Skipton Building Society

Pillar 3 Disclosures

for the Year Ended 31 December 2010

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Contents

1.0 Introduction

1.1 Background

From 1 January 2007 the Capital Requirements Directive (Basel II) came into force in the UK and the Skipton Building Society Group adopted the capital adequacy rules from 1 January 2008. These rules require building societies and banks to assess the adequacy of their capital resources given the risks they face in order to ensure the continued protection of their investors' deposits. The rules are set out in the Capital Requirements Directive under three pillars:

Pillar 1 sets out the minimum regulatory capital resources requirement, predominantly comprising credit risk and operational risk.

Pillar 2 covers management's assessment of the additional capital resources required to cover specific risks faced by the institution that are not covered by the minimum regulatory capital resources requirement set out under Pillar 1. The amount of additional capital requirement is assessed by the FSA during its Supervisory Review and Evaluation Process (SREP).

Pillar 3 requires building societies and banks operating under the Basel II framework to disclose quantitative and qualitative information regarding their risk assessment processes and capital resources, and hence their capital adequacy.

1.2 Basis and frequency of disclosure

This Pillar 3 report is based upon the Group's Annual Report and Accounts for the year ended 31 December 2010, unless otherwise stated. Subsequent disclosures will be issued on an annual basis as soon as practicable after the publication of the Group's Annual Report and Accounts.

1.3 Media and location of publication

Reports of this nature will be published on Skipton Building Society's website (skipton.co.uk).

1.4 Verification of disclosure

These disclosures have been reviewed by the Group's Internal Audit Function and Board Audit Committee. However, there is no requirement for the disclosures to be externally audited; although some of the information within the disclosures also appears in the Group's 2010 Annual Report and Accounts which are externally audited.

2.0 Scope of application

For accounting purposes the Society's consolidation group comprises the Society and all of its subsidiaries (ie full group consolidation).

For prudential and Pillar 3 reporting purposes consolidation is carried out at the following levels:

- Solo consolidation group
- UK consolidation group

However, the risks within the Skipton Group are controlled and managed on a full consolidation level so for Pillar 3 purposes the capital adequacy of the full group has also been disclosed.

Solo consolidation group

As at 31 December 2010 the Solo consolidation group consists of Skipton Building Society, Amber Homeloans Limited, North Yorkshire Mortgages Limited and Skipton Building Society Covered Bonds LLP.

UK consolidation group

As at 31 December 2010 the UK consolidation group (UKCG) consists of the entire Group with the exception of the following entities in accordance with BIPRU 8.5.1:

- Connells Limited and subsidiary companies
- Jade Software Corporation Limited
- Mutual One Limited
- Northwest Investments NZ Limited
- Private Health Partnership group
- Skipton Trustees Limited

One of the subsidiary companies within the full group and the UK consolidation group is Skipton International Limited which is based in Guernsey and regulated by the Guernsey Financial Services Commission.

2.1 Recent developments

On 30 June 2010 the Society merged with the former Chesham Building Society and therefore all of the figures included within this report as at 31 December 2010 represent the merged position.

In September 2010, a Board Risk Committee was formed which is responsible for the oversight of the risk management framework and monitoring of the business risk profile.

3.0 Risk management objectives and policies

3.1 Introduction

The Board understands that risks arise as a consequence of decisions taken in order to achieve its business objectives but endeavours, through positive mitigation strategies, to manage these in a manner that optimises returns whilst protecting members' interests and the Group's reserves. To this end, the Board ensures that an effective risk management framework is maintained to identify, prioritise, manage and report on the risks faced by the Group.

3.2 Risk appetite

As a mutual organisation the Skipton Board is charged with the protection of member deposits and bases its risk appetite on avoiding strategies or business practices which would in any way threaten member interests.

The Board's risk appetite, inter alia, specifically addresses the maintenance of stakeholders' confidence, profit performance, capital and liquidity adequacy, fair treatment of customers and the operational control framework and is supported by a comprehensive range of metrics used to assess business performance and risk exposure against its risk appetite.

3.3 Group risk management framework

Through its risk management framework, the Group has a formal structure for managing 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, comprising:

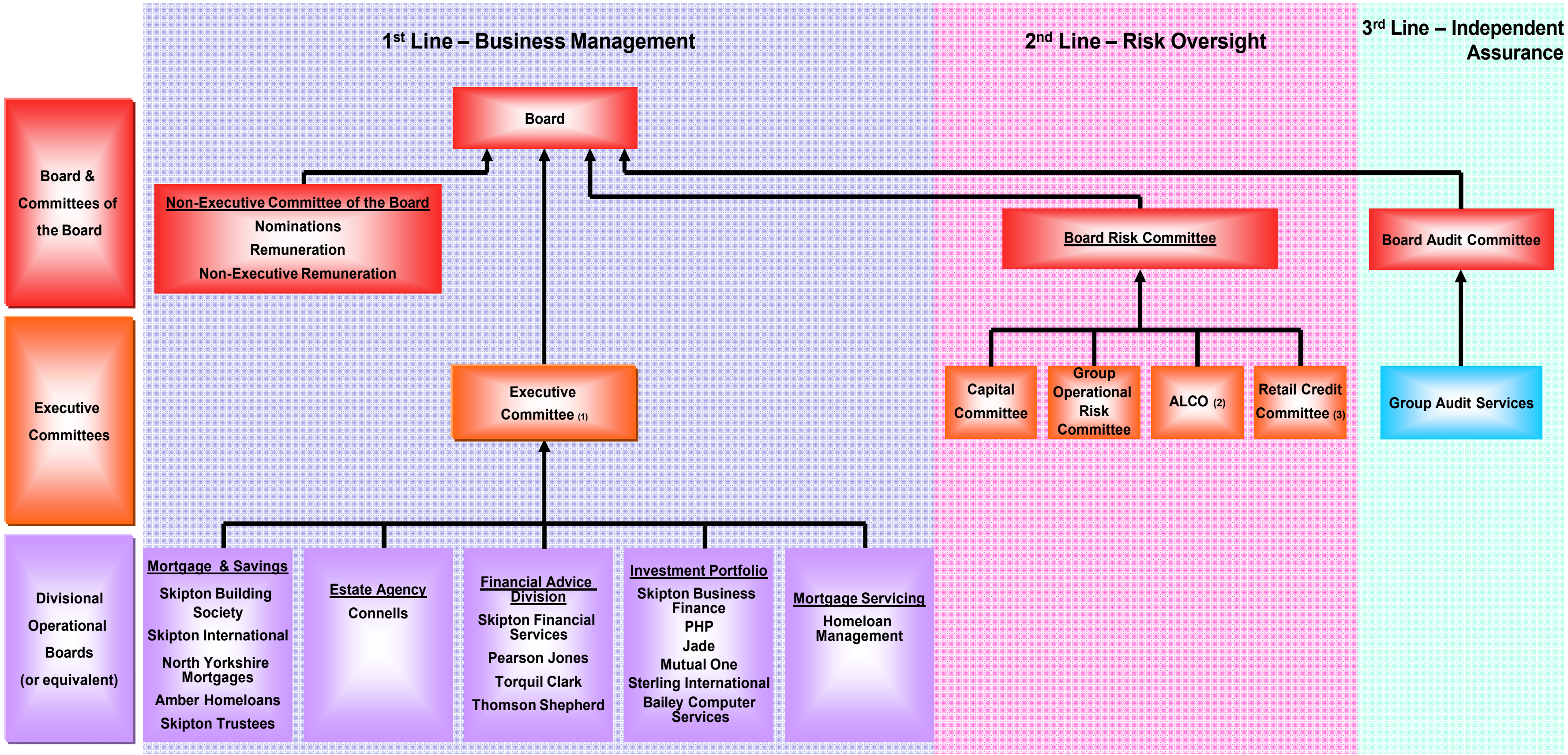
- **First line** of defence, being line management within the business which, through the implementation of the organisation's risk framework, identifies, assesses, and manages risk.

- **Second line** of defence comprising independent risk functions (Operational, Credit and Market) and related risk functions including Compliance, Systems Security, Finance and Insurance. These functions challenge, monitor, guide and support the business in managing its risk exposure. The Risk framework includes a number of risk committees (Asset and Liability Committee ('ALCO'), Retail Credit Committee ('RCC') and Group Operational Risk Committee ('GORC')) responsible for setting policy and framework and monitoring implementation by the business. The independent risk functions are represented on each of these risk committees. The Capital Committee is also responsible for reviewing Group policies in relation to capital and for monitoring compliance with these policies and the Group's overall capital adequacy.

  To strengthen governance and risk management oversight a Board Risk Committee was formed during the year. Chaired by a Non-Executive Director the Committee is responsible for oversight of the risk management framework and monitoring of business risk profile against the Board's approved risk appetite statement.

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

Skipton Group Governance Framework



1. The Executive Committee receives reports from the Transformation Board, Products Approval Group, Health, Safety & Security Working Group and Society Operational Risk Committee to assist in the execution of its duties.
2. ALCO receives reports from the Wholesale Credit Committee to assist in the execution of its duties
3. The Retail Credit Committee receives reports from the Credit Risk Working Group, Credit Modelling Working Group and Provisions Group to assist in the execution of its duties

The roles and responsibilities of the Board and the risk management committees are set out in the following paragraphs.

3.4 Board

- The Board is responsible for the development of the Group's strategy and corporate objectives.
- In pursuit of its corporate objectives the Board ensures the Group remains within its agreed risk appetite statement.
- The Board is responsible for ensuring that appropriate levels of capital and liquidity are maintained throughout the economic cycle and during periods of general business stress.
- To achieve this, the Board on a regular basis receives and considers for approval the Group's Internal Capital Adequacy Assessment Process (ICAAP) document, the Group's Internal Liquidity Adequacy Assessment (ILAA) document and key risk reports for all risk categories.

3.5 Executive Committee

The Executive Committee is responsible for ensuring that the Group meets its strategic and operational objectives as defined in the Corporate Plan. Mr Cutter (Group Chief Executive) chairs the Committee which comprises the Group Finance Director and other Senior Executives.

3.6 Asset and Liability Committee

The Asset and Liability Committee is primarily responsible for developing and maintaining policies on structural risk management, liquidity and deposit funding, recommending changes to these policies to the Board, 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 Twigg (Group Finance Director) chairs the Committee which comprises the Group Chief Executive, Chief Risk Officer and Secretary and Senior Executives from Treasury, Finance, Risk and the Group's lending division.

3.7 Retail Credit Committee

The Retail Credit Committee 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 the residual values of leased and other assets, recommending changes to these policies to the Board 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, Chief Risk Officer and Secretary together with Senior Executives from Credit Risk, Finance and the Group's lending businesses.

3.8 Group Operational Risk Committee

The Group Operational Risk Committee meets bi-monthly and its primary responsibility is to develop and keep under review the Group's operational risk management framework. Mr Gibson (Chief Risk Officer and Secretary) chairs the Committee which comprises the Chief Operating Officer, Group Finance Director and Senior Executives from each of the divisions and the Operational Risk team.

3.9 Board Audit Committee

The Audit Committee, which meets at least four times a year, comprises three Non-Executive directors, currently Ms Kinney (Chairman), Mr Thompson and Mr Hutton. In addition, the Group Chief Executive, Group Finance Director, Chief Risk Officer and Secretary, external audit representatives and the General Manager, Audit Services, 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. Ms Kinney is a Fellow of the Institute of Management Accountants.

The responsibilities of the Committee are in line with the provisions of the Financial Reporting Council Guidance on Audit Committees. The Audit Committee's primary responsibilities include:

- monitoring the integrity of the Group's financial statements, any formal announcements relating to the Group's financial performance and significant reporting judgements contained in them;

- monitoring the effectiveness of the external audit process and making recommendations to the Board on the appointment, re-appointment and remuneration of the external auditors;

- ensuring that an appropriate relationship between the Group and the external auditors is maintained, including reviewing non-audit services which can be provided and fees;

- reviewing the effectiveness of the internal audit function. The Committee is responsible for approving, upon the recommendation of the Group Chief Executive, the appointment and removal of the General Manager, Audit Services.

The Board has delegated responsibility for reviewing the effectiveness of the Group's internal controls and risk management systems to the Audit Committee.

3.10 Board Risk Committee

The Board Risk Committee, established in September 2010, is responsible for ensuring that the Group implements an effective risk governance structure. It comprises two Non-Executive Directors, currently Mr Hales (Chairman) and Mr Thompson. The Group Chief Executive and Group Finance Director make up the committee. In addition, the meetings are also attended by the Chief Risk Officer and Secretary and the General Manager, Audit Services.

3.11 Capital Committee

The Capital Committee meets quarterly and is an executive committee that reviews Group policies in relation to capital and monitors both compliance with these policies and the Group's overall capital adequacy. The committee also reviews and manages the forecast capital adequacy of the regulated entities within the Group to ensure the Group's capital resources are utilised in the most efficient manner to achieve its corporate objectives. Mr Ndawula (General Manager, Group Finance) chairs the Committee which comprises the Group Chief Executive, Group Finance Director, Chief Risk Officer and Secretary together with Senior Executives from the Treasury, Risk and Finance functions.

3.12 Remuneration Committee

The Remuneration Committee is responsible for determining, on behalf of the Board, the Group's remuneration policy and reviewing its adequacy and effectiveness. The Committee is also responsible for setting, reviewing and approving remuneration for the Chairman, the Executive Directors and certain other key individuals. The Committee also receives recommendations from the Group Chief Executive for approval of the remuneration for Senior Executives. From the 1 January 2011, the Society came within the scope of the FSA Remuneration Code for the first time and accordingly, remuneration for code staff also falls within the remit of the Remuneration Committee.

The Committee comprises three Non-Executive Directors, Messrs Hutton (Chairman) and Hales and Ms Kinney. The Chairman, Group Chief Executive, Chief Risk Officer and Secretary, Human Resource representatives and external advisers may be invited to attend meetings as and when appropriate.

Further details regarding the remuneration policy are set out in the Directors' Remuneration Report in the 2010 Annual Report and Accounts.

Code Staff
Code staff are defined by the FSA as 'staff that have a material impact on the firm's risk profile, this includes staff that perform significant influence functions, senior managers and risk takers'.

The table below sets out the aggregate quantitative remuneration for code staff in relation to their services for the Skipton Group for the year ended 31 December 2010.

	Number of beneficiaries	**Fixed remuneration £000**	**Variable remuneration £000**	**Total remuneration £000**	**Deferred variable remuneration £000**
Senior management*	17	2,546.6	615.7	3,162.3	39.7
Other code staff**	34	2,994.5	258.9	3,253.4	-

**Includes Senior Executive body for the Society and relevant group companies.*
***This takes into account 14 code staff who are no longer part of the organisation.*

Remuneration Structures

The main components of remuneration for code staff are as follows:

- **Basic salary** – this takes into account job content and responsibilities, individual performance (assessed annually against personal objectives) and salary levels of similar positions in comparable organisations.
- **Variable pay** – senior managers and other code staff in the Group are eligible to participate in a discretionary non-pensionable annual bonus scheme. This is calculated by reference to business performance measured together with individual performance against personal objectives, both of which are linked to the achievement of the Group's strategic objectives (which include effective risk management). As a mutual building society, the Society does not issue shares on the Stock Exchange. For this reason the annual performance pay cannot be based upon Share Option Schemes or Share Incentives Plans. The 2011 scheme incorporates the requirements of the FSA Remuneration Code such as deferral and performance adjustment in the event of poorer than expected results.
- **Pensions –** the Society contributes up to 8% of salary for members of the stakeholder scheme depending on the contribution level of the individual. Society Executive Directors' pension benefits are outlined in the 2010 Annual Report and Accounts. Other code staff within the Group receive stakeholder pension contributions of up to 12.5% of their salary.
- **Benefits -** include the provision of a car or car allowance and private medical insurance for code staff.

4.0 Capital resources

4.1 Total capital resources

The table below sets out the capital resources of the full group, UK consolidation group and Solo consolidation group as at 31 December 2010.

	2010 Full group[1] £m	2009 Full group £m	2010 UK group £m	2009 UK group £m	2010 Solo group £m	2009 Solo group £m
Tier 1						
Reserves	809.6	752.2	747.3	697.2	701.7	639.7
Permanent Interest Bearing Shares (PIBS)	90.0	90.0	90.0	90.0	90.0	90.0
Pension fund deficit adjustment	3.7	8.7	3.7	3.3	3.7	3.3
Unrealised losses on available-for-sale debt securities	6.9	6.2	6.9	6.2	6.0	7.0
Unrealised losses on cash flow hedges	(0.3)	16.0	(0.3)	16.0	(0.3)	16.4
Total Tier 1 capital before deductions	**909.9**	**873.1**	**847.6**	**812.7**	**801.1**	**756.4**
Deductions from Tier 1 capital:						
Goodwill	(168.6)	(159.8)	(35.7)	(40.3)	-	-
Intangible assets	(22.3)	(22.4)	(12.9)	(13.3)	(3.4)	(4.0)
Material holdings (50%)	-	-	-	-	(33.1)	(35.7)
Total Tier 1 capital after deductions	**719.0**	**690.9**	**799.0**	**759.1**	**764.6**	**716.7**
Tier 2						
Subordinated debt	204.4	207.8	204.4	207.8	216.9	220.3
Collective impairment allowance	21.2	29.6	21.2	29.6	21.2	29.6
Total Tier 2 capital	**225.6**	**237.4**	**225.6**	**237.4**	**238.1**	**249.9**
Deductions from Tier 1 and Tier 2 capital:						
Investment in subsidiary companies	-	-	(96.4)	(84.0)	(121.4)	(108.9)
Material holdings (50%)	-	-	-	-	(33.1)	(35.7)
Total capital after deductions	**944.6**	**928.3**	**928.2**	**912.5**	**848.2**	**822.0**

4.2 Tier 1 capital

Tier 1 capital comprises internally generated capital from retained profits and issued capital in the form of Permanent Interest Bearing Shares (PIBS). For capital purposes unrealised gains / losses on available-for-sale debt securities and cash flow hedges are removed from reserves in accordance with GENPRU 1.3.36. In addition, an adjustment has been made for the pension fund obligation as permitted by GENPRU 1.3.9.

All PIBS 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, creditors and investment members of the Society. Under the FSA rules PIBS are included in the Group's capital resources in accordance with UK GAAP rather than IFRS.

The regulatory capital rules allow the pension fund deficit, which for accounting purposes is deducted from reserves, to be added back to reserves and instead a deduction is made for the cash that is expected to be paid in addition to the normal contributions over the next five years.

Goodwill and intangible assets are deducted from capital for regulatory purposes.

[1] The Group is not required by the FSA to hold a minimum level of capital at a full consolidation group level.

4.3 Tier 2 capital

Tier 2 capital comprises subordinated debt and collective impairment allowances. Under GENPRU 2.2.46 Tier 2 capital cannot exceed 50% of total Tier 1 capital. As demonstrated in the table on the previous page this requirement is satisfied at all three levels of consolidation.

The subordinated note holders' rights are subordinated to those of the depositors and other creditors. Further details regarding subordinated debt are set out in note 29 of the Group's 2010 Annual Report and Accounts. Under FSA rules subordinated debt is included in the Group's capital resources in accordance with UK GAAP rather than IFRS. In the last five years to maturity subordinated debt instruments are amortised down to zero on a straight line basis in accordance with GENPRU 2.2.196.

4.4 UK and Solo consolidation

At a Solo consolidation level the cost of investment classed as material holdings outside the Solo consolidation group is required to be deducted from capital resources. A material holding represents an investment in a financial institution or credit institution which exceeds 10% of the share capital of the issuer, eg the Society's investment in Skipton International Limited. This deduction is split equally between Tier 1 and Tier 2.

At both a UK and a Solo consolidation level the cost of investment in subsidiary companies outside the group is required to be deducted from Tier 1 and Tier 2 capital, to the extent it is not deducted as a material holding, in accordance with the GENPRU 2.2.239.

5.0 Capital adequacy

5.1 Summary of approach to capital adequacy planning

Capital is held by the Group to absorb losses which may occur during the economic cycle. The Internal Capital Adequacy Assessment Process (ICAAP) is the means by which the Group ensures:

- it has sufficient levels of capital resources to pursue the corporate objectives as set out in the Group Corporate Plan in light of the risks it faces; and
- it has sufficient capital resources to trade through a variety of scenarios including a severe recession, if necessary by applying appropriate management actions.

In formulating the Group's three year Corporate Plan, the Board considers its overall objectives and evaluates these in light of its agreed risk appetite statement.

Under FSA rules (Pillar 1) a minimum level of capital must be held for credit risk, operational risk and market risk for the Solo and UK consolidation groups. The Group has adopted the standardised approach to calculate the minimum regulatory capital resource requirement for credit risk and operational risk, and market risk has been calculated under the Position Risk Requirement (PRR) approach.

The table below sets out the minimum capital resources requirements (Pillar 1) for the Solo, UK and full consolidation groups, together with their capital adequacy positions as at 31 December 2010.

	2010 Full group[2] £m	2009 Full group £m	2010 UK group £m	2009 UK group £m	2010 Solo group £m	2009 Solo group £m
Credit Risk (Standardised)	401.7	454.6	396.0	449.1	385.3	437.5
Operational Risk (Standardised)	53.0	57.8	23.2	26.1	3.3	4.0
Market Risk (Foreign Exchange PRR)	0.5	0.6	-	0.1	-	-
Total minimum capital requirement	**455.2**	**513.0**	**419.2**	**475.3**	**388.6**	**441.5**
Total capital resources (section 4.1)	**944.6**	**928.3**	**928.2**	**912.5**	**848.2**	**822.0**
Excess of own funds over minimum capital requirement under Pillar 1	**489.4**	**415.3**	**509.0**	**437.2**	**459.6**	**380.5**
Capital ratio (%)	**207.5%**	**181.0%**	**221.4%**	**192.0%**	**218.3%**	**186.2%**

5.2 Capital reporting

The Pillar 1 regulatory capital adequacy of the Solo and UK consolidation groups is reported to the FSA quarterly and bi-annually respectively. Pillar 1 minimum capital adequacy at both a Solo and UK consolidation group level is also reported (actual and forecast) to the Board monthly.

The results of the ICAAP are articulated in a single document which is reviewed and approved by the Board and updated at least annually and more frequently should a significant change in the Group's risk profile occur. The Board also receive summarised updates of the ICAAP document during the course of the year.

5.3 Transferability of capital

In order to ensure the greatest degree of flexibility in the allocation of capital, the Board aims to retain the maximum possible level of capital in the Solo consolidation group and UK consolidation group – the regulated entities. However, this broad principle is subject to a number of regulatory, taxation and commercial considerations which are considered before any decisions regarding dividend payments from group entities are finalised. There are no current or foreseeable material, practical or legal impediments to the prompt repayment of liabilities among the Society and its subsidiary undertakings.

[2] The Group is not required by the FSA to hold a minimum level of capital at a full consolidation group level.

6.0 Minimum capital requirement – Pillar 1

This section sets out the details of each of the Pillar 1 components: credit risk; operational risk, and market risk. Each subsection includes the minimum capital component for the full consolidation group, the UK consolidation group and the Solo consolidation group.

6.1 Credit risk overview

Credit risk is defined as the current or prospective loss to earnings and impact to capital arising from lending as a result of counterparties defaulting on their obligations due to the Group. The Group faces this risk in respect of:

- individual customers (residential retail lending);
- businesses (through historical commercial lending). The Society ceased new commercial lending in November 2008 when it was concluded that the outlook for commercial property was poor; and
- other financial institutions (wholesale lending).

Changes in the credit quality and the recoverability of loans and amounts due from counterparties influence the Group's exposure to credit risk. Adverse changes in the credit quality of counterparties, collateral values or deterioration in the wider economy, including rising unemployment, deterioration in household finances and further 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. A reversal of the economic recovery and continuation of the falls in house prices and commercial property values could affect the level of impairment losses.

The Group has embedded a comprehensive and robust risk management framework with clear lines of accountability and oversight as part of its overall governance framework. The Group has effective processes and policies to monitor, control, mitigate and manage credit risk within the Group's credit risk appetite. The Group has adopted the standardised approach for calculating the Pillar 1 capital requirements for all categories of credit risk.

	Exposure value £m	Capital requirement £m
Corporates – other lending to corporates	30.6	2.5
Retail – debt factoring loans	31.8	1.9
Secured on real estate property	9,254.7	306.6
Past due items	340.2	28.5
Other items	30.8	1.2
Total loans and advances to customers	**9,688.1**	**340.7**
Central governments or central banks	2,038.1	-
Regional governments or local authorities	0.5	-
Multilateral development banks	301.6	-
Financial institutions	523.9	11.6
Securitisation positions – see section 6.1.7	281.8	12.4
Short-term claims on institutions and corporates	233.6	3.7
Total wholesale lending	**3,379.5**	**27.7**
Other items – eg fixed assets, derivatives, and sundry debtors	503.4	33.3
Total other	**503.4**	**33.3**
Total	**13,571.0**	**401.7**

The following table details the minimum capital requirement for credit risk for the UK consolidation group as at 31 December 2010 broken down by exposure value.

	Exposure value £m	Capital requirement £m
Corporates – other lending to corporates	30.6	2.5
Retail – debt factoring loans	31.8	1.9
Secured on real estate property	9,257.3	306.7
Past due items	340.2	28.5
Other items	25.5	0.7
Total loans and advances to customers	**9,685.4**	**340.3**
Central governments or central banks	2,038.1	-
Regional governments or local authorities	0.5	-
Multilateral development banks	301.6	-
Financial institutions	507.4	11.3
Securitisation positions – see section 6.1.7	281.8	12.4
Short term claims on institutions and corporates	233.6	3.7
Total wholesale lending	**3,363.0**	**27.4**
Other items – eg fixed assets, derivatives, and sundry debtors	440.0	28.3
Total other	**440.0**	**28.3**
Total	**13,488.4**	**396.0**

The following table details the minimum capital requirement for credit risk for the Solo consolidation group as at 31 December 2010 broken down by exposure value.

	Exposure value £m	Capital requirement £m
Corporates – other lending to corporates	22.2	1.8
Retail – other	0.7	-
Secured on real estate property	8,801.0	293.5
Past due items	338.9	28.4
Other items	-	-
Total loans and advances to customers	**9,162.8**	**323.7**
Central governments or central banks	2,038.1	-
Regional governments or local authorities	0.5	-
Multilateral development banks	301.6	-
Financial institutions	459.6	10.2
Securitisation positions – see section 6.1.7	281.8	12.4
Short term claims on institutions and corporates	233.6	3.7
Total wholesale lending	**3,315.2**	**26.3**
Other items – eg fixed assets, derivatives, and sundry debtors	502.2	35.3
Total other	**502.2**	**35.3**
Total	**12,980.2**	**385.3**

6.1.1 Credit risk: loans and advances to customers

The Group actively lends in the prime residential (inclusive of buy to let) UK mortgage market through Skipton Building Society and via Skipton International Ltd across the Channel Islands.

Retail Credit Risk is managed in accordance with Board approved risk appetite and lending policy. The risk appetite defines a series of Board approved limits regarding customer and collateral credit quality which all lending activity must adhere to. Lending policy defines the Board's approach to credit granting. Lending policy and risk appetite are subject to regular review and annual Board approval. The credit decision process is achieved by automated credit scoring and policy rules with lending policy criteria supporting manual underwriting process. All aspects of the credit decision process are subject to regular development, validation and independent review ensuring they support decisions in line with Board expectations.

The Group also retains credit exposures through Amber Homeloans and North Yorkshire Mortgages which comprises residential (inclusive of buy to let) UK mortgages across prime and sub-prime markets. These portfolios were closed to new lending in 2008 and are subject to ongoing monitoring of credit performance.

The Retail Credit Committee provides oversight to the effectiveness of retail credit risk management across the Group.

The table below sets out the gross credit risk arising from loans and advances to customers.

			2010	
	Full group 09 / 10 average £m	**Full consolidation group £m**	**UK consolidation group £m**	**Solo consolidation group £m**
Total residential mortgages	9,602.3	9,092.7	9,095.2	8,637.7
Commercial loans	512.6	501.2	501.2	501.2
Other lending:				
Debt factoring loans	36.1	39.5	39.5	-
Other loans	49.6	54.7	49.5	23.9
Gross balances	**10,200.6**	**9,688.1**	**9,685.4**	**9,162.8**
Impairment provisions	(82.2)	(79.4)	(79.4)	(78.7)
Fair value adjustment	195.7	206.0	206.0	201.9
Total	**10,314.1**	**9,814.7**	**9,812.0**	**9,286.0**

Commercial lending

Skipton Building Society retains a commercial loan portfolio which is UK based and is closed to new lending. This portfolio is subject to ongoing monitoring of credit performance supporting the management of the Society and counterparty interests. The RCC provides oversight to the effectiveness of commercial credit risk management across the Group. The table below sets out the Skipton Group's commercial loan exposure by industry type. The commercial loan exposures are held by the Society.

	2010 £m
Leisure and hotel	47.7
Retail	17.6
Nursing / residential homes	32.7
Offices	17.5
Commercial investment and industrial units	358.9
Miscellaneous	26.8
Total	**501.2**

Credit exposures are well diversified geographically at a regional level, controlled via risk appetite limits and subject to regular review. Controls and monitoring are in place to minimise geographic concentrations at more granular levels ie postcode areas, industry type etc.

6.1.2 Credit risk: wholesale lending

The Group's Market Risk function oversees credit control of the Group's Treasury assets, in terms of country, sovereign and financial institution exposures. 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. This element of credit risk is managed by the Treasury function within the strict limits set by ALCO with a regular review of credit policies and performance through the Wholesale Credit Committee.

The table below sets out the liquidity book by industry sector / asset class.

			2010	
	Full group 09/10 average £m	**Full consolidation group £m**	**UK consolidation group £m**	**Solo consolidation group £m**
Cash in hand and balances with the Bank of England	968.3	664.6	664.5	664.5
Cash with banks and building societies	366.0	294.6	278.2	258.9
Gilts	176.8	200.8	200.8	200.8
Treasury bills	374.7	749.4	749.4	749.4
Certificates of deposit	554.5	205.4	205.4	205.4
Local authority investments	5.5	0.5	0.5	0.5
Fixed rate bonds	368.2	452.6	452.6	452.6
Floating rate notes	607.8	530.8	530.8	502.6
Residential mortgage backed securities	244.6	233.3	233.3	233.3
Commercial mortgage backed securities	52.9	47.7	47.7	47.7
Total	**3,719.3**	**3,379.7**	**3,363.2**	**3,315.7**

This table clearly shows that the Group has a suitably varied liquidity portfolio and does not have significant exposures concentrated to one specific asset class. The table below sets out the maturity of the liquidity book.

		2010	
	Full consolidation group £m	**UK consolidation group £m**	**Solo consolidation group £m**
Loans and advances to credit institutions			
Repayable on demand	101.9	86.5	68.5
In not more than three months	184.9	183.9	183.9
In more than one year	7.1	7.1	7.1
	293.9	**277.5**	**259.5**
Debt securities			
In not more than one year	1,100.6	1,100.6	1,089.3
In more than one year	1,320.6	1,320.6	1,302.4
	2,421.2	**2,421.2**	**2,391.7**
Cash in hand and balances with the Bank of England			
Repayable on demand	664.6	664.5	664.5
	664.6	**664.5**	**664.5**
Total	**3,379.7**	**3,363.2**	**3,315.7**

The table below sets out the capital held for the liquidity book by credit rating.

Rating	Full consolidation group Exposure £m	Full consolidation group Capital £m	UK consolidation group Exposure £m	UK consolidation group Capital £m	Solo consolidation group Exposure £m	Solo consolidation group Capital £m
Aaa	2,572.6	3.7	2,572.5	3.7	2,572.5	3.7
Aa1	82.6	1.3	81.8	1.3	76.8	1.2
Aa2	171.5	2.7	169.1	2.6	159.3	2.5
Aa3	307.6	5.0	295.6	4.8	283.7	4.6
A1	153.5	4.0	153.5	4.0	142.1	3.8
A2	9.3	0.2	9.3	0.2	9.3	0.2
A3	25.1	0.9	24.0	0.9	24.0	0.9
Baa1	6.3	0.5	6.3	0.5	6.3	0.5
Baa2	6.7	0.5	6.6	0.5	6.6	0.5
Baa3	34.7	1.5	34.7	1.5	25.0	1.0
Caa1	7.4	7.4	7.4	7.4	7.4	7.4
Unrated:						
Building societies	3.0	-	3.0	-	3.0	-
Local authorities	0.5	-	0.5	-	0.5	-
Total	**3,380.8**	**27.7**	**3,364.3**	**27.4**	**3,316.5**	**26.3**

The Group's treasury investments are held to provide actual liquidity and 98% of these investments are rated A3 or better (as shown above).

The Group's policy is that initial investments in treasury assets must be investment grade or above.

Within the treasury investments portfolio, the Group has no direct sovereign exposure to Greece, Ireland, Italy, Portugal and Spain ('GIIPS') as at 31 December 2010. The Group does have £38m of senior debt exposure to financial institutions based in Ireland. However, whilst the economic environment in Ireland remains very challenging, we do not currently expect any impairment to be required.

The table below sets out the capital held for the liquidity book by geographical region.

Geographical region	Full consolidation group Exposure £m	Full consolidation group Capital £m	UK consolidation group Exposure £m	UK consolidation group Capital £m	Solo consolidation group Exposure £m	Solo consolidation group Capital £m
UK	2,632.1	18.5	2,618.7	18.2	2,601.9	17.8
Rest of Europe	622.4	6.5	622.4	6.5	596.4	5.9
Far East	2.9	0.1	2.9	0.1	2.9	0.1
North America	81.2	1.3	81.1	1.3	76.1	1.2
Australasia	42.2	1.3	39.2	1.3	39.2	1.3
Total	**3,380.8**	**27.7**	**3,364.3**	**27.4**	**3,316.5**	**26.3**

To obtain the risk weights and hence calculate the minimum credit risk capital requirement for wholesale lending exposures, Skipton uses Moody's, Fitch and Standard & Poor's as External Credit Assessment Institutions (ECAIs). The Group's preference is to use the long-term rating; however, the short-term rating is used if this is unavailable. For asset-backed securities, the issue rating is used. This process is documented within the Treasury Policy and is supported by Treasury credit procedures.

The table below sets out exposure values and risk weightings associated with each credit quality step under the standardised approach (asset-backed securities are covered in section 6.1.7).

Central Governments and Central Banks				
Credit quality step	**Maturity**	**Risk weighting**	**Moody's[3] ratings**	**Exposure values £m**
1	-	0%	Aaa	**2,038.1**

Regional Governments and Local Authorities				
Credit quality step	**Maturity**	**Risk weighting**	**Moody's ratings**	**Exposure values £m**
Unrated	-	20%	Unrated	**0.5**

Multilateral Development Banks				
Credit quality step	**Maturity**	**Risk weighting**	**Moody's ratings**	**Exposure values £m**
1	-	0%	Aaa	**301.6**

Financial Institutions				
Credit quality step	**Maturity**	**Risk weighting**	**Moody's ratings**	**Exposure values £m**
1	-	20%	Aaa to Aa3	531.2
2	Residual / original maturity < 3 months	20%	A1 to A3	75.3
2	Original maturity > 3 months	50%	A1 to A3	110.4
3	Original maturity > 3 months	50%	Baa1 to Baa3	37.6
Unrated	-	20%	Unrated	3.0
				757.5

Residential Mortgage Backed Securities				
Credit quality step	**Maturity**	**Risk weighting**	**Moody's ratings**	**Exposure values £m**
1	-	20%	Aaa to Aa3	231.1
2	-	50%	A1 to A3	2.2
				233.3

Commercial Mortgage Backed Securities				
Credit quality step	**Maturity**	**Risk weighting**	**Moody's ratings**	**Exposure values £m**
1	-	20%	Aaa to Aa3	31.0
3	-	100%	Baa1 to Baa3	10.1
5	-	1250%	B1 and below	7.4
				48.5

Full group total	**3,379.5**

[3] The Group uses Moody's, Fitch and Standard and Poor's, however, the preference is to use Moody's and that is why the table shows Moody's ratings.

6.1.3 Concentration risk

Concentration risk is the risk that the Group suffers losses from being over-exposed to sectoral, geographic, product type or other portfolio concentrations.

Both retail mortgage and commercial lending concentration risk is managed within the risk appetite set by the Board, including specific sectoral, geographic and product type limits. RCC monitors and reports on concentration risk monthly.

Exposure limits are monitored and controlled within the operational underwriting area via system driven limits, strong mandate controls and are independently reviewed by the Policy and Assurance unit within Credit Risk.

Credit exposures are well diversified geographically at a regional level controlled via risk appetite limits and are subject to regular review.

ALCO sets policy limits to manage Treasury credit risk concentrations. ALCO monitors adherence to aggregate counterparty, geographic, asset class, and economic sector exposures monthly.

6.1.4 Impairment

Impairment of loans and advances to customers

The Group assesses monthly the trends of balances of those financial assets or groups of financial assets that are impaired, with RCC and the Board receiving trend and emergence analysis relating to each sector of the secured lending portfolio in respect of residential and commercial assets. At each balance sheet date RCC considers the level of provisions and takes into account the effect of expected macroeconomic factors, such as unemployment and house prices. In turn these impact on the performing portfolios for the calculation of collective impairment, and the quantum assessed to meet any losses which may arise as a result of ultimate foreclosure.

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 are experiencing significant financial difficulty, default or delinquency in interest or principal payments, or the debt being renegotiated to reduce the burden on the borrower. Based upon these assessments an individual impairment reduction of these assets is made.

As part of our strategy to support customers in arrears the Group applies a policy of capitalising residential arrears, with the customer’s consent, once the customer has made at least six consecutive contractual monthly mortgage repayments following the instance of non-payment. The effect is to bring the loan account up to date and it is therefore no longer past due or individually impaired. If a customer’s arrears have previously been capitalised, the customer is required to have made at least 12 consecutive contractual monthly repayments in order to qualify for further capitalisation.

The Society applies a similar policy for its commercial loan book as for its residential book, whereby customer arrears can be capitalised following six consecutive contractual monthly repayments following the instance of non-payment, or 12 such repayments if the account has previously had arrears capitalised.

For the purposes of the information set out in this document ‘past due’ is defined as one day over the date of which a monthly contractual instalment is due.

The following table shows the balance of those loans that have been renegotiated during the year to 31 December 2010 and would have been past due or impaired if their terms had not been renegotiated:

	Full group £m 2010	Full group £m 2009	UK group £m 2010	UK group £m 2009	Solo group £m 2010	Solo group £m 2009
Residential	**114.9**	94.3	**114.9**	94.3	**113.8**	88.7
Commercial	**6.2**	11.1	**6.2**	11.1	**6.2**	11.1

The level of capitalised arrears is built into the loan impairment models utilised by the group.

The table below provides further information on residential loans and advances by payment due status.

	2010		
	Full consolidation group £m	**UK consolidation group £m**	**Solo consolidation group £m**
Neither past due nor individually impaired	8,542.2	8,544.7	8,093.8
Past due but not individually impaired:			
Up to 3 months	91.1	91.1	85.9
3 to 6 months	15.1	15.1	13.7
6 to 9 months	4.8	4.8	4.8
9 to 12 months	3.3	3.3	3.3
Over 12 months	4.3	4.3	4.3
Total	**8,660.8**	**8,663.3**	**8,205.8**
Individually impaired	406.6	406.6	406.6
Possessions	25.3	25.3	25.3
Total	**9,092.7**	**9,095.2**	**8,637.7**

The overall exposure is greater at a UK consolidation group level than a full group level due to consolidation adjustments made at a full group level for Connells' procuration fees. Connells 'sits' outside the UK consolidation group.

The table below provides further information on commercial loans and advances by payment due status.

Full consolidation group, UK consolidation and Solo group	**2010 £m**
Neither past due nor individually impaired	475.1
Past due but not individually impaired:	
Up to 3 months	5.4
3 to 6 months	1.7
6 to 9 months	1.6
9 to 12 months	-
Over 12 months	-
Total	**483.8**
Individually impaired	17.2
Possessions	0.2
Total	**501.2**

The table below sets out the impairment losses on loans and advances for the full group and UK consolidation group for the year ended 31 December 2010.

Full group and UK consolidation group	**Loans fully secured on residential property**	**Loans fully secured on land**	**Other loans**	**Total**
	£m	**£m**	**£m**	**£m**
At 1 January 2010				
Individual impairment	50.8	1.8	2.9	55.5
Collective impairment	24.3	5.3	-	29.6
	75.1	**7.1**	**2.9**	**85.1**
Transfer of engagements				
Individual impairment	-	-	-	-
Collective impairment	0.5	0.1	-	0.6
	0.5	**0.1**	**-**	**0.6**
Amounts written off during the year				
Individual impairment	(20.4)	(0.5)	(0.2)	(21.1)
	(20.4)	**(0.5)**	**(0.2)**	**(21.1)**
Unwind of merger fair value adjustments				
Collective impairment	(1.7)	-	-	(1.7)
	(1.7)	**-**	**-**	**(1.7)**
Income Statement				
Impairment losses on loans and advances				
Individual impairment	13.3	0.9	10.2	24.4
Collective impairment	(3.9)	(3.4)	-	(7.3)
	9.4	**(2.5)**	**10.2**	**17.1**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year				
Individual impairment	(0.6)	-	-	(0.6)
Charge for the year	**7.1**	**(2.5)**	**10.2**	**14.8**
At 31 December 2010				
Individual impairment	**43.1**	**2.2**	**12.9**	**58.2**
Collective impairment	**19.2**	**2.0**	**-**	**21.2**
	62.3	**4.2**	**12.9**	**79.4**

The Group's impairment charge on loans and advances reduced year-on-year to £15m (2009: £44m). The reduction is mainly due to the Group's action to proactively manage loans which have gone into arrears whilst supporting such customers where possible especially within the Amber Homeloans and North Yorkshire Mortgages portfolios. In the Society an impairment charge of £13m (2009: £10m) was recognised.

The loan books in our Guernsey based subsidiary, Skipton International, and our debt factoring business, Skipton Business Finance, remain of high quality and the charge for impairment losses on these loans remains negligible at £0.4m (2009: £0.4m) for the year.

Skipton International and Skipton Business Finance are the only lending entities that sit outside the Solo consolidation Group. The overall impairment at a Solo consolidation level for the year ended 31 December 2010 was therefore only £0.4m lower than the full group and UK consolidation Group which are set out above.

Impairment of treasury assets

The table below sets out the Treasury asset loan impairment position for the Skipton Group for the year ended 31 December 2010 which is the same for all levels of consolidation.

Full consolidation group, UK consolidation and Solo group	**£m**
At 1 January 2010	
Individual impairment	0.8
Amounts written off during the year	
Individual impairment	-
Income Statement	
Impairment losses on treasury assets	
Individual impairment	-
Adjustment to impairment losses on loans and advances resulting from recoveries during the year	
Individual impairment	-
Charge for the year	-
At 31 December 2010	
Individual impairment	0.8
	0.8

6.1.5 Credit risk mitigation

The Group has available to it a variety of methods and techniques to reduce the credit risk of its lending predicated on a principle of forbearance where borrowers are experiencing periods of difficulties in servicing their loans. The Group employs staff with considerable experience in individually assessing borrowers' financial capability and to assist borrowers accordingly where it is practical and within a Treating Customers Fairly framework. This may include advising them of interim arrangements open to them to assist in periods of difficulty or recommending external resources that could be accessed including relevant debt counselling services.

Residential mortgages

Residential lending secured against a property is only permitted if the property is insured for normal property damage perils. Borrowers may also seek to protect against loss of earnings as a result of sickness and unemployment by purchasing an optional mortgage payment protection policy.

The ultimate source of collateral and final recourse for credit risk mitigation remains the borrower's property in the event of a borrower defaulting on their loan. The extent of mitigation is predetermined by the original and current loan-to-value (LTV) assessed by either a valuation conducted by a suitably qualified professional firm or, in instances of lower LTV lending, by employing an Automatic Valuation Model which is subject to conditions and key assumptions agreed ultimately by RCC and set within the lending criteria.

Commercial mortgages

The commercial property is the primary source of collateral utilised for credit risk mitigation and in all instances will be secured by way of first legal charge over the freehold or long leasehold property. The primary security may be supplemented, depending on the nature and amount of the loan and the security offered, by other forms of security deemed appropriate and considered on a case by case basis. The forms of additional security could comprise legal undertakings, mortgage debentures, equitable charges and personal guarantees or as sanctioned by the Commercial Underwriting team who are suitably experienced to make these determinations. The Group ceased originations of new commercial lending during 2008 but will consider alterations to present commercial borrowings on a case by case basis.

For all commercial securities, valuations are always undertaken prior to inception of the loan by suitably qualified professionals with relevant expertise in commercial properties and the Group may seek subsequent valuations as it is deemed appropriate. The legal documentation is performed by reference to selected solicitors acting for the Group and appointed to ensure that the covenants are robust and enforceable in addition to the validity of any additional security afforded or required as a condition of our loan.

For a commercial security the requirement for insurance is considered. Such insurance must be taken out and maintained for the duration of the loan in relation to normal property damage perils and must protect against insurable events. Other specialist insurance risk coverage may be requested at the discretion of the Group on a case by case basis.

6.1.6 Credit derivatives

The Group does not currently use credit derivatives for risk mitigation.

6.1.7 Securitisation

The Group did not have any securitisation issues in existence at 31 December 2010; however the Group's inaugural securitisation issue took place on 31 March 2011. The Group does have exposure to Mortgage Backed Securities (see section 6.1.2).

6.1.8 Derivative counterparty credit risk mitigation

The Group uses derivative instruments (interest rate, foreign currency and equity) to hedge its exposure to market risk. Credit Support Annexes (CSA) that are collateralised with cash exist for collateralising derivative transactions with counterparties to which the Group has its largest derivatives exposures. The CSA counterparties are banks that satisfy the credit assessment process specified in the Society's Wholesale Credit Policy.

The Group measures derivative counterparty credit exposure values using the counterparty credit risk mark to market method. This exposure value is derived by adding the net market value of the contract (replacement cost) to the contract's potential credit exposure, which is derived by applying a multiple based on the contract's residual maturity to the notional value of the contract.

The total exposure value on derivative counterparty credit risk exposures at 31 December 2010 was:

Derivative exposures	**Full consolidation group £m**	**UK consolidation group £m**	**Solo consolidation group £m**
Total exposure excluding CSA deposits	103.0	103.0	103.0
Netting benefits	-	-	-
Exclude intra-group exposures	(11.5)	(11.5)	(6.0)
Exclude collateral deposited with the Group	(16.3)	(16.3)	(16.3)
Total exposure	**75.2**	**75.2**	**80.7**

The total exposure value by credit quality step at 31 December 2010 was:

Financial Derivative Exposure Values						
Credit quality step	**Maturity**	**Risk weight**	**Moody's ratings**	**Full consol £m**	**UK consol £m**	**Solo consol £m**
1	-	20%	Aaa to Aa3	74.2	74.2	74.2
2	Original maturity > 3 months	50%	A1 to A3	1.0	1.0	1.0
Unrated	-	20%	Unrated	-	-	5.5
Total				**75.2**	**75.2**	**80.7**

Wrong-way risk may occur when exposure to a counterparty is adversely correlated with credit quality of the counterparty. The Society has minimal exposure.

The Society holds Credit Support Annex agreements with derivative counterparties in which collateral is either placed with a counterparty, if the net market value of the derivatives is in favour of the counterparty, or received by the Society, if the net market value of the derivatives is in favour of the Society. If the Society were to be downgraded, there would be no impact on the collateral required.

6.2 Operational risk

The Society has adopted the standardised approach to operational risk, compliant with the requirements of BIPRU 6, and has defined operational risk as “the risk of loss arising from inadequate or failed internal processes, people or systems or from external events”. This definition includes legal, financial (the risk of loss arising from poor financial control) and reputational risk.

6.2.1 Operational risk oversight and governance

Operational risk management is overseen by an executive Group Operational Risk Committee (GORC) that reviews the Group’s operational risk management framework and standards, monitors the Group’s exposure to operational risks and reviews the framework for measuring and controlling these risks. GORC also makes recommendations in relation to control improvements and is responsible for making recommendations to the Board Risk Committee on what the operational risk appetite should be, which is defined at divisional level.

6.2.2 Operational risk framework

Through the 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
- Customer / Client Experience
- Financial Management & Management Information
- Fraud
- Information Security
- Information Technology
- Legal & Regulatory
- People
- Premises
- Process
- Third Party Relationships

Each business entity within the Group has nominated “Risk Champions”, who are supported by a central operational risk function to ensure consistency across the Group, consolidating, analysing and challenging line management in its assessment of risk, proposed actions and timelines. This independent function reports on the key operational risks facing the business to GORC bi-monthly (via the Board Risk Committee quarterly).

At an operational level, the Group manages its operational risk exposures through a framework of internal controls and risk mitigation techniques such as insurance and business continuity planning. Risks are monitored through a risk and control self-assessment process and analysis of actual loss and ‘near miss’ data. Operational risk self-assessment is undertaken by each business unit quarterly, specifying the likelihood and financial impact of specific operational risk events (analysed by each operational risk sub-category). Consolidated outputs of the self-assessment process are reviewed by the Divisional / Operational Board of each Group entity at least annually.

Given the nature of the regulated sectors in which the Group operates one of the key operational risks is the potential failure to maintain ongoing compliance with relevant external regulation across the Group. Each of the regulated businesses has an established Compliance team which both monitors compliance with existing legislation and considers the impact of new requirements. Oversight is provided by a central Compliance function which ensures best practice is adhered to and shared across the Group as appropriate.

The FSA initiated a market-wide review of the sale of Mortgage Payment Protection and Payment Protection Policies during 2010. Four businesses within the Group have sold such policies and while initial review suggests that appropriate sales practices have been employed, the FSA's proposed approach to reviewing such sales is rigorous and could see unexpected compensation payments, however these are not expected to materially impact the Group's performance.

6.2.3 Minimum capital resources requirement for operational risk (Pillar 1)

Through its adoption of the standardised approach to operational risk management, the Society calculates its Pillar 1 capital requirement for operational risk, based upon the sum of the average of three years' net income, segmented by business line and multiplied by the published regulatory 'beta factors'.

As at 31 December 2010 this approach resulted in the Pillar 1 minimum capital requirements as follows:

Pillar 1	Full consolidation group £m	UK consolidation group £m	Solo consolidation group £m
Operational risk capital requirement	**53.0**	**23.2**	**3.3**

6.3 Market risk

Market risk is the risk that the value of, or income from, the Group's assets and liabilities is impacted as a result of changes in market risk factors. The Group's market risk factors comprise three types of risk: interest rate risk, currency risk and equity risk. The other standard risk factor is commodity prices, which does not impact the Group.

ALCO provides oversight of the effectiveness of the control framework in place to manage market risk.

6.3.1 Interest rate risk

This is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Interest rate risk arises from the mortgage, 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 reported to ALCO monthly. This risk is managed through the use of appropriate derivatives, with established risk limits and other control procedures.

The interest rate exposures during 2010 were as follows:

	As at 31 December £m	Average £m	High £m	Low £m	Board Limit at 31 December £m
Static Earnings-at-risk	1.8	3.4	5.4	1.7	8.2
Historical Value-at-risk	1.0	0.9	2.4	0.1	6.2
2% Parallel interest rate shift	11.1	6.5	19.1	-	25.0

6.3.2 Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

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 issuance denominated in foreign currency is immediately swapped into GBP. The exception to this is the Group's equity investments in Jade Software Corporation 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 material and are not hedged, but are recognised in the Group's translation reserve.

The Group has a small exposure to foreign currency interest rates at the year end arising from a hedging mismatch on a Sterling mortgage product whose rate is linked to US Dollar interest rates. In addition, the Group has Euro debt issuances, however due to the effect of cross currency swaps the net exposure is immaterial.

The Group's exposure to foreign exchange risk is calculated in accordance with BIPRU 7.5, representing 8% of the net sterling equivalent of the foreign currency assets and liabilities. As at 31 December 2010, the foreign currency risk capital requirement was as follows:

Pillar 1	**Full consolidation group £m**	**UK consolidation group £m**	**Solo consolidation group £m**
Foreign exchange risk capital requirement	**0.5**	**-**	**-**

6.3.3 Equity risk

Equity risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in equity stock markets. The Group's policy is to have no material exposure to equity risk which is evidenced by both valuation and notional balance positions. ALCO monitors any exposure monthly.

As at 31 December 2010, the Group had £179.7m of equity related savings balances which were fully hedged. Therefore, the Group's exposure to equity risk, net of hedging, is immaterial.

7.0 Other risks faced by the business

This section sets out the other risks faced by the business above and beyond the Pillar 1 risks set out in section 6 above.

7.1 Business risk

The Skipton Group is almost solely focused in the UK market and the main divisions are in large part 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 (Base and LIBOR);
- inflation;
- unemployment; and
- the housing market (volume of transactions and house price inflation).

The Mortgage and Savings division continued to face challenges from the low interest rate environment in 2010. Although net interest margin improved, it remains under continuing pressure. The margin compression continues to be exacerbated by the dislocation in the retail savings market following the credit crunch and the Society, as with all banks and building societies, has had to reduce its reliance on wholesale funding. Although residential impairment levels have reduced, the prospect of increasing unemployment and the reduction in refinancing opportunities, compounded by weaker asset prices will present continued challenge.

The Society took decisive action to remove the Standard Variable Rate ('SVR') cap from 1 March 2010, and increase its SVR to 4.95%. This was taken in response to exceptional circumstances within the economy, in particular the historically low level of Bank Base Rate. The Society has committed to re-impose the cap once 'exceptional circumstances' (as defined to affected borrowers) no longer prevail.

The Mortgage Services division is impacted by the changing dynamic in the lending landscape as the impact of the credit crunch changes the share of competition in the UK mortgage market, with a reduction in the overall level of mortgage lending. Whilst, inevitably, the business has seen a fall in the value of assets it manages, due in part to increased forbearance by its clients and the weak recovery of the economy this has been partially offset by arrears management fees.

The performance of the Estate Agency division is principally driven by the volume of property transactions, particularly second hand property sales. This market is heavily influenced by consumer confidence, much of which is borne out of the overall level of unemployment and interest rates. The Estate Agency division has a partial counter-cyclical hedge against the performance of its core business through its Asset Management businesses that assist lenders in their management of non-performing loans.

The Financial Advice division is also exposed to the wider UK economy. The main influence on its performance is consumer confidence and the willingness of customers to invest in longer-term products.

7.2 Liquidity risk

This is the risk that the Group is unable to meet its current and future financial obligations as they fall due. These obligations include investors' deposits as well as repayments of other borrowings and loan capital.

The Board 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 personnel (ie independent of Treasury). In addition, a series of liquidity stress tests are performed weekly by Market Risk and formally reported to ALCO monthly, to ensure the Group maintains adequate liquidity for business purposes even under stressed conditions. If at any time the test results forecast that the Society may be approaching the limits set by ALCO, action can be taken in line with the documented Contingency Funding Plan. These tests include idiosyncratic stresses, a market wide stress and combinations of both.

The wholesale markets remain constrained and opportunities for the Group to raise longer-term unsecured funding in public debt markets remain limited.

The majority of our funding comes from retail sources and we have been successful in attracting such balances in recent years. As savers continue to demand a safe haven for their deposits we will continue to offer good value products to attract further balances.

We continue to maintain a close watching brief on the money markets, but until such times as we believe the markets are returning to more normal conditions we will continue to hold high levels of liquidity and fund growth in lending from retail balances.

The FSA introduced new requirements (PS09/16 Strengthening Liquidity Standards) for liquidity management and reporting applicable from June 2010. The Society has made significant investment in its infrastructure to comply with this and is compliant with the new regulatory requirements. The Board operates an Internal Liquidity Adequacy Assessment ('ILAA') process which analyses the Society's current and future liquidity requirements. The Board has defined its liquidity risk appetite which is monitored daily. Since the introduction of the new liquidity regime regulations, the Society has satisfied all its liquidity risk appetite tests at all times.

7.3 Pension obligation risk

Pension obligation risk is the risk that the Group's obligations towards its pension schemes may lead to the Group not being able to pay its other liabilities as they fall due; and the risk that an increase in the funding requirements results in a significant reduction in the Group's capital resources. The Group's exposure to pension risk emanates from its five defined benefit pension schemes, all of which have been closed to new members for a number of years.

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

- Senior management and the scheme trustees receive professional advice, from separate actuarial advisers, regarding the management of the pension scheme obligations on a regular basis.

- The pension trustees meet every quarter to monitor and make, in consultation with the principal employer, investment decisions with regard to the plan assets within the five schemes.

- The pension obligation position is updated every quarter and reported to the Board and the pension scheme trustees.

The Group also performs stress testing on the pension scheme liabilities and assets as part of its capital planning methodologies, articulated in the ICAAP.

During 2010, the Group commenced an enhanced transfer value (ETV) exercise to reduce the Group's pension risk profile.

7.4 Reputational risk

Reputational risk arises from deterioration in the perception of the Society's or Group's standing in the eyes of either the wholesale markets or the general public. Management has considered how this might arise and what the impact could be. An event threatening the Society's or Group's reputation may result in an increase in retail deposit outflows and / or counterparties withdrawing funding lines to the Group.

7.5 Insurance risk

Insurance risk is the risk that the Group's insurers will be unable to pay in the event of a legitimate claim being made. This risk is controlled by ensuring that all the Group's insurers have a suitable credit rating as assessed and recommended by our professional advisers.

Insurance risk also relates to the risk that insurance contracts written by a firm are not adequately covered. The Group is not exposed to this risk as it does not write insurance contracts. Any risk relating to miss-selling of a third party's insurance contracts eg general insurance or life sales, is captured under operational risk.

7.6 Investment risk

Investment risk is the risk that a fall in the carrying value of the Group's businesses may result in the Society losing the capital that it has invested in the subsidiary companies.

Investment risk is monitored and managed by the Skipton Group via a series of controls, including:

- monthly review of subsidiary performance by the Board;
- Senior Group Executives act as non-executive directors of subsidiary companies and therefore attend Divisional / Operational Board of each business Division;
- the bi-annual assessment of the carrying value of subsidiary investments is reported to the Board; and
- initial and future investment in subsidiary companies must be approved by the Executive Committee and / or the Board in accordance with documented mandates.

7.7 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.

7.8 Regulatory risk

Regulatory risk is the risk arising from regulatory changes and enforcement with the potential for fines and / or restrictions in business activities.

Over recent years, the financial services industry has seen increased regulatory scrutiny and supervision around governance, capital, liquidity and remuneration. There has also been focus on conduct and treating customers fairly.

The Group regularly engages with the FSA and other regulators to proactively manage this risk.

7.9 Credit rating downgrade

A further decline in the Society's credit rating could result in it becoming more difficult to secure wholesale funding and at a higher cost. In addition, in the short term the Group would also have to increase its level of retail funding. Whilst the Group's strong retail franchise would enable this, such funding would be expected to come at a higher cost to the Group. The impact that a credit rating downgrade would have on liquidity is included in the weekly stress testing carried out by Market Risk and is reported to ALCO and the Board on a monthly basis.