13.1)	(0.6)	(0.8)	0.4	(34.9)	-	-	(34.9)
Profit / (loss) after tax	**77.6**	**50.1**	**0.8**	**4.4**	**(11.0)**	**121.9**	**24.8**	**-**	**146.7**
Total assets	**15,752.1**	**273.9**	**25.7**	**118.5**	**(188.5)**	**15,981.7**	**-**	**-**	**15,981.7**
Total liabilities	**14,790.0**	**133.0**	**9.0**	**105.4**	**(127.6)**	**14,909.8**	**-**	**-**	**14,909.8**
Capital expenditure	**3.8**	**10.5**	**0.5**	**2.1**	**-**	**16.9**	**1.4**	**-**	**18.3**

Total income can be analysed as follows:

2014

	Mortgages and Savings £m	Estate Agency £m	Financial Advice £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Continuing operations £m	Dis-continued operations £m	Inter-divisional adjustments relating to discontinued operations £m	Total £m
External income	209.8	332.6	43.1	30.8	1.3	617.6	49.6	(0.6)	666.6
Income from other segments	9.1	4.6	(7.5)	(0.7)	(5.5)	-	-	-	-
Total income	**218.9**	**337.2**	**35.6**	**30.1**	**(4.2)**	**617.6**	**49.6**	**(0.6)**	**666.6**

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39. Group segmental reporting (continued)

2013	Mortgages and Savings* £m	Estate Agency £m	Financial Advice £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Continuing operations £m	Dis-continued operations £m	Inter-divisional adjustments relating to discontinued operations £m	Total £m
Interest receivable and similar income	392.1	0.6	0.2	3.1	(2.6)	393.4	-	-	393.4
Interest payable and similar charges	(251.3)	(0.1)	(0.2)	(1.9)	2.7	(250.8)	-	-	(250.8)
Fees and commissions receivable	23.6	284.1	49.6	30.8	(15.0)	373.1	59.3	(6.5)	425.9
Fees and commissions payable	(7.3)	(1.7)	(9.1)	(0.9)	8.2	(10.8)	(0.7)	6.5	(5.0)
Fair value gains on financial instruments	3.9	-	-	-	-	3.9	-	-	3.9
(Loss) / profit on disposal of subsidiary undertakings	(0.1)	-	-	24.8	-	24.7	-	-	24.7
Dividend income from equity share investments	-	1.1	-	-	-	1.1	-	-	1.1
Share of profits / (losses) from joint ventures and associates	-	2.2	-	(0.9)	-	1.3	-	-	1.3
Other income	2.9	(0.5)	-	3.1	2.4	7.9	-	(1.3)	6.6
Total income	163.8	285.7	40.5	58.1	(4.3)	543.8	58.6	(1.3)	601.1
Employee and pension costs	(50.4)	(151.4)	(26.4)	(22.6)	0.5	(250.3)	(32.5)	-	(282.8)
Depreciation, amortisation and impairment of property, plant and equipment and investment property	(4.8)	(6.8)	(1.0)	(3.4)	0.7	(15.3)	(4.2)	-	(19.5)
Other administrative expenses	(26.7)	(67.1)	(8.3)	(11.4)	(20.3)	(133.8)	(20.5)	1.3	(153.0)
Operating profit / (loss) before impairment losses and provisions	81.9	60.4	4.8	20.7	(23.4)	144.4	1.4	-	145.8
Impairment losses / provisions for liabilities	(30.4)	(10.2)	(0.9)	(0.2)	-	(41.7)	(0.5)	-	(42.2)
Profit / (loss) before tax	51.5	50.2	3.9	20.5	(23.4)	102.7	0.9	-	103.6
Taxation	(12.0)	(11.8)	(0.9)	(2.6)	1.0	(26.3)	(0.1)	-	(26.4)
Profit / (loss) after tax	39.5	38.4	3.0	17.9	(22.4)	76.4	0.8	-	77.2
Total assets	14,238.0	219.0	31.2	134.4	(161.1)	14,461.5	25.2	-	14,486.7
Total liabilities	13,422.8	91.9	5.9	105.1	(76.5)	13,549.2	2.6	-	13,551.8
Capital expenditure	2.1	9.3	1.3	3.7	(0.2)	16.2	2.8	-	19.0

Total income can be analysed as follows:

2013	Mortgages and Savings* £m	Estate Agency £m	Financial Advice £m	Investment Portfolio £m	Sundry incl. inter-divisional adjustments £m	Continuing operations £m	Dis-continued operations £m	Inter-divisional adjustments relating to discontinued operations £m	Total £m
External income	154.1	280.3	48.4	57.6	3.4	543.8	58.6	(1.3)	601.1
Income from other segments	9.7	5.4	(7.9)	0.5	(7.7)	-	-	-	-
Total income	163.8	285.7	40.5	58.1	(4.3)	543.8	58.6	(1.3)	601.1

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

40. Capital structure

The PRA regulates the Group which is required to manage its capital in accordance with the rules and guidance issued by the PRA. The capital requirements of the Group are monitored on a monthly basis and the results of this monitoring are reported to the Board. Capital is ultimately held for the protection of depositors and other creditors. The internal level of capital is set with the aim of ensuring that the business has sufficient levels of capital for current and projected future activities, to withstand downturn stresses, and to ensure that the minimum regulatory requirement is always met.

Throughout the year the Group complied with and maintained surplus capital above the externally imposed capital requirements.

The following table shows the composition of the prudential group's regulatory capital at 31 December 2014 under CRD IV:

	CRD IV Fully Loaded[1]	**CRD IV Transitional**	CRD IV Fully Loaded[2]	CRD IV Transitional[2]
	31.12.14	**31.12.14**	1.1.14	1.1.14
	£m	**£m**	£m	£m
Common Equity Tier 1				
Reserves (note 3)	**952.8**	**949.7**	821.3	817.1
Prudential adjustments (note 4)	**(0.9)**	**(0.9)**	(1.1)	(1.1)
Deductions from Tier 1 capital (note 5)	**(11.2)**	**(11.2)**	(29.7)	(29.7)
Unrealised gains on available-for-sale debt securities	**-**	**(2.6)**	-	-
Unrealised losses on cash flow hedges	**5.3**	**5.3**	11.0	11.0
Total Common Equity Tier 1	**946.0**	**940.3**	801.5	797.3
Additional Tier 1 capital – PIBS (note 6)	**-**	**72.0**	-	72.0
Total Tier 1 capital	**946.0**	**1,012.3**	801.5	869.3
Tier 2				
Subordinated liabilities (note 6)	**4.4**	**37.7**	6.4	54.1
PIBS (note 7)	**40.0**	**18.0**	40.0	18.0
Total Tier 2 capital (note 8)	**44.4**	**55.7**	46.4	72.1
Total Own funds	**990.4**	**1,068.0**	847.9	941.4
Risk weighted assets - unaudited				
Retail mortgages	**4,454.9**	**4,454.9**	4,110.8	4,110.8
Commercial mortgages	**359.3**	**359.3**	392.5	392.5
Treasury assets (note 9)	**413.4**	**413.4**	461.7	461.7
Other assets (note 10)	**303.4**	**303.4**	322.3	322.3
Operational risk	**297.0**	**297.0**	339.5	339.5
Market risk	**-**	**-**	0.7	0.7
Total risk weighted assets	**5,828.0**	**5,828.0**	5,627.5	5,627.5
Capital ratios – unaudited				
Common Equity Tier 1 (CET 1) (%) (note 11)	**16.23**	**16.13**	14.24	14.17
Tier 1 (%) (note 11)	**16.23**	**17.37**	14.24	15.45
Total capital (%) (note 11)	**16.99**	**18.33**	15.07	16.73

Notes

1 The key impact on Own funds of the CRD IV fully loaded rules are that all existing additional Tier 1 and Tier 2 instruments that become ineligible as capital by 1 January 2022 are excluded in full now. The fully loaded CET 1 ratio is higher than the transitional CET 1 ratio as certain fair value adjustments made in relation to these instruments are not deducted from reserves under the fully loaded position.

2 The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy and a revised interpretation of the CRD IV regulations. Further explanation of these movements is set out in the notes below.

3. Reserves consist of the general reserve, unrealised gains / losses on available-for-sale assets and the cash flow hedging reserve.

4. Prudential adjustments include deductions to capital for deferred tax and a valuation adjustment ('AVA') on fair value assets. AVA has been applied to prudently provide for the downside of fair value exposures that are intrinsically subjective in nature.

5. Under PRA rules intangible assets must be deducted from regulatory capital.

6. Under PRA rules Permanent Interest Bearing Shares (PIBS) and subordinated liabilities are included in the solvency calculation in accordance with UK GAAP rather than IFRS. The PIBS and subordinated liabilities are disclosed at par value, therefore the associated merger fair value adjustments are recognised in the general reserve. Subordinated liabilities with less than five years to maturity are amortised from a capital perspective. In addition, the fully loaded prior year figures have been restated to remove a £10m tranche of subordinated debt which has been reclassified as ineligible under CRD IV.

7. Under CRD IV all of our PIBS will be phased out of Tier 1 capital as they fail to satisfy the CRD IV requirements. However £40m of our PIBS will continue to satisfy the criteria for Tier 2 capital and will therefore be phased into Tier 2.

8. Historically Tier 2 capital has included the add-back of collective provisions. This is no longer permitted under CRD IV. The prior year figures have also been restated to reflect this treatment.

40. Capital structure (continued)

9. The Group is already required to hold regulatory capital in order to cover potential losses which could arise if the counterparties to its derivative contracts fail to meet their financial obligations before the maturity date; this is known as the counterparty credit risk. It places a valuation on the risk that the counterparty will default on its obligations before the maturity of the contract. CRD IV extends this concept by introducing the requirement to hold additional regulatory capital in order to protect the Group from exposure to potential mark to market losses that could arise if the creditworthiness of those same counterparties were to deteriorate; this is known as a credit valuation adjustment charge. The prior year figures have been restated to include a credit valuation adjustment charge.
10. Other assets include capital required for debt factoring loans, property, plant and equipment, cost of investment in subsidiary companies outside the prudential group, other debtors and the fair value of hedged assets. The calculation of the capital required for the fair value of hedged assets in relation to mortgage assets has been revised reflecting regulatory guidance. The prior year figures have also been restated to reflect this treatment.
11. Calculated as relevant capital divided by risk weighted assets.

41. Adoption of new and revised International Financial Reporting Standards

Disclosed below are new standards which have been adopted during the year:

- IFRS 10 *Consolidated Financial Statements*. This new standard is effective from 1 January 2014 and replaces part of IAS 27 *Consolidated and Separate Financial Statements*, as well as SIC-12 *Consolidation - Special Purpose Entities*. The new standard applies to the consolidated financial statements only within these accounts and defines the principle of control and establishes control as the basis for determining which entities are consolidated into the consolidated financial statements. The standard also sets out the accounting requirements for the preparation of consolidated financial statements. The new standard has resulted in no changes to the financial statements of the Group.
- IFRS 11 *Joint Arrangements*. This new standard is effective from 1 January 2014 and replaces IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities - Non-Monetary Contributions by Venturers*. The new standard applies to the consolidated financial statements only within these accounts and removes the choice to apply the proportionate consolidation method, requiring all joint arrangements to be accounted for under the equity method. The new standard has resulted in no changes to the financial statements of the Group.
- IFRS 12 *Disclosure of Interests in Other Entities*. This standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity, and is effective from 1 January 2014. The standard applies to the consolidated financial statements only within these accounts and has resulted in enhanced disclosure within notes 13 and 17, where further disclosure is provided in respect of unconsolidated structured entities and non-controlling interests respectively, but otherwise has had no impact on the financial statements.
- IAS 27 (revised) *Separate Financial Statements*. This revised standard applies to only the Society's financial statements within these accounts and applies to entities that are required to prepare separate financial statements where that entity holds investments in subsidiaries, associates or jointly controlled entities and has had no impact on these financial statements.
- IAS 28 (revised) *Investments in Associates and Joint Ventures*. This standard applies to the consolidated financial statements only within these accounts and prescribes the accounting for investments in associates and sets out requirements for the application of the equity method when accounting for investments in associates and joint ventures, including guidance on how such investments should be tested for impairment. The revised standard has had no impact on the financial statements of the Group.
- *Investment Entities* (amendments to IFRS 10, IFRS 12 and IAS 27). The amendments to these standards apply to entities whose business purpose is to invest funds solely for returns from capital appreciation, investment income or both. The amendments to these standards have had no impact on the financial statements of the Group.
- Amendments to IAS 32 *Offsetting Financial Assets and Financial Liabilities*. This amendment provides clarification of the rules surrounding offsetting of financial assets and financial liabilities. The revised standard has had no impact on the financial statements of the Group.
- Amendments to IAS 36 *Recoverable Amount Disclosures for Non-Financial Assets*. This amendment changes the disclosure requirements surrounding recoverable amounts of non-financial assets where the recoverable amount is based on fair value less costs to sell. The revised standard has had no impact on the financial statements of the Group.
- Amendments to IAS 39 *Novation of Derivatives and Continuation of Hedge Accounting*. This amendment provides an exception to the requirement for hedge accounting to be discontinued when a hedging instrument is required to be novated to a central counterparty as a result of laws or regulations. The revised standard has had no impact on the financial statements of the Group.

41. Adoption of new and revised International Financial Reporting Standards (continued)

In addition, the Directors have early adopted the principles of IFRIC 21 *Levies*, which was formally endorsed by the EU during the year for accounting periods beginning on or after 16 June 2014, and which provides clarification of the accounting for government imposed levies within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This interpretation changes the date at which the Society's provision for the Financial Services Compensation Scheme (FSCS) levy is recognised. Further details are provided in note 1b).

The Group notes that there are also new accounting standards on the horizon, which are neither adopted by the EU nor effective at 31 December 2014 including IFRS 9. IFRS 9 is still subject to EU endorsement, but will be effective for reporting periods beginning on or after 1 January 2018. This standard will require financial assets to be classified at either amortised cost or at fair value (through either the Income Statement or through Other Comprehensive Income), and removes the available-for-sale category for financial assets. In addition the standard will address impairment of financial assets, which will be based on expected credit losses rather than incurred credit losses as at present, as well as general hedge accounting. As such the Group is monitoring the development of this standard and considering the associated impact on the Group financial statements, which is likely to be significant.

In addition, IFRS 15 *Revenue from Contracts with Customers* will be effective for reporting periods beginning on or after 1 January 2017. This standard specifies how and when an entity should recognise revenue, providing a simple, principles based five-step model to be applied to all contracts with customers. The standard also prescribes further disclosure requirements in this area. We are currently establishing the likely impact of the standard for the Group; it is anticipated that the timing of when revenue should be recognised on certain revenue streams within the Group may be impacted and therefore the overall impact on the Group may be significant.

42. Subsequent events

On 6 February 2015, the Group agreed the sale of its entire shareholding in Pearson Jones plc and its subsidiary businesses, subject to regulatory approval and certain other conditions, for an undisclosed sum. Whilst this business is classified as held for sale at 31 December 2014, it is not considered a major line of business for the Group and has therefore not been classified as discontinued. The contribution of this business to the Group's profit after tax in 2014 was £1.4m.

There have been no other material subsequent events between 31 December 2014 and the approval of this Annual Report and Accounts by the Board.

Country by Country Reporting

Introduction

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of the EU's Capital Requirements Directive (CRD IV). The purpose of the regulations is to provide clarity on the source of the Group's income and the location of its operations.

Nature of the Group's activities

The Skipton Building Society Group holds an investment in a number of subsidiary undertakings. The building society and the majority of its subsidiary undertakings are incorporated in the UK, with the exception of the entities listed below. For a full list of the principal trading subsidiaries in the Group and the nature of their activities, please refer to note 17a) of these financial statements.

Name of subsidiary undertaking	Principal business activity	Country of incorporation	% ownership interest 31.12.14
Jade Software Corporation Limited	Provider of software development services	New Zealand	56.4
Northwest Investments NZ Limited	Provider of software development services	New Zealand	100.0
Skipton International Limited	Offshore deposit taker and lender	Guernsey	100.0

Jade Software Corporation Limited also holds a 100% ownership in the following subsidiary undertakings, all of which carry out the principal business activity of the Jade group of businesses.

Name of subsidiary undertaking	Country of incorporation
Jade Software Corporation (NZ) Limited	New Zealand
Jade Software Corporation Pty Limited	Australia
Jade Software Corporation UK Limited	UK
Jade Software Corporation USA	USA

In addition, the Group holds a non-controlling interest of 21.7% in Wynyard Group Limited, which is incorporated in New Zealand and has subsidiaries in Australia, Canada and the UK.

Country by country disclosures

An analysis of turnover, which is regarded as total income as defined below (and which excludes dividend income from subsidiaries), profit before tax, the current tax charge, corporation taxes paid, public subsidies received and the average number of employees on a full-time equivalent basis for the year ended 31 December 2014 is set out below. The information presented is at a full Group level of consolidation, consistent with these financial statements and reflects total operations of the Group including the discontinued operation. Total income is defined as net interest income plus fees and commissions receivable (net of fees and commissions payable), together with all other components of operating income.

£m	UK	Australia	Guernsey	New Zealand	Republic of Ireland	USA	Total
Total income - gross	662.5	1.6	15.8	12.8	0.5	0.4	**693.6**
Intra-group adjustments	(25.8)	-	(0.5)	(0.7)	-	-	**(27.0)**
Total income - net	636.7	1.6	15.3	12.1	0.5	0.4	**666.6**
Profit before tax - gross	194.0	0.3	12.2	(1.2)	0.1	0.1	**205.5**
Intra-group adjustments	(23.2)	-	-	(0.7)	-	-	**(23.9)**
Profit before tax - net	170.8	0.3	12.2	(1.9)	0.1	0.1	**181.6**

£m	UK	Australia	Guernsey	New Zealand	Republic of Ireland	USA	Intra-group adjustments	Total
Current tax expense	36.8	-	1.2	-	-	-	0.6	**38.6**
Corporation taxes paid	29.5	0.1	1.4	-	-	-	-	**31.0**
Public subsidies received*	-	-	-	0.2	-	-	-	**0.2**
Average number of employees	7,570	10	34	168	8	6	-	**7,796**

* Public subsidies received relate to cash payments received from governments in the form of grants.

Annual Business Statement

1. Statutory percentages

	As at 31 December 2014 %	Statutory limit %
Lending limit	**7.53**	25.00
Funding limit	**14.15**	50.00

These percentages form part of the audited accounts.

Explanation

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 fully secured on residential property. Business assets are defined as the total assets of the Group plus provisions for impairment losses on loans and receivables, less liquid assets, intangible assets, property, plant and equipment and investment properties as shown within the Group Statement of Financial Position.

The funding limit measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. We have taken advantage of the relief set out in SI 2007/No 860, effective from April 2007, to exclude retail offshore deposits from the total of wholesale funds.

The statutory limits are as laid down under the Building Societies Act 1986 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

	2014 %	2013 %
As a percentage of shares, deposits and borrowings:		
(i) Gross capital	**8.95**	9.02*
(ii) Free capital	**7.38**	7.14*
(iii) Liquid assets	**18.36**	18.61
As a percentage of mean total assets:		
(i) Group profit after taxation – continuing operations	**0.80**	0.54*^
(ii) Group management expenses – continuing operations	**2.80**	2.83^
(iii) Society management expenses	**0.57**	0.50
As a percentage of closing total assets:		
(i) Group profit after tax – continuing operations	**0.76**	0.53*^

* The comparative figures have been restated due to a change in accounting policy relating to the FSCS levy. Further details are provided in note 1b).

^ The comparative figures have been re-presented to reflect the disposal of Homeloan Management Limited and its subsidiary companies, which became a discontinued operation during 2014. Further details are provided in note 17b).

These percentages form part of the audited accounts.

Explanation

The above percentages have been calculated from the Group and Society Income Statements and Statements of Financial Position.

Shares, deposits and borrowings represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest and the fair value adjustment for hedged risk.

Gross capital represents the general reserve together with the available-for-sale reserve, cash flow hedging reserve, translation reserve, subordinated liabilities, subscribed capital, and non-controlling interests, as shown within the Group Statement of Financial Position.

Free capital represents gross capital and provisions for collective impairment losses on loans and advances to customers, less property, plant and equipment, investment properties and intangible assets as shown within the Group Statement of Financial Position.

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

Mean total assets are the average of the 2014 and 2013 total assets.

Management expenses represent administrative expenses from continuing operations.

3. Information relating to Directors at 31 December 2014

The Board of Directors at 31 December 2014, their dates of birth and dates of appointment as a Director are as follows:

	Date of Birth	Date of Appointment
C Black	20 August 1958	1 March 2013
M Cassoni	27 December 1951	31 July 2012
I M Cornelius*	11 February 1969	11 June 2012
D J Cutter*	1 January 1962	1 January 2000
R D East	18 March 1960	29 November 2011
M H Ellis	4 August 1951	24 May 2011
P R Hales	21 October 1946	29 May 2007
G E Picken	21 April 1949	17 January 2012
H C Stevenson	10 November 1960	1 March 2013
P J S Thompson	28 September 1946	1 April 2009

* Executive Directors

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

The Directors' business occupations and other Directorships at 31 December 2014 were:

C Black	Non-Executive Director	Bolt Learning Limited Cheryl Black & Partners Limited GSI Corporation Limited Skipton Group Holdings Limited Southern Water Services Limited Telefonica UK Pension Trustee Limited Unum Limited
M Cassoni	Non-Executive Director	AO World Plc GFI Group Inc Jacob's Island (Providence Square Blocks A, B & C) Limited Skipton Group Holdings Limited The People's Operator Plc
I M Cornelius	Building Society Commercial Director	Amber Homeloans Limited North Yorkshire Mortgages Limited Skipton Group Holdings Limited Skipton Financial Services Limited Skipton International Limited Skipton Trustees Limited

D J Cutter	Building Society Group Chief Executive	Bailey Computer Services Limited Connells Limited Craven Educational Trust Leeds Share Shop Limited Malsis School Trust North West Investments NZ Limited Sequence (UK) Limited Skipton Group Holdings Limited Skipton Group Limited Skipton Investments Limited Skipton Limited Skipton Mortgages Corporation Limited Skipton Mortgages Limited Skipton Premier Mortgages Limited Skipton Premises Limited Skipton Share Dealing Services Limited Skipton Trustees Limited
R D East	Non-Executive Director	Cattles Holdings Limited Cattles Limited Cattles Properties (Ruddington) Limited Compass Credit Limited Dial4aloan Limited Echo 2014 Limited Hampshire Trust Plc LGH Delta Limited Moneytopia Bank Limited Recordpoint Limited Skipton Group Holdings Limited Statusclaim Limited Supremeaccess Limited Welcome Financial Services Limited Westernissue Limited
M H Ellis	Non-Executive Director & Chairman	M H Ellis Consulting Limited Leeds Theatre Trust Limited Skipton Group Holdings Limited
P R Hales	Chartered Insurer	Clear View Assured Limited Sandringham Financial Partners Limited Skipton Group Holdings Limited The Chartered Insurance Institute Pension Scheme
G E Picken	Non-Executive Director	Connells Limited Hampshire Trust Plc HICL Infrastructure Company Limited Skipton Group Holdings Limited
H C Stevenson	Non-Executive Director	Henley Business School Skipton Group Holdings Limited St Ives Plc Trinity Mirror Group Plc
P J S Thompson	Solicitor (Non-Practising)	Giggleswick School Institute of Directors Rushbond Plc Skipton Group Holdings Limited TEP Electrical Distributors Limited

Messrs Cornelius and Cutter have service contracts entered into on 7 December 2012 and 1 January 2000 respectively which may be terminated by either party giving one year’s notice.

Glossary

Set out below are the definitions of terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue.
Asset backed securities (ABS)	An asset backed security is a security whose value and income payments are derived from and collateralised (or 'backed') by a specified pool of underlying assets. Typically these assets are pools of residential or commercial mortgages.
Basel II	Basel II was the second of the Basel Accords, issued by the Basel Committee on Banking Supervision, which defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the PRA Handbook.
Basel III	Basel III became effective in the UK on 1 January 2014 and sets out details of strengthened global regulatory standards on bank capital adequacy and liquidity.
Buy-to-let mortgages	Mortgages offered to customers purchasing residential property to be rented to others to generate a rental income.
Commercial mortgage backed securities (CMBS)	Securities that represent interests in a pool of commercial mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal).
Common Equity Tier 1 capital	Common Equity Tier 1 (CET 1) capital primarily comprises internally generated capital from retained profits. An adjustment is made to deduct intangible assets and goodwill. CET 1 capital is fully loss absorbing.
Contractual maturity	The final payment date of a loan or other financial instrument, at which point the entire remaining outstanding principal and interest is due to be repaid.
CRD IV	CRD IV is made up of the Capital Requirements Regulation (CRR), which is directly applicable to firms across the EU, and the Capital Requirements Directive (CRD), which must be implemented through national law. CRD IV became effective in the UK from 1 January 2014.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Delinquency	A debt or financial obligation is considered to be in a state of delinquency when payments are overdue.
Derivative financial instruments	A derivative financial instrument is a type of financial instrument (or an agreement between two parties) that has a value based on the underlying asset, index or reference rate it is linked to. The Group uses derivative financial instruments to hedge its exposures to market risks such as interest rate, equity and currency risk.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period.
Fair value	Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised Financial Services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the Financial Services industry. Every firm authorised by the FCA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Forbearance strategies	Strategies to assist borrowers in financial difficulty, such as arrears capitalisation, a reduction in the monthly payment, a conversion to interest only or a mortgage term extension. Forbearance strategies aim, if possible, to avoid foreclosure or repossession.
Free capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment, investment properties and intangible assets.
Funding for Lending Scheme	A scheme launched by the Bank of England and HM Treasury in August 2012 which provides funding to participating banks and building societies with the aim of stimulating lending within the economy.

Glossary *(continued)*

Funding limit	Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement.
Goodwill	Goodwill arises on the acquisition of subsidiary undertakings, joint ventures, associates or businesses and 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.
Gross capital	The aggregate of the general reserve, translation reserve, available-for-sale reserve, cash flow hedging reserve, subscribed capital, subordinated liabilities and non-controlling interests.
Help to Buy	A government-backed scheme in the UK that aims to help first time buyers, whereby the Government effectively provides an equity loan to assist the purchase of new build properties.
Impaired loans	Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.
Individually / collectively assessed	Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be realised.
Individual Capital Adequacy Assessment Process (ICAAP)	The Group's own assessment, as part of regulatory requirements, of the levels of capital that it needs to hold in respect of the risks it faces under a business as usual scenario and a variety of stress scenarios.
Individual Liquidity Adequacy Assessment (ILAA)	The Group's own assessment that current and projected levels of liquidity are sufficient and appropriate for the Group's plans, under a variety of stress scenarios. It also details the Group's compliance with the PRA's regulatory BIPRU 12 requirements.
Internal ratings-based approach (IRB)	An advanced approach to measuring capital requirements in respect of credit risk under Basel II and, from 1 January 2014, CRD IV. The IRB approach may only be used with permission from the PRA.
International Swaps and Derivatives Association (ISDA) Master Agreement	A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions.
Investment grade	The range of credit ratings from Aaa to Baa3, as measured by external credit rating agencies.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property. The calculation of the lending limit is explained in the Annual Business Statement.
Leverage ratio	The ratio of Tier 1 capital divided by total exposure, which includes on and off balance sheet assets, after netting derivatives.
Liquid assets	The total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.
Liquidity ratio	Liquid assets as a percentage of shares, deposits and borrowings.
Loan-to-value ratio (LTV)	A ratio which expresses the balance of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in a house price index (HPI)).
Loans past due / past due loans	Loans on which payments are overdue including those on which partial payments are being made.
Management expenses	Management expenses represent administrative expenses. The management expense ratio is management expenses expressed as a percentage of mean total assets.
Material Risk Takers (MRTs)	A group of employees to which the FCA's Remuneration Code applies. MRTs consist of Executive Directors, Non-Executive Directors and certain senior managers who could have a material impact on the firm's risk profile.
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
Medium term notes (MTN)	Corporate notes continuously offered by an entity to investors through a dealer.
Member	A person who has a share investment or a mortgage loan with the Society.
Mortgage backed securities (MBS)	Assets which are backed by underlying mortgage collateral.

Net interest income	The difference between interest received on assets and interest paid on liabilities.
Net interest margin	Net interest income as a percentage of mean total assets.
Permanent Interest Bearing Shares (PIBS) or subscribed capital	Unsecured, deferred shares that are a form of Tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing members of Skipton Building Society.
Prime	Prime mortgages are those granted to the most credit worthy category of borrower.
Put option	Where the Group acquires a majority shareholding in a subsidiary undertaking, but grants the non-controlling shareholders an option to sell their shares to the Group at some future date, a put option obligation exists.
Renegotiated loans	Loans are classed as renegotiated, with the customer's consent, when their terms have changed during the year. Loans and advances may be renegotiated whether or not the customer is experiencing financial difficulty in repaying their loan with the Group.
Repo / reverse repo	Short to medium term funding agreements which allow a borrower to sell a financial asset, such as an ABS or Government bonds as security for cash. As part of the agreement the borrower agrees to repurchase the security at some later date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo, which can typically be resold or repledged if desired.
Residential loans	Mortgage lending secured against residential property.
Residential mortgage backed securities (RMBS)	A category of ABS that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal).
Risk appetite	The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Society's members whilst achieving business objectives.
Risk weighted asset (RWA)	The value of assets, after adjustment, under CRD IV rules to reflect the degree of risk they represent.
Securitisation	A process by which a group of assets, usually loans, are aggregated into a pool which is used to back the issuance of new securities. A firm transfers these assets to a special purpose vehicle which then issues securities backed by the assets. The Group has established securitisation structures as part of its funding activities. These securitisation structures use retail / residential mortgages as the asset pool.
Shares	Money deposited by non-corporate depositors in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.
Shares, deposits and borrowings	The total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue, including accrued interest and fair value adjustments for hedged risk.
Subordinated debt / liabilities	A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors and investing members (other than holders of PIBS).
Sub-prime	Loans to borrowers typically having weakened credit histories that include payment delinquencies and in some cases potentially more severe problems such as court judgements and discharged bankruptcies.
Tier 1 capital	A measure of financial strength. Tier 1 capital is divided into Common Equity Tier 1 and other Tier 1 capital. Common Equity Tier 1 capital comprises general reserves from retained profits. The book values of goodwill and other intangible assets are deducted from Common Equity Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as PIBS are included in other Tier 1 capital (i.e. not Common Equity Tier 1).
Tier 2 capital	Tier 2 capital comprises regulated subordinated liabilities and PIBS that have been transitioned out of additional Tier 1 capital.
Wholesale funding	Amounts owed to credit institutions, amounts owed to other customers and debt securities in issue excluding balances deposited by offshore customers.

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