Pillar 3 Disclosures
31 December 2014

SKIPTON
BUILDING SOCIETY
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1.0 INTRODUCTION

This document presents the consolidated Pillar 3 disclosures of the Skipton Building Society Group (the 'Group') as at 31 December 2014.

1.1 Background

On 1 January 2014 the Basel II regulation was replaced by Basel III which was implemented through the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), together referred to as CRD IV.

The primary objective of these new regulations is to strengthen the capital position of the banking sector and make it more resilient to future financial or wider economic shocks.

Part of these reforms has involved introducing more stringent conditions regarding the eligibility of capital instruments and their ability to absorb losses. This has resulted in some instruments no longer being eligible for capital and for those not fully loss absorbing to be phased out under transitional arrangements, over the period to 1 January 2022.

These disclosures have been prepared under CRD IV Part Eight (Articles 431 to 455) of Regulation (EU) No 575/2013.

1.2 Basis and frequency of disclosure

These Pillar 3 disclosures are based upon the Group's Annual Report and Accounts for the year ended 31 December 2014, unless otherwise stated. Disclosures are issued on an annual basis in conjunction with the publication of the Group's Annual Report and Accounts.

The introduction of CRD IV means that the Group's capital position for 2014 is prepared on a different basis to that reported in our 2013 disclosures. Where appropriate we have provided comparative capital numbers as at 1 January 2014 adjusted for the new regulations.

The Society will produce interim disclosures should there be any significant changes to its risk profile.

1.3 Media and location of publication

These Pillar 3 disclosures are published on Skipton Building Society's website (www.skipton.co.uk).

1.4 Verification of disclosure

The control environment surrounding the preparation of these disclosures has been reviewed by the Group's Internal Audit function. These disclosures have also been reviewed by the Board Risk Committee. 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 2014 Annual Report and Accounts which are externally audited.

1.5 Scope of application

The balances within the Annual Report and Accounts are prepared in line with International Financial Reporting Standards (IFRS), whilst the balances within the Pillar 3 disclosures are prepared in line with CRD IV. This results in some differences between the two documents. A reconciliation of the accounting values to regulatory capital values has been performed in section 3.7.

For accounting purposes the Society's consolidation group comprises the Society and all of its subsidiaries (i.e. full group consolidation). For prudential regulation and Pillar 3 reporting purposes consolidation is carried out at the following levels:

- Individual consolidation group
- Prudential consolidation group

At 31 December 2014, the individual consolidation group comprised of the following companies:

- Skipton Building Society
- Amber Homeloans Limited (Amber)
- North Yorkshire Mortgages Limited (NYM)

At 31 December 2014 the prudential consolidation group comprised of the following companies:

- Skipton Building Society
- Amber Homeloans Limited (Amber)
- North Yorkshire Mortgages Limited (NYM)
- Darrowby No. 1 plc
- Darrowby No. 2 plc
- Darrowby No. 3 plc
- Pearson Jones plc*
- Skipton Financial Services Limited (SFS)
- Skipton Business Finance Limited
- Skipton International Limited (SIL)
- Skipton Investments Limited
- Bailey Computer Services Limited*
- Skipton Group Holdings Limited

*Since 31 December 2014, the Group has agreed to sell Pearson Jones plc with completion conditional upon regulatory approval and certain other conditions. In addition during 2014 we ceased to provide computer services to other building societies through Bailey Computer Services Limited.

Skipton International Limited is based in Guernsey and is regulated by the Guernsey Financial Services Commission (GFSC).

The Pillar 3 disclosures focus on the prudential group and the individual group as these are the levels we are regulated at. Historically we have provided disclosures at a full group level however as we are not regulated at this level under CRD IV this information is no longer provided.

1.6 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 prudential consolidation group and individual consolidation group – the regulated entities. However, this broad principle is subject to a number of regulatory, taxation and commercial considerations which are taken into account before decisions regarding dividend payments from group entities are finalised. The Board considers that there is no current or foreseeable material, practical or legal impediments to the prompt repayment of liabilities between the individual consolidation group and its subsidiary undertakings.

Prior consent is required from the GFSC before any capital can be repatriated or dividends paid by Skipton International Limited.

2.0 RISK MANAGEMENT OBJECTIVES AND POLICIES

2.1 Introduction

The Society is a mutual organisation run for the benefit of its members. The Board adopts a prudent approach to managing risk in order to increase the long term value for the benefit of members. The key risks to which the Group is exposed include business risk, reputational risk, credit risk, regulatory risk, market risk, currency risk, pension obligation risk, operational risk, model risk, technological risk, interest rate risk, equity risk, liquidity risk and taxation risk. These risks are explained in detail in sections 5 and 6 of these disclosures and in the Risk Management Report of the Annual Report and Accounts, pages 49-55.

2.2 Risk appetite

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

The Board's risk appetite, inter alia, specifically addresses the maintenance of stakeholders' confidence, credit risk appetite, capital and liquidity adequacy, fair treatment of customers, the culture of the business 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.

2.3 Group risk management framework

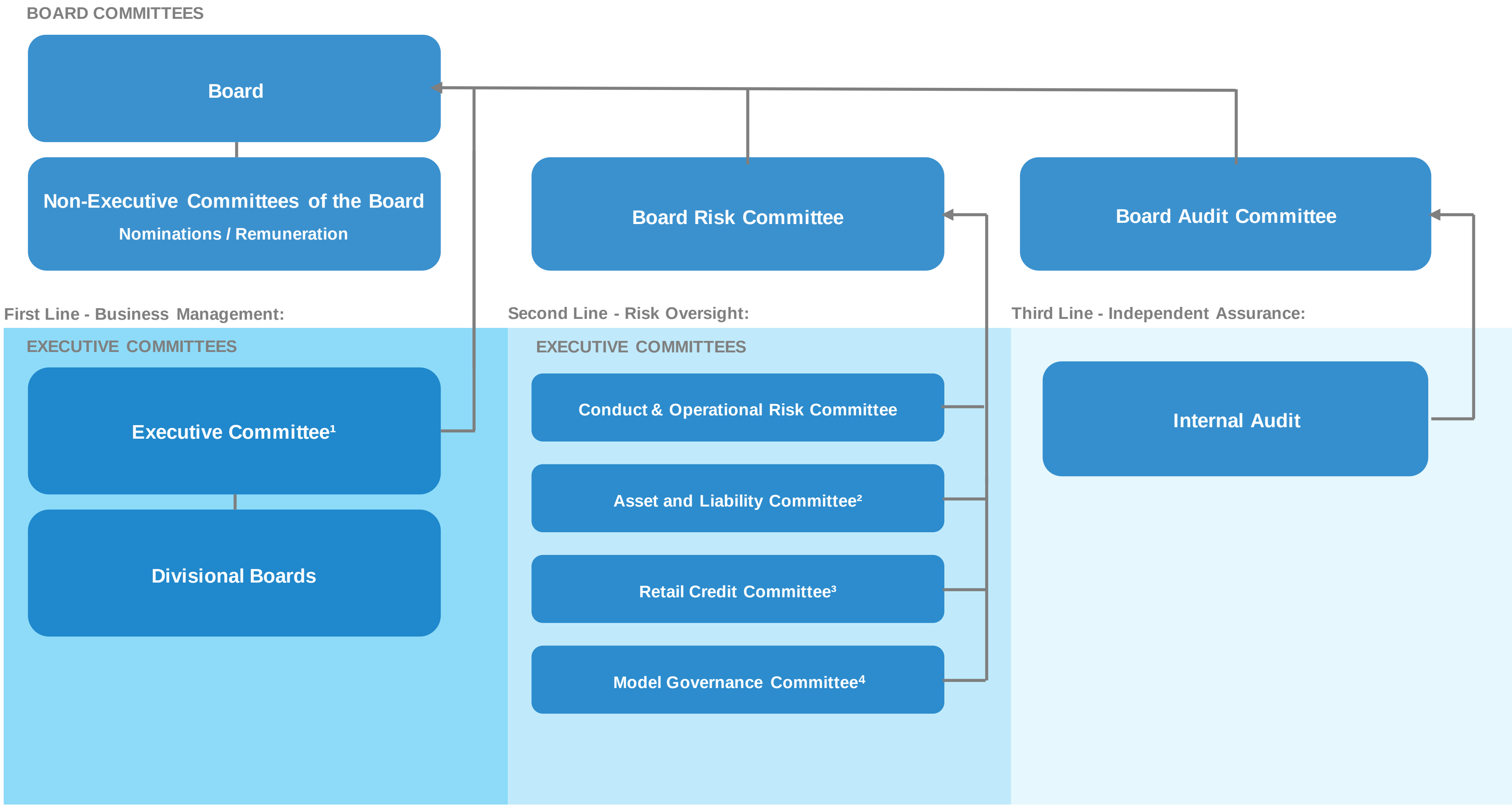
Through the Group's risk management framework and governance structure, the Group has a formal mechanism for identifying and addressing risks throughout the business. This framework is designed to deliver the corporate plan in line with the Board's overall risk appetite and is based upon the best practice '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 the Conduct and Operational Risk Committee, the Asset and Liability Committee, the Retail Credit Committee and the Model Governance Committee – details of which are set out on page 9. These sub-committees 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, for 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 Internal Audit, 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 table on the following page summarises the Governance Framework of the Skipton Group outlying the key committees and their reporting lines. Further details on the specific responsibilities of the Board and the Executive Committees are summarised in this section and set out in detail in the Directors' Report on Corporate Governance and the Risk Management Report in the Annual Report and Accounts.



1. The Executive Committee receives reports from the Project Prioritisation Approval Group, Products Approval Group, Health, Safety & Security Working Group and Society Operational Risk Committee to assist in the execution of its duties.
2. The Asset and Liability Committee receives reports from the Group Wholesale Credit Committee, Secured Funding Committee and Dynamic Model Committee to assist in the execution of its duties.
3. The Retail Credit Committee receives reports from the Credit Risk Working Group and Credit Risk Provisions Group to assist in the execution of its duties.
4. The Model Governance Committee receives reports from the Model Working Group to assist in the executions of its duties.

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

2.4 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 on the following page. 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.

2.5 Board Risk Committee

The Board Risk Committee (BRC) 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, Non-Executive Director, 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 BRC.

The Board Risk Committee also has a number of sub-committees, which have day-to-day responsibility for risk management oversight. These committees are set out in sections 2.6 to 2.9 below.

2.6 Conduct and Operational Risk Committee

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.

2.7 Asset and Liability Committee

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.

2.8 Retail Credit Committee

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.

2.9 Model Governance Committee

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.

2.10 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 Executive Directors and other senior executives.

2.11 Audit Committee

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 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. The Committee's 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 auditors, 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 Internal Audit and Compliance Monitoring functions and review their material findings; and
- To report to the Board how the Committee has discharged its responsibilities.

2.12 Remuneration Committee

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 – Material Risk Takers (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 subsidiaries. For the Prudential Regulation Authority (PRA) and Financial Conduct Authority (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 Board 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.

2.13 Non-Executive Remuneration Committee

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.

3.0 CAPITAL RESOURCES

3.1 Total capital resources

The following tables show the capital resources as at 31 December 2014 under CRD IV applying both the transitional rules and the CRD IV end-point or 'fully loaded' position for both the prudential and the individual consolidation group. Comparative figures are given as at 1 January 2014 to provide a CRD IV comparative for 2013 year end. The key difference between the transitional and fully loaded position is that under the fully loaded rules all existing additional tier 1 and tier 2 instruments that became ineligible as capital are excluded in full.

Prudential Consolidation Group	**Transitional CRD IV**		**Fully Loaded CRD IV**	
	31.12.2014 £m	**1.1.2014[1] £m**	**31.12.2014 £m**	**1.1.2014[1] £m**
Common Equity Tier 1				
Reserves	949.7	817.1	952.8	821.3
Prudential adjustments (note 2)	(0.9)	(1.1)	(0.9)	(1.1)
Deductions from common equity tier 1 capital	(11.2)	(29.7)	(11.2)	(29.7)
Unrealised gains on available-for-sale debt securities	(2.6)	-	-	-
Unrealised losses on cash flow hedges	5.3	11.0	5.3	11.0
Total Common Equity Tier 1	**940.3**	**797.3**	**946.0**	**801.5**
Additional Tier 1				
Permanent Interest Bearing Shares (PIBS)	**72.0**	**72.0**	**-**	**-**
Total Tier 1 capital	**1,012.3**	**869.3**	**946.0**	**801.5**
Tier 2				
Subordinated liabilities (note 3)	37.7	54.1	4.4	6.4
Permanent Interest Bearing Shares (PIBS)	18.0	18.0	40.0	40.0
Total Tier 2 capital (note 4)	**55.7**	**72.1**	**44.4**	**46.4**
Total capital	**1,068.0**	**941.4**	**990.4**	**847.9**

Individual Consolidation Group	**Transitional CRD IV**		**Fully Loaded CRD IV**	
	31.12.2014 £m	**1.1.2014[1] £m**	**31.12.2014 £m**	**1.1.2014[1] £m**
Common Equity Tier 1				
Reserves	924.7	786.1	927.7	791.2
Prudential adjustments (note 2)	(0.9)	(1.0)	(0.9)	(1.0)
Deductions from common equity tier 1 capital	(1.7)	(1.5)	(1.7)	(1.5)
Unrealised (gains) / losses on available-for-sale debt securities	(2.6)	-	-	-
Unrealised losses on cash flow hedges	5.3	11.0	5.3	11.0
Total Common Equity Tier 1	**924.8**	**794.6**	**930.4**	**799.7**
Additional Tier 1				
Permanent Interest Bearing Shares (PIBS)	**72.0**	**72.0**	**-**	**-**
Total Tier 1 capital	**996.8**	**866.6**	**930.4**	**799.7**
Tier 2				
Subordinated liabilities (note 3)	37.7	54.1	4.4	6.4
Permanent Interest Bearing Shares (PIBS)	18.0	18.0	40.0	40.0
Total Tier 2 capital (note 4)	**55.7**	**72.1**	**44.4**	**46.4**
Total capital	**1,052.5**	**938.7**	**974.8**	**846.1**

Notes

1. The comparative figures have been restated from those disclosed in Section 8, CRD IV, in the 2013 document, due to a change in accounting policy relating to the Financial Services Compensation Scheme (FSCS) levy and a revised interpretation of the CRD IV regulations. Further explanation of these movements is set out in the notes below.

2. Prudential adjustments include deductions to capital for deferred tax and an Additional 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. The prior year figures have been restated to reflect this treatment.
3. The prior year figures 'fully loaded' figures have been restated to remove a tranche of £10m of subordinated liabilities that do not satisfy the CRD IV eligibility criteria for capital. This tranche was repaid at par in September 2014.
4. 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.

3.2 Common equity tier 1 capital

Reserves consist of the general reserve, the unrealised gains on available-for-sale assets and the cash flow hedging reserve. In line with CRD IV the available-for-sale gain and the cash flow hedging reserve are reversed out of Common Equity Tier 1. Prudential adjustments include deductions to capital for deferred tax and an Additional Valuation Adjustment (AVA) on fair value assets. The AVA has been applied to prudently provide for the downside of fair value exposures that are intrinsically subjective in nature. Under PRA rules goodwill and intangible assets are also deducted from regulatory capital.

3.3 Additional tier 1 capital

Additional Tier 1 capital comprises issued capital in the form of PIBS.

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, payables and investing members of the Society. One tranche of PIBS with a par value of £50m has future quarterly call dates commencing on 13 April 2017 providing the Society with an opportunity to repay the shares at par. On the initial call date this tranche of PIBS will no longer remain eligible for regulatory capital. The remaining PIBS do not have call dates and will remain eligible for regulatory capital but will be phased out of Tier 1 capital into Tier 2 capital over a transitional period to 1 January 2022.

Under PRA rules PIBS and subordinated liabilities are included in the solvency calculation in accordance with UK GAAP rather than IFRS. The PIBS and subordinated debt are therefore disclosed at par value and the associated merger fair value adjustments are included within the general reserve.

Appendix 2 shows the key features of the PIBS issued by the Society.

3.4 Tier 2 capital

Tier 2 capital comprises regulated subordinated liabilities and PIBS that have been transitioned out of additional Tier 1 capital. The criteria that subordinated liability instruments are required to satisfy to be eligible for regulated capital have been revised under CRD IV. Where a capital instrument *fails* to satisfy the CRD IV criteria it may be treated in one of the following ways depending on the terms associated with the instrument:

- The instrument may be removed from capital immediately, either from 1 January 2014 when CRD IV became effective, or from its first call date after 1 January 2014.
- The instrument may be phased out of capital over ten years (or less if maturity occurs before this). This treatment is referred to as 'grandfathering'.

As a result, subordinated liabilities with a regulatory capital value of £38.6m (nominal value of £45.3m) became ineligible to continue as regulatory capital in 2014. Of the remaining £37.7m of regulatory capital at 31 December 2014 (nominal value £58m), £4.4m is fully eligible for regulatory capital and £33.3m is subject to 'grandfathering' rules.

Subordinated liability instruments with less than five years to maturity and that continue to be eligible or are grandfathered are amortised down to zero on a straight line basis in accordance with Article 486 of CRD IV.

Appendix 2 shows the key features of these instruments issued by the Society.

3.5 Capital buy back

In September 2014 the Society repaid, at par, £10m of fixed rate notes repayable in 2019. This subordinated liability was no longer eligible as regulatory capital under new CRD IV rules.

3.6 Regulatory capital flow statement

The table on the following page shows the flow of regulatory capital and associated movements that have occurred from 31 December 2013 to 31 December 2014. This table is presented at a prudential group level on a transitional basis as this represents our current regulatory capital position at our highest regulated consolidation group.

This shows an increase in Common Equity Tier 1 primarily due to profits generated during the year with no significant movements experienced in other balances.

	Prudential Consolidation Group £m
Common Equity Tier 1 capital at 31 December 2013	**810.4**
Restatement of opening reserves (note 1)	5.7
Profit for the year	126.8
Actuarial loss on retirement benefit obligation	(11.5)
AVA required under CRD IV	(0.9)
Tax on items taken directly to reserves	2.3
Movement in fair value for PIBS and subordinated liabilities (note 2)	1.3
Removal of pension adjustment no longer required under CRD IV	(12.9)
Net reduction in goodwill	10.9
Net reduction in intangible assets	8.2
Common Equity Tier 1 capital at 31 December 2014	**940.3**
Tier 1 capital at 31 December 2013	**90.0**
Phasing of PIBS from Tier 1 to Tier 2 capital	(18.0)
Tier 1 capital at 31 December 2014	**72.0**
Tier 2 capital at 31 December 2013	**106.7**
Amortisation of Tier 2 subordinated liabilities	(6.4)
Capital no longer eligible	(38.6)
Collective provisions no longer allowable under CRD IV	(24.0)
Phasing of PIBS from Tier 1 to Tier 2 capital	18.0
Tier 2 capital at 31 December 2014	**55.7**
Deduction from Tier 1 and Tier 2 capital at 31 December 2013	**(97.5)**
Change in treatment under CRD IV (note 3)	97.5
Deduction from Tier 1 and Tier 2 capital at 31 December 2014	**-**
Total capital at 31 December 2013	**909.6**
Total capital at 31 December 2014	**1,068.0**

Notes

1. The opening position has been restated due to a change in accounting policy relating to the FSCS levy.
2. Under PRA rules PIBS and subordinated liabilities are included in the solvency calculation in accordance with UK GAAP rather than IFRS. The PIBS and subordinated debt are therefore disclosed at par value and the associated merger fair value adjustments are included within the general reserve.
3. Under Basel II a deduction was required for the prudential groups cost of investment in subsidiary companies outside the group. Under CRD IV the cost of investment is risk weighted at 100% rather than being deducted from capital resources.

The table above shows how the Group's strong financial performance has strengthened our capital position despite the recognition of the CRD IV requirements this year, which have resulted in £38.6m of our regulatory capital instruments, with a nominal value of £45.3m, becoming ineligible for regulatory purposes.

3.7 Reconciliation of balance sheet capital to regulatory capital

The table below shows how the full Group balance sheet capital values translate to a regulatory capital equivalent for the prudential consolidation group at 31 December 2014. The regulatory capital figures are shown on a transitional basis in accordance with CRD IV for the prudential consolidation group.

	Accounting Balance Sheet £m	Adjustments £m	Regulatory Capital £m
Common equity tier 1 capital			
Total equity attributable to members	1,071.9		
Reserves attributable to non regulatory subsidiaries		(119.1)	
Regulatory adjustments to Common Equity Tier 1;			
Intangible fixed assets		(2.0)	
Goodwill		(9.2)	
Removal of available-for-sale reserve – ineligible for regulatory capital		(2.6)	
Removal of cash flow hedging reserve – ineligible for regulatory capital		5.3	
AVA		(0.9)	
Regulatory adjustment for fair value of PIBS and subordinated liabilities		(3.1)	
Total common equity tier 1 capital	**1,071.9**	**(131.6)**	**940.3**
Tier 1 capital			
Subscribed capital (PIBS)	94.3		
Regulatory removal of accrued interest		(2.4)	
Regulatory removal of fair value adjustment for hedged risk		(4.9)	
Regulatory removal of fair value adjustment of PIBS		3.0	
Regulatory transfer of PIBS to Tier 2 capital		(18.0)	
Total tier 1 capital	**94.3**	**(22.3)**	**72.0**
Tier 2 capital			
Subordinated liabilities	98.0		
Regulatory removal of accrued interest		(1.5)	
Regulatory removal of fair value adjustment for hedged risk		(3.4)	
Reversal of amortised discount on issue		0.2	
Amortisation of subordinated liabilities with less than five years to maturity		(20.4)	
Subordinated liabilities not eligible for regulatory capital		(35.3)	
Regulatory transfer of PIBS from Tier 1 capital		18.0	
Regulatory removal of fair value adjustment of subordinated liabilities		0.1	
Total tier 2 capital	**98.0**	**(42.3)**	**55.7**
Total capital resources	**1,264.2**	**(196.2)**	**1,068.0**

4.0 CAPITAL ADEQUACY

4.1 Summary of capital adequacy

Under PRA rules a minimum level of capital (Pillar 1) must be held for credit risk, operational risk and market risk for the individual and prudential consolidation groups. The Group has adopted the standardised approach to calculate the minimum regulatory capital resource requirement for credit risk and operational risk. Market risk has been calculated in accordance with Article 83 of CRD IV and the relevant articles of the CRR. Section 5 sets out further detail on the capital requirements under Pillar 1.

The tables below set out the capital adequacy of both the prudential and individual groups under both the transitional and fully loaded CRD IV definitions, applying the risk weighted assets and capital requirements calculated under Pillar 1.

Prudential Consolidation Group

	Transitional CRD IV		Fully Loaded CRD IV	
	31.12.14 £m	1.1.14[1] £m	31.12.14 £m	1.1.14[1] £m
Total common equity tier 1	**940.3**	**797.3**	946.0	801.5
Total tier 1 capital	**1,012.3**	**869.3**	946.0	801.5
Total own funds	**1,068.0**	**941.4**	990.4	847.9
Risk weighted assets				
Credit risk (notes 2,3,4)	5,531.0	5,287.3	5,531.0	5,287.3
Operational risk	297.0	339.5	297.0	339.5
Market risk	-	0.7	-	0.7
Total risk weighted assets (RWA)	**5,828.0**	**5,627.5**	5,828.0	5,627.5
Pillar 1 capital requirement (RWA x 8%)	**466.2**	**450.2**	466.2	450.2
Excess capital over minimum Pillar 1 requirement	**601.8**	**491.2**	524.2	397.7
Capital ratios				
Common equity tier 1 (%)	**16.13**	**14.17**	16.23	14.24
Tier 1 (%)	**17.37**	**15.45**	16.23	14.24
Total capital (%)	**18.33**	**16.73**	16.99	15.07

Individual Consolidation Group

	Transitional CRD IV		Fully Loaded CRD IV	
	31.12.14 £m	1.1.14[1] £m	31.12.14 £m	1.1.14[1] £m
Total common equity tier 1	**924.8**	**794.6**	930.4	799.7
Total tier 1 capital	**996.8**	**866.6**	930.4	799.7
Total own funds	**1,052.5**	**938.7**	974.8	846.1
Risk weighted assets				
Credit risk (notes 2,3,4)	5,464.4	5,334.5	5,464.4	5,334.5
Operational risk	199.9	125.2	199.9	125.2
Market risk	-	-	-	-
Total risk weighted assets (RWA)	**5,664.3**	**5,459.7**	5,664.3	5,459.7
Pillar 1 capital requirement (RWA x 8%)	**453.1**	**436.8**	453.1	436.8
Excess capital over minimum Pillar 1 requirement	**599.4**	**501.9**	521.7	409.3
Capital ratios				
Common equity tier 1 (%)	**16.33**	**14.55**	16.43	14.65
Tier 1 (%)	**17.60**	**15.87**	16.43	14.65
Total capital (%)	**18.58**	**17.19**	17.21	15.50

Notes

1. The comparative figures have been restated from those disclosed in Section 8, CRD IV, in the 2013 document, due to a change in accounting policy relating to the Financial Services Compensation Scheme (FSCS) levy and a revised interpretation of the CRD IV regulations. See notes in section 3 for further information on the restatement of capital resources. The notes below set out the explanation for the restatement of risk weighted assets.
2. 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.
3. 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.
4. The Society is required to hold regulatory capital in order to cover potential losses which could arise if the counterparties to its secured funding transactions (which include repurchase and reverse repurchase transactions) fail to meet their financial obligations before the maturity date this is known as the counterparty credit risk. The Society uses the Standardised Approach to measure the counterparty credit risk of all of its secured funding transactions. The Society is not required to hold additional capital to cover credit valuation adjustment charge in respect of secured funding transactions.

Total common equity tier 1 is higher under the fully loaded basis as the fair value adjustment for PIBS and subordinated liabilities totalling £3.0m is removed increasing general reserves. The available-for-sale gain as at 31 December 2014 totalling £2.6m is also allowable under the fully loaded position in accordance with CRD IV so is included in common equity tier 1.

The capital required for credit risk increased during the year due to an increase in residential mortgage balances of £1.3bn for the prudential group and £1.2bn for the individual group as a result of new lending during the year. The capital required for operational risk decreased during the year at a prudential consolidation group level due to the disposal of two subsidiary companies; Homeloan Management Ltd and Torquil Clark Ltd. The operational risk requirement for the individual consolidation group has increased due to the growth in the mortgage book.

4.2 Capital reporting

The Pillar 1 regulatory capital adequacy at an individual and prudential consolidation group level is reported to the PRA quarterly in our Common Reporting (COREP) returns. It is also reported to the Board monthly along with forecast positions.

4.3 Internal capital adequacy assessment process

The Group holds capital to absorb losses which may occur in 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
- 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 five year Corporate Plan, the Board considers its overall objectives and evaluates these in light of its agreed risk appetite statements.

The ICAAP is used to identify the amount of additional capital (called 'Pillar 2' capital) required to cover the risks not covered by Pillar 1 as well as the amount of additional capital required to ensure that the Group can trade through a variety of stress scenarios including a severe recession if necessary by applying management actions.

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. Section 6 sets out the additional risks considered in the Pillar 2 assessment.

5.0 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 prudential consolidation group and the individual consolidation group.

5.1 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.

Changes in the credit quality and the recoverability of loans and amounts due from customers and other counterparties influence the Group's exposure to credit risk. The Group's strategy is to maintain a prudent approach to credit risk, to ensure the credit quality of new lending. Adverse changes in the wider economy, including falling house prices or commercial property values, rising unemployment, and an increase in interest rates, will impact customer's ability to service their obligations and will affect the recoverability and value of the Group's assets and influence its financial performance through an increase in the level of impairment losses.

The controlled management of credit risk is therefore critical to the Group's overall strategy, and there has been substantial investment in the credit risk function during the year. The Group has 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 monthly RCC and ALCO, through the Group Wholesale Credit Committee, provide oversight to the effectiveness of the management of credit risk across the Group to ensure that the appropriate processes and policies are in place to monitor, control, mitigate and manage credit risk 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.

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, and the amounts it is willing to lend to these counterparties, to levels appropriate with the perceived risk.

The following tables detail the minimum capital requirements for credit risk for the prudential consolidation group and individual consolidation group as at 31 December 2014 broken down by exposure value:

Prudential Consolidation Group	Exposure Value[1] £m	Risk Weighted Assets £m	Capital Requirement £m
Corporates (note 2)	61.4	48.9	3.9
Retail (note 3)	2.0	1.2	0.1
Secured by mortgages on immovable property	13,373.7	4,722.6	377.8
Exposures in default (note 4)	176.9	179.8	14.4
Total loans and advances to customers	**13,614.0**	**4,952.5**	**396.2**
Central governments or central bank	1,401.3	-	-
Multilateral Development Banks	175.7	-	-
Institutions	639.3	230.2	18.4
Corporates	6.1	-	-
Covered Bonds	48.5	4.9	0.4
Claims on institutions and corporates with a short-term credit assessment	229.8	46.2	3.7
Securitisation positions	207.4	41.5	3.3
Credit Valuation Adjustment (note 5)	112.4	88.0	7.0
Total wholesale funding	**2,820.5**	**410.8**	**32.8**
Equity	87.3	87.3	7.0
Other items	82.2	80.4	6.4
Total other	**169.5**	**167.7**	**13.4**
Total	**16,604.0**	**5,531.0**	**442.4**

Individual Consolidation Group	Exposure Value £m	Risk Weighted Assets £m	Capital Requirement £m
Corporates (note 6)	64.6	64.6	5.2
Retail	-	-	-
Secured by mortgages on immovable property	12,535.1	4,440.3	355.2
Exposures in default	176.9	179.8	14.4
Total loans and advances to customers	**12,776.6**	**4,684.7**	**374.8**
Central governments or central bank	1,401.3	-	-
Multilateral Development Banks	175.7	-	-
Institutions	581.5	216.3	17.3
Corporates	32.9	1.7	0.1
Covered Bonds	48.5	4.9	0.4
Claims on institutions and corporates with a short-term credit assessment	204.8	41.2	3.3
Securitisation positions	207.4	41.5	3.3
Credit Valuation Adjustment (note 5)	117.8	93.7	7.5
Total wholesale funding	**2,769.9**	**399.3**	**31.9**
Equity	174.1	304.2	24.3
Other items	74.6	76.2	6.1
Total other	**248.7**	**380.4**	**30.4**
Total	**15,795.2**	**5,464.4**	**437.1**

Notes

1. The exposure value includes items which are off balance sheet, such as our mortgage pipeline, derivatives, netting and repos which have a capital requirement but do not appear in the accounting balance sheet of the regulated group. The exposure balance is also adjusted for credit risk mitigation techniques, for further details see section 5.1.8 to 5.1.10.
2. This balance is made up of exposures related to debt factoring and invoice discounting in Skipton Business Finance (SBF).
3. This is made up of debt factoring and invoice discounting exposures in SBF.
4. Exposures in default refers to those accounts greater than three months in arrears.
5. 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.
6. This balance is made up of exposures to other group companies not within the individual consolidation.

The balances in the following sections represent the accounting balances and not the risk exposure amounts used to calculate the capital requirements which are adjusted for off-balance sheet items and credit risk mitigation techniques.

The table below shows the mix of the loans and advances to customers at the reporting date:

Loans and advances to customers	Prudential Consolidation Group Average 13/14	Prudential Consolidation Group		Individual Consolidation Group Average 13/14	Individual Consolidation Group	
		2014	2013		**2014**	2013
	£m	**£m**	£m	**£m**	**£m**	£m
Total residential mortgages	11,560.4	12,208.4	10,912.3	10,865.9	11,469.0	10,262.8
Commercial loans	396.0	382.1	409.8	396.0	382.1	409.8
Debt factoring loans	61.4	63.8	58.9	-	-	-
Other loans	42.4	44.0	40.8	0.7	0.5	0.9
Gross balances	**12,060.2**	**12,698.3**	11,421.8	**11,262.6**	**11,851.6**	10,673.5
Impairment provisions	(59.0)	(58.9)	(59.1)	(58.2)	(58.1)	(58.3)
Fair value adjustment for hedged risk	181.6	203.8	159.3	179.3	199.3	159.3
Total	**12,182.8**	**12,843.2**	11,522.0	**11,383.7**	**11,992.8**	10,774.5

The commercial loans balance for the prudential and individual consolidation group includes £50.7m of exposures to Small and Medium Entities (SMEs) and the debt factoring loans balance within the prudential consolidation group has an exposure of £62.2m to SMEs. The Group has increased its overall lending throughout the year with both the Society and SIL significantly growing their mortgage books whilst the Amber and NYM mortgage books continue to run-off.

5.1.1 Retail credit risk

The Group currently lends in the prime residential UK mortgage market, including buy-to-let, through the Society, and via Skipton International Limited who primarily operate in the Channel Islands, and to a very limited extent in the UK. The Board's credit risk appetite defines a number of limits to control the extent of both credit and concentration risk to which all lending activity must adhere.

The credit decision process utilises automated credit scoring and policy rules with lending policy criteria supported by manual underwriting to provide a human touch. All aspects of the credit decision process are subject to regular independent review and oversight ensuring they support decisions in line with the Board's credit 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. 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 while the portfolios run-off. The performance of these portfolios has continued to improve over the reporting period with arrears balances falling by 18% over the past 12 months (from £278m to £227m).

The majority of loans and advances to customers are secured on UK residential properties and are geographically diverse, managed and controlled via concentration risk limits as shown in the table on the following page.

The Society is currently in the process of applying to become an Internal Ratings Based (IRB) lender. The establishment of the Model Governance Committee to oversee the IRB and other credit risk models (which cover the Society, Amber and NYM residential portfolios), combined with investment in the Society's credit risk modelling capability, ensures that the Group has the right analytical tools to facilitate the appropriate management of credit risk.

The tables below provide further information on types of lending and geographical split. The full group position reported in the full Group Annual Report and Accounts is less than the prudential consolidation group due to consolidation adjustments made to eliminate intra group trading.

Lending analysis

	Prudential Consolidation Group				**Individual Consolidation Group**			
	2014		2013		**2014**		2013	
	£m	**%**	£m	%	**£m**	**%**	£m	%
Prime:								
Residential	8,999.7	73.8	7,572.9	69.4	8,344.8	72.7	7,004.7	68.3
Buy-to-let	2,146.0	17.6	2,081.5	19.0	2,061.5	18.0	2,000.2	19.5
Self build	67.1	0.5	84.7	0.8	67.1	0.6	84.7	0.8
Fast track	86.0	0.7	125.0	1.1	86.0	0.7	125.0	1.2
Self certified	613.8	5.0	589.8	5.4	613.8	5.4	589.8	5.8
Sub-prime:								
Residential	60.8	0.5	105.9	1.0	60.8	0.5	105.9	1.0
Buy-to-let	53.7	0.4	62.0	0.6	53.7	0.5	62.0	0.6
Self build	0.5	-	0.6	-	0.5	-	0.6	-
Self certified	180.8	1.5	289.9	2.7	180.8	1.6	289.9	2.8
Total	**12,208.4**	**100.0**	10,912.3	100.0	**11,469.0**	**100.0**	10,262.8	100.0

The mortgage book is predominantly comprised of prime residential and buy-to-let loans. All new lending is on this basis, with a prudent risk appetite tightly controlled within approved Board limits. The remaining categories relate to portfolios that are all in run-off.

Geographical analysis

	Prudential Consolidation Group				**Individual Consolidation Group**			
	2014		2013		**2014**		2013	
	£m	**%**	£m	%	**£m**	**%**	£m	%
North	463.0	3.8	414.4	3.8	463.0	4.0	414.4	4.0
Yorkshire	1,221.8	10.0	1,127.5	10.3	1,221.8	10.7	1,127.5	11.0
East Midlands	834.1	6.8	733.0	6.7	834.1	7.3	733.1	7.1
East Anglia	770.2	6.3	681.2	6.2	770.2	6.7	681.2	6.6
London	1,381.6	11.3	1,293.1	11.9	1,380.5	12.0	1,293.1	12.6
South East	2,299.4	18.9	2,037.0	18.7	2,299.1	20.0	2,036.8	19.9
South West	1,063.9	8.7	936.2	8.6	1,063.6	9.3	936.2	9.1
West Midlands	732.9	6.0	634.8	5.8	732.8	6.4	634.8	6.2
North West	1,296.9	10.6	1,156.0	10.6	1,296.8	11.3	1,156.0	11.3
Wales	250.9	2.1	212.1	1.9	250.9	2.2	212.1	2.1
Scotland	1,099.1	9.0	969.1	8.9	1,099.1	9.6	969.0	9.4
Northern Ireland	57.1	0.5	68.5	0.6	57.1	0.5	68.6	0.7
Channel Islands	737.5	6.0	649.4	6.0	-	-	-	-
Total	**12,208.4**	**100.0**	10,912.3	100.0	**11,469.0**	**100.0**	10,262.8	100.0

The mortgage book remains well diversified by geographic region, with concentration risk limits in place to ensure that the Society does not become over-exposed to any individual economic region.

Loan-to-value information on the prudential and individual consolidation group's residential loan portfolio is set out as follows:

Indexed loan-to-value analysis

	Prudential Consolidation Group				**Individual Consolidation Group**			
	2014		2013		**2014**		2013	
	£m	**%**	£m	%	**£m**	**%**	£m	%
<70%	6,840.7	56.1	5,078.6	46.5	6,458.2	56.3	4,740.2	46.2
70% - 80%	2,749.7	22.5	2,115.2	19.4	2,580.9	22.5	1,974.1	19.2
80% - 90%	1,802.5	14.8	2,103.0	19.3	1,662.6	14.5	1,971.0	19.2
90% - 100%	590.7	4.8	1,026.2	9.4	547.8	4.8	993.3	9.7
>100%	224.8	1.8	589.3	5.4	219.5	1.9	584.2	5.7
	12,208.4	**100.0**	10,912.3	100.0	**11,469.0**	**100.0**	10,262.8	100.0

The indexed loan-to-value is updated on a quarterly basis to reflect changes in house prices via the Halifax house price index which is applied to the portfolio on a regional basis. The policy for new lending 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 prudential consolidation group residential mortgages was 50.3% (2013: 52.9%) and for the individual consolidation group residential mortgages was 49.8% (2013: 52.6%).

The table below shows the maturity analysis for loans and advances to customers as at 31 December 2014 for the prudential and individual consolidation groups.

Maturity analysis	**Prudential Consolidation Group £m**	**Individual Consolidation Group £m**
On call and at short notice	67.3	3.5
In not more than three months	26.9	18.9
In more than three months but not more than one year	64.9	40.0
In more than one year but not more than five years	615.8	480.4
In more than five years	12,127.2	11,508.1
Gross balances	**12,902.1**	**12,050.9**
Less: Impairment	(58.9)	(58.1)
Total	**12,843.2**	**11,992.8**

5.1.2 Commercial credit risk

The Society's commercial loan 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. As all commercial lending is in the Society the analysis is the same for the prudential and individual groups.

An analysis of loans secured on commercial property by industry type is provided below:

	Prudential and Individual Consolidation Groups			
	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
Total	**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.

An analysis of loans secured on commercial property by geography is provided below.

	Prudential and Individual Consolidation Groups			
	2014		2013	
Geographical analysis	**£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

Loan-to-value information on the prudential and individual consolidation group's commercial loan portfolio is set out as follows:

Indexed loan-to-value analysis	**Prudential and Individual Consolidation Groups**			
	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 loans was 56.7% (2013: 56.3%). The increase in balances of loans with an LTV greater than 100% is due to the significant revaluation exercise that continues to be undertaken on higher value commercial properties.

5.1.3 Debt factoring / invoice discounting

These loans principally comprise loans made by our factored debt and invoice discounting business, Skipton Business Finance Limited, which continue to be managed by appropriately skilled teams.

5.1.4 Wholesale lending credit risk

The Group's wholesale credit risk arises principally from assets held for prudential liquidity and general business purposes. The risk is that counterparties with whom the Group invests fail to repay the capital or interest obligations when they fall due. This element of credit risk is managed by the Treasury function within the limits set by ALCO, with a regular review of credit policies and exposures through the Group Wholesale Credit Committee (a sub-committee of ALCO). The processes for limit allocation and credit assessment are documented within the Treasury Policy.

Netting and collateralisation agreements are used to reduce credit exposure, which are discussed further under section 5.1.9. The table below sets out the liquidity book by industry sector / asset class as at 31 December 2014.

	Prudential Consolidation Group Average 13/14 £m	Prudential Consolidation Group £m	Individual Consolidation Group Average 13/14 £m	Individual Consolidation Group £m
Cash in hand and balances with the Bank of England	967.8	1,076.1	967.8	1,076.1
Cash with banks and building societies	345.4	372.3	222.3	245.5
Gilts	383.7	288.5	383.7	288.5
Certificates of deposit	160.5	258.4	146.7	230.8
Fixed rate bonds	188.9	211.5	188.5	206.3
Floating rate notes	156.5	138.3	161.0	128.2
Residential mortgage backed securities	234.3	207.4	749.7	706.5
Commercial mortgage backed securities	9.3	-	9.3	-
Covered Bonds	40.0	48.6	40.0	48.6
Total	**2,486.4**	**2,601.1**	**2,869.0**	**2,930.5**

Following the implementation of CRD IV the 2013 comparative balances have been updated for the individual consolidation group to comply with the new regulations.

This table shows that the Group has a suitably varied liquidity portfolio and does not have significant exposures concentrated to one specific asset class outside of Buffer requirements, as per BIPRU 12.7. The table below sets out the maturity of the liquidity book as at 31 December 2014.

	Prudential Consolidation Group £m	Individual Consolidation Group £m
Loans and advances to credit institutions		
Repayable on demand	289.9	222.1
In not more than three months	59.0	-
In more than one year but not more than five years	12.0	12.0
In more than five years	11.4	11.4
	372.3	**245.5**
Debt securities		
Repayable on demand	-	-
In not more than three months	185.5	160.4
In more than three months but not more than one year	239.7	227.0
In more than one year but not more than five years	558.0	1,052.0
In more than five years	169.5	169.5
	1,152.7	**1,608.9**
Cash in hand and balances with the Bank of England		
Repayable on demand	1.076.1	1,076.1
	1,076.1	**1,076.1**
Total	**2,601.1**	**2,930.5**

The individual consolidation group has a higher balance than the prudential consolidation group due to balances held on the Society's balance sheet associated with Darrowby No.1, No.2 and No.3, the

Society's Special Purpose Vehicles (SPVs) which consolidate on a prudential level, for further information please see section 5.1.11.

The table below sets out the capital held for the liquidity book by credit rating. During 2014 this approach has been reviewed to incorporate the requirements of the CRD IV regulations. For 31 December 2014 figures below we use the lower of Moody's or Fitch ratings if both rate the same asset.

	Prudential Consolidation Group			**Individual Consolidation Group**		
Rating	**Exposure £m**	**Risk Weighted Assets £m**	**Capital Req't £m**	**Exposure £m**	**Risk Weighted Assets £m**	**Capital Req't £m**
Aaa	430.5	46.1	3.7	929.5	46.1	3.7
Aa1	1,399.1	0.1	-	1,399.1	0.1	-
Aa2	74.2	14.8	1.2	-	-	-
Aa3	238.5	47.8	3.8	223.4	44.6	3.6
A1	49.4	14.5	1.2	45.5	13.8	1.1
A2	297.8	103.5	8.3	225.0	86.7	7.0
A3	25.5	12.8	1.0	25.5	12.8	1.0
Baa1	84.4	41.1	3.3	80.8	40.4	3.2
Unrated	1.7	1.6	0.1	1.7	1.6	0.1
Total	**2,601.1**	**282.3**	**22.6**	**2,930.5**	**246.1**	**19.7**

The Group's treasury investments are held to provide liquidity and 99.9%, at a prudential consolidation group level, of these investments are investment grade (i.e. are rated Baa3 or better).

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

Within the treasury investments portfolio the Group had no direct sovereign exposure to Greece, Ireland, Italy, Portugal, Cyprus and Spain at 31 December 2014.

The table below sets out the risk weighted assets for the liquidity book by geographical region as at 31 December 2014.

	Prudential Consolidation Group			**Individual Consolidation Group**		
Geographical region	**Exposure £m**	**Risk Weighted Assets £m**	**Capital Req't £m**	**Exposure £m**	**Risk Weighted Assets £m**	**Capital Req't £m**
UK	2,104.5	211.4	16.9	2,537.4	196.0	15.7
Rest of Europe	179.1	37.9	3.0	161.4	34.3	2.8
North America & Canada	86.6	22.0	1.8	35.8	11.8	0.9
Australasia	55.1	11.0	0.9	20.1	4.0	0.3
Supranational Institutions	175.8	-	-	175.8	-	-
Total	**2,601.1**	**282.3**	**22.6**	**2,930.5**	**246.1**	**19.7**

To obtain the risk weights and hence calculate the minimum credit risk capital requirement for wholesale lending exposures, the Society uses Moody's and Fitch as External Credit Assessment Institutions (ECAIs).

The Group's preference is to use the long-term rating, however, if this is unavailable the short-term rating is used. 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 for the prudential consolidation group. The credit quality step is assigned based upon the type of exposure and its associated credit rating.

Central Governments and Central Banks				
Credit quality step	**Maturity**	**Risk weighting**	**Moody's ratings**	**Exposure values £m**
1	All	0%	Aaa-Aa3	**1,394.8**

Multilateral Development Banks				
Credit quality step	**Maturity**	**Risk weighting**	**Moody's ratings**	**Exposure values £m**
1	All	0%	Aaa-Aa3	**175.8**

Financial Institutions				
Credit quality step	**Maturity**	**Risk weighting**	**Moody's ratings**	**Exposure values £m**
1	All	20%	Aaa to Aa3	315.7
2	Residual / original maturity < 3 months	20%	A1 to A3	185.0
2	Original maturity > 3 months	50%	A1 to A3	187.7
3	Original maturity < 3 months	20%	Baa1 to Baa3	3.6
3	Original maturity > 3 months	50%	Baa1 to Baa3	80.8
4	All	100%	Unrated	1.7
				774.5

Residential Mortgage Backed Securities				
Credit quality step	**Maturity**	**Risk weighting**	**Moody's ratings**	**Exposure values £m**
1	All	20%	Aaa to Aa3	**207.4**

Covered Bonds				
Credit quality step	**Maturity**	**Risk weighting**	**Moody's ratings**	**Exposure values £m**
1	All	10%	Aaa to Aa3	**48.6**

Total	**2,601.1**

5.1.5 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 and strong mandate controls. These are independently reviewed by the Policy and Risk Framework team within Credit Risk.

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

ALCO (under delegated authority from the Board) sets policy limits to manage wholesale lending credit risk concentrations. Compliance with these limits is monitored daily, and formally reported to the Group Wholesale Credit Committee and ALCO monthly.

5.1.6 Impairment provisions

Loan loss impairment is held for all mortgage loans where objective evidence indicates losses are likely, where 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, evidenced by arrears or default or delinquency in their contractual monthly mortgage repayments or where the debt is being renegotiated to reduce the burden on the borrower.

For properties that are in possession, or where circumstances warrant (for example, properties that are on a defined ‘watch list’) a specific provision is calculated on an account-by-account basis, the provision is calculated as the difference between the mortgage balance and the potential recovery amount driven primarily by the present value of the mortgaged property. 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 recovered, impairment is calculated through the use of credit risk models used to estimate losses by looking at groups of loans with similar characteristics, based on historical data including the probability of possession given default and average forced sale discounts.

Modelled impairment is also held against the remaining portfolio of loans and advances where evidence indicates that credit losses have been incurred but not yet identified at the reporting date. The impairment value is calculated by the use of credit risk models that use historic data on our mortgage portfolios where accounts 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 modelled 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.

Further overlays are applied to ensure that the appropriate level of provisions is being held on accounts that are in long term arrears and to provide for accounts that are currently performing purely due to the low interest rate environment.

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

	Prudential Consolidation Group		**Individual Consolidation Group**	
	2014 £m	2013 £m	**2014 £m**	2013 £m
Neither past due nor individually impaired	11,868.1	10,490.8	11,129.5	9,843.9
Individually impaired:				
Low risk	95.7	160.8	95.2	159.9
High risk	236.1	241.9	235.8	240.2
Possessions	8.5	18.8	8.5	18.8
	12,208.4	10,912.3	**11,469.0**	10,262.8

Accounts are classified as impaired when they have missed one or more payments. Consequently all past due accounts are classified as impaired. 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%.

The performance of the Society's prime residential mortgage book remains good with arrears rates falling. Arrears levels within the specialist residential mortgage portfolios held in Amber and NYM have also fallen, leading to a significant reduction in impaired loans.

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 recover. 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. All customer accounts are monitored regularly to ensure that these strategies remain appropriate.

The tables on the following page provide further information on residential mortgages at 31 December 2014, for the prudential and individual consolidation groups, 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:

Prudential Consolidation 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	**11,868.1**	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**
	12,208.4	**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**
	12,161.6	**5.3**	**75.1**	**42.9**	**30.7**	**154.0**	**1.3**

Individual Consolidation 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	**11,129.5**	4.3	41.6	21.2	25.4	**92.5**	**0.8**
Individually impaired:							
Low risk	**95.2**	-	13.6	4.5	1.9	**20.0**	**21.0**
High risk	**235.8**	0.8	19.2	4.9	2.2	**27.1**	**11.5**
Possessions	**8.5**	-	0.4	0.5	-	**0.9**	**10.6**
	11,469.0	**5.1**	**74.8**	**31.1**	**29.5**	**140.5**	**1.2**
Collective impairment	**(26.9)**	-	-	-	-	**-**	**-**
Individual impairment	**(19.9)**	(0.3)	(1.9)	(0.9)	(0.2)	**(3.3)**	**16.6**
	11,422.2	**4.8**	**72.9**	**30.2**	**29.3**	**137.2**	**1.2**

Account renegotiation options are considered on a case-by-case basis in line with industry guidance and best practice to support customers through a temporary period of financial difficulty. The impact of any such forbearance is recognised within our provisioning policy. The proportion of renegotiated mortgage accounts within the portfolios has reduced during the year to the end of 2014, a trend that is in line with the overall reduction in mortgage arrears.

When a loan is not collectable, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recorded in the income statement.

The collective impairment includes £17.5m that relates to an equity release residential mortgage book. Under the terms of these mortgages 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.

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.

The table on the following page shows the impairment charges for the year to the income statement for residential lending and other loans for the prudential consolidation group.

Prudential Consolidation Group	**Loans fully secured on residential property £m**	**Other loans £m**	**Total £m**
At 1 January 2014			
Individual impairment	29.9	1.1	31.0
Collective impairment	18.6	-	18.6
	48.5	**1.1**	**49.6**
Amounts written off during the year, net of recoveries			
Individual impairment	(11.6)	(0.4)	(12.0)
Collective impairment	(0.1)	-	(0.1)
	(11.7)	**(0.4)**	**(12.1)**
Income statement			
Impairment losses on loans and advances			
Individual impairment	2.1	0.2	2.3
Collective impairment	8.4	-	8.4
	10.5	**0.2**	**10.7**
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**	**0.2**	**10.2**
At 31 December 2014			
Individual impairment	**19.9**	**0.9**	**20.8**
Collective impairment	**26.9**	**-**	**26.9**
	46.8	**0.9**	**47.7**

The performance of the Society's prime residential mortgage book remains good and arrears levels within the specialist residential mortgage portfolios held in Amber and NYM have also fallen leading to a significant reduction in impairment held compared with the prior year. However, the overall impairment requirement has only reduced slightly due to an increase in the loan loss impairment held for equity release.

Commercial Impairment Provisions

Individual impairment provisions are made to reduce the value of commercial loans to the present value that is ultimately likely to be received, based upon objective evidence.

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 an estimate of the current property valuation (based on a third party valuation index) which is discounted further to assume a forced sale value in addition to default propensity modelling which is modelling the likelihood of default.

In addition a management overlay is applied to ensure that the appropriate level of provisions is being held and reflective of likely future losses.

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

	Prudential and Individual Consolidation Groups	
	2014	2013
	£m	£m
Neither past due nor individually impaired	375.3	395.1
Individually impaired:		
Low risk	0.8	3.0
High risk	6.0	11.7
	382.1	409.8

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%.

The Group applies the same policy of forbearance to its commercial customers as it does to its residential customers.

The table below shows the impairment charges for commercial lending for the year to the income statement for the prudential and individual consolidation groups:

	Loans fully secured on land £m
At 1 January 2014	
Individual impairment	5.4
Collective impairment	4.1
	9.5
Amounts written off during the year	
Individual impairment	(1.4)
Collective impairment	-
	(1.4)
Income statement	
Impairment losses on loans and advances	
Individual impairment	2.6
Collective impairment	0.5
	3.1
Adjustment to impairment losses on loans and advances resulting from recoveries during the year	
Individual impairment	-
Charge for the year	**3.1**
At 31 December 2014	
Individual impairment	6.6
Collective impairment	4.6
	11.2

The table on the following page 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.

Prudential and Individual Consolidation Groups	**2014** £m	**Capitalisation** £m	**Reduced payment** £m	**Transfer to interest only** £m	**Total renegotiations** £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**

5.1.7 Impairment of treasury assets

The table below sets out the Treasury asset loan impairment position for the Group for the year ended 31 December 2014 which is the same for all levels of consolidation. The table highlights an additional £2.0m impairment which was taken during the year in respect of a Financial Institution asset and £5.5m of impairment which was utilised following the sale of a legacy UK Commercial Mortgage Backed Security (CMBS).

Prudential and Individual Consolidation Groups	**£m**
At 1 January 2014	
Individual impairment	6.0
	6.0
Amounts written off during the year	
Individual impairment	(5.5)
	(5.5)
Income Statement	
Impairment losses on treasury assets	
Individual impairment	2.0
	2.0
Adjustment to impairment losses on loans and advances resulting from recoveries during the year	
Individual impairment	-
Charge for the year	**2.0**
At 31 December 2014	
Individual impairment	2.5
	2.5

5.1.8 Credit risk mitigations

The Group has available to it a variety of methods and techniques to reduce the credit risk of its lending. New lending policy is prudent, assessing both the overall risk of the customer and their ability to service the debt in a higher interest rate environment.

Where a customer gets into financial difficulty experienced staff are employed to assess individual borrowers' financial capability, assisting where practical and ensuring a fair outcome for the customers concerned. 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.

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 such assets acquired in its operations.

Residential mortgages

Typically 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 is 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 were undertaken prior to inception of the loan by suitably qualified professionals with relevant expertise in commercial properties. In addition to the requirement to revalue all commercial properties with a balance greater than €3m every three years, 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.

5.1.9 Wholesale counterparty credit risk mitigation

Collateral held as security for wholesale assets is determined by the nature of the instrument. Loans, debt securities and treasury bills are generally unsecured, with the exception of securitisation positions which are secured by pools of financial assets.

For repurchase agreements, the Global Master Repurchase Agreement (GMRA) document is utilised to mitigate credit risk. Valuations are agreed with the relevant counterparties and collateral is then exchanged in order to bring the credit exposure within agreed tolerances.

Derivative counterparty credit risk mitigation is discussed under the following section.

5.1.10 Derivative counterparty credit risk mitigation

The Group uses derivative instruments (interest rate, foreign currency and equity) to hedge its exposure to market risk. 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 by the Group in accordance with the Building Societies Act 1986 to hedge risk exposures only and are not used for trading or speculative purposes. The principal derivatives used by the Group are interest rate exchange contracts, commonly known as interest rate swaps, interest rate options and foreign exchange contracts.

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 addresses this risk by using legal documentation for counterparty derivative transactions that grants legal rights of set-off for those transactions. Accordingly, the credit risk associated with such contracts is reduced to the extent that negative mark to market valuations on derivatives will be offset by positive mark to market values on derivatives, subject to a minimum exposure of zero.

International Swaps and Derivatives Association (ISDA) documentation confers the ability to use designated cash collateral to set against derivative credit exposures in the event of counterparty default. Frequent (at least weekly) rebalancing of the collateral reduces the potential increase in future credit exposure. For such collateralised exposures, the posting of collateral reduces the impact of the current market value to the difference between the market value of the sensitivities and the value of the collateral. The difference is limited by the operational use of ‘thresholds’ and ‘minimum transfer amounts’ which set criteria to avoid the movement of small amounts of collateral.

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

The exposure value on derivative counterparty credit risk exposures at 31 December 2014 was:

Exposure to Derivative Counterparty Credit Risk	**Prudential Consolidation Group £m**	**Individual Consolidation Group £m**
Interest rate contracts	158.9	159.9
Foreign exchange contracts	-	-
Other contracts	34.1	34.1
Gross positive fair value of contracts	**193.0**	194.0
Netting benefits	(78.2)	(72.1)
Netted current credit exposure	**114.8**	121.9
Collateral held	(47.3)	(47.3)
Net derivative credit exposure	**67.5**	74.6

Note 14 of the statutory accounts disclose Mark To Market’s (MTM’s) on all derivatives and the notionals (face value of the contracts). The purpose of Pillar 3 is to disclose replacement costs of those derivatives and, therefore, we include calculated add-ons to the MTM hence the difference in value. The add-ons are additional amounts to recognise potential future credit exposure and are currently calculated based on the notional, residual maturity and type of contract.

The net exposure value to derivatives at 31 December 2014 was £67.5m for prudential consolidation group, and £74.6m for the individual consolidation group.

As at 31 December 2014, the external counterparties with whom the Group held derivative instruments had Moody's or equivalent credit ratings ranging from Aaa to Baa1.

If the Society is downgraded, there would be no material impact on the collateral required. Wrong-way risk may occur when the credit risk related to an exposure to a counterparty is adversely correlated with the credit quality of the counterparty. The Society is not exposed to this type of risk.

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

5.1.11 Securitisation

The Group has securitised certain residential mortgage loans by the transfer of the beneficial interest in such loans to three special purpose vehicles (SPVs). The securitisation enables a subsequent issuance of debt by the SPVs, 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.

At the end of 2014, the SPVs named Darrowby No. 1 plc (Darrowby 1), Darrowby No. 2 plc (Darrowby 2) and Darrowby No. 3 plc (Darrowby 3), constituted wholesale funding of £723m (net of amortised costs). Our securitisation capability allows the Group to access this source of funding and provides further opportunity for wholesale funding in the future. The Society takes the role of seller, administrator and cash manager in relation to each of the transactions and retains the first loss element.

As there is not considered to be a transfer of significant credit risk, the Society does not calculate risk weighted exposure amounts for any positions it holds in the securitisation and these continue to be calculated in line with capital requirements consistent with other mortgage assets.

Darrowby 1 was incorporated in November 2010. In March 2011, Darrowby 1 issued £1,032m of AAA rated debt securities. The Notes are rated by both Fitch and Moody's. As at 31 December 2014, rated debt securities totalled £347m of which £213m was held by the Group and partially pledged in a repurchase agreement.

Darrowby 2 was incorporated in June 2011. In May 2012, Darrowby 2 issued £475m of AAA rated debt securities. The Notes are rated by both Fitch and Moody's. As at 31 December 2014, rated debt securities totalled £244m.

Darrowby 3 was incorporated in July 2013. In April 2014, Darrowby 3 issued £400m of AAA rated debt securities. The Notes are rated by both Fitch and Moody's. As at 31 December 2014, rated debt securities totalled £348m.

31 December 2014

Securitisation Company	Type	Gross Assets Securitised £m	Notes held by third parties[1] £m	Notes held by the Group[1,2] £m	Underlying assets past due and impaired £m
Darrowby 1	Residential Mortgage Backed Securities	505.7	134.3	381.0	8.7
Darrowby 2	Residential Mortgage Backed Securities	304.8	243.5	71.0	2.3
Darrowby 3	Residential Mortgage Backed Securities	386.6	348.2	47.0	1.0

31 December 2013

Securitisation Company	Type	Gross Assets Securitised £m	Notes held by third parties[1] £m	Notes held by the Group[1,2] £m	Underlying assets past due and impaired £m
Darrowby 1	Residential Mortgage Backed Securities	633.5	184.3	460.3	9.2
Darrowby 2	Residential Mortgage Backed Securities	379.6	322.7	71.0	2.5
Darrowby 3	Residential Mortgage Backed Securities	-	-	-	-

Notes

1. Excludes accrued interest
2. Retained rated Class A Notes (and those partially pledged in a repurchase agreement) and Class B Notes

The Group also has exposure to its investment in Mortgage Backed Securities (see section 5.1.4).

5.2 Operational risk

5.2.1 Conduct and operational risk definition and approach

Conduct and operational risk is the risk of poor customer outcomes or financial loss resulting from inadequate or failed internal processes, systems, people, culture and/or from external factors.

The Group has adopted the standardised approach to operational risk, compliant with the requirements of CRD IV.

With a diverse business model and an ever more competitive operating environment, the Board acknowledges that the Group is exposed to increased levels of operational risk from continuing operations, for example in terms of systems capability and staff competencies. The financial services sector also faces growing levels of financial crime, particularly in relation to e-distribution channels, which require increasingly sophisticated controls.

5.2.2 Operational risk framework

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

- Information Technology
- Legal and Regulatory
- People & Culture
- Property & Facilities
- Process Management
- Third Party Relationships
- Business Continuity
- Change Management
- Customer & Client Experience
- Financial Control and Management Information
- Financial Crime
- Information Security

The Group's Conduct and Operational Risk 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 manage or mitigate those risks. The framework is updated periodically to take account of changes in business profile, new product development, and the external operating environment.

The Conduct and Operational Risk framework reflects common risk themes, for example, Financial Crime and Information Security, where customer assets and/or customer data are at risk of compromise. The Group continues to invest in, and further enhance, its conduct and operational risk management processes and oversight arrangements.

5.2.3 Operational risk oversight and governance

Oversight and governance arrangements for the setting and management of a robust conduct and operational risk management policy and framework are the responsibility of the Board, Board Risk Committee and the Conduct and Operational Risk Committee. Each committee has defined Terms of Reference detailing their accountability and responsibilities.

The role of the Conduct and Operational Risk Committee (CORC) is to ensure that appropriate frameworks are in place to identify, assess and manage 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 appetite statements.

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 and risk events which are used to identify any potential systemic weaknesses in operating processes.

Given the nature of the regulated sectors in which the Group operates it is key to ensure ongoing compliance with relevant external regulation across the Group. To manage this, each of the regulated businesses has an established Compliance team which monitors both compliance with existing legislation and considers 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.

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

Through its adoption of the standardised approach to operational risk management, the Group 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 risk factors, known as 'beta factors'.

As at 31 December 2014 this approach resulted in the Pillar 1 minimum risk weighted assets as follows:

	Prudential Consolidation Group		**Individual Consolidation Group**	
	2014 £m	**2013 £m**	**2014 £m**	**2013 £m**
Operational Risk Weighted Asset (RWA)	**297.0**	339.5	**199.9**	125.2
Operational Risk Capital Requirement (RWA x 8%)	**23.8**	27.2	**16.0**	10.0

The capital required for operational risk decreased during the year at a prudential consolidation group level due to the disposal of two subsidiary companies; Homeloan Management Ltd and Torquil Clark Ltd.

5.3 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; foreign currency risk; and equity risk. The Society is not impacted by commodity price risk. Market risk arises only in the banking book (apart from the Group's defined benefit pension schemes which is managed by the Trustees of the schemes – see section 6.6) as the Group does not have a trading book.

The Society's Treasury function is responsible for managing the Group's exposure to all aspects of market risk in the banking book within the operational limits set out in the Group's Treasury Policy. The Market and Liquidity Risk function (second line of defence) monitors the interest rate exposure of the Group through a variety of interest rate risk metrics e.g. static earnings at risk and historical value at risk.

ALCO recommends the Group's Treasury Policy to BRC for approval on an annual basis. ALCO receives regular information on all relevant aspects of market risk exposure, including the continuing effectiveness of hedges. Currency risk is included in the Society's Pillar 1 capital requirement calculations; other market risks are considered under Pillar 2 capital requirements.

5.3.1 Currency risk

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

Throughout the year, the Group had no material direct exposure to foreign currency exchange fluctuations. The Group's currency risk appetite is low and any issuance denominated in foreign currency is immediately swapped into Sterling.

The Group's exposure to foreign exchange risk is calculated in accordance with CRD IV, representing 8% of the net sterling equivalent of the foreign currency assets and liabilities. As at 31 December 2014, the capital required for the foreign currency risk was negligible at both the prudential and individual consolidation levels.

The own funds requirement under Articles 351 and 352 of CRR is De Minimis. For both the prudential and the individual consolidation group the own funds requirement for foreign-exchange risk is below the 2% of own funds threshold, contained within Article 351 of the CRR.

6.0 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 5. These risks are considered under Pillar 2 of the risk management framework.

6.1 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.

6.2 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.

6.3 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.

6.4 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.

6.5 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.

6.6 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 Trustees receive professional advice from different actuarial advisers.
- The pension scheme Trustee meets 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 BRC.

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

6.7 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. 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.

6.8 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 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. As part of the Interest Rate Risk Calculation, there are a series of assumptions concerning prepayment of loans of different durations. These assumptions are based on historical prepayment profiles for each specific duration. In addition, it is assumed that non-maturing deposits are stable.

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 exchange 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.

The Group uses a number of different metrics to monitor interest rate risk and details of these are set out below.

Repricing Gap Analysis

To assess the Pillar 2 capital requirement for interest rate risk, the Group determines the effect on the Group's asset and liability gap positions of a 2% parallel shift in interest rates for all maturities. Results are compared to Board and Operational limits weekly and formally reported to ALCO and the Board monthly.

An analysis of repricing dates is performed to ensure that excessive net assets or liabilities repricing within a given time period is avoided. Key assumptions used in the repricing gap analysis include that net free Reserves are assumed to re-price proportionately across repricing bands (up to six years); that small amounts of mortgage loan prepayments will occur; and that fixed assets and other liabilities are classified as having 'non-specific' repricing.

Earnings-at-Risk and Market Value Sensitivity

Other interest rate risk metrics employed by the Group incorporate Earnings-at-Risk and market value methodologies, which calculate interest rate risk exposure positions. The Historical Value-at-Risk metric is based on 250 historical data observations going back over approximately the last seven years, whilst the Earnings-at-Risk metric uses 100 stochastically paths as the basis for calculation. All of these approaches employ 95% confidence intervals and are multi-currency. Additionally, 99% confidence intervals are shown for information. These advanced interest rate risk measurement exposures, which are compared to Board and Operational limits at least monthly and are formally reported to ALCO and the Board monthly, are used to guide interest rate risk management decisions.

Although these measures provide valuable insights to 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. As previously mentioned, the 99% confidence levels are also monitored to try to mitigate this limitation;
- 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; however, analysis on dynamic positions is now being performed.

The interest rate exposures during 2014 were as follows:

	As at 31 December	**Average**	**High**	**Low**
	£m	**£m**	**£m**	**£m**
Static Earnings-at-risk	11.9	7.9	11.9	4.3
Historical Value-at-risk	1.4	3.3	5.2	1.4
2% Parallel interest rate shift	10.3	8.2	14.6	4.4

6.9 Equity risk

This is the risk of loss due to movements in equity markets. The Group is exposed to savings products where the return to the customer is linked to the performance of equity markets and hedges this risk through the use of derivative contracts.

As at 31 December 2014 the Group had £135m of equity related savings balances which were appropriately hedged.

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).

6.10 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 and maintain public confidence.

The Group's Treasury function is responsible for the day-to-day management of the Group's liquidity and wholesale funding. 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 and Risk personnel (i.e. independent of Treasury) and additionally, a series of liquidity stress tests are performed weekly by the Market Risk team and formally reported to ALCO and the Board, to ensure that the Group maintains adequate liquidity for business purposes even under stressed conditions.

The Group's liquidity and funding policies have been reviewed and enhanced in line with the PRA's liquidity regime *PRA Policy Statement 09/16 'Strengthening Liquidity Standards'* and, since June 2010, the Group has reported its liquidity position against Individual Liquidity Guidance (ILG) provided by the PRA for regulatory purposes. The Group continues to exceed both the ILG requirement and satisfy its own internal liquidity risk appetite.

Liquidity regulation is changing towards the international CRD IV measures, namely the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). The Society has already been measuring and monitoring its compliance against these ratios, and has both an LCR and NSFR comfortably in excess of 100% and is therefore in a good position for when the regulations come into force in October 2015 and January 2018 respectively.

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.

During this year, the Group has been using the Funding for Lending Scheme with the Bank of England. However, the Group's main source of funding is retail deposits, which accounted for 85.9% (2013: 84.6%) of the total funding.

The Group also maintained the quality of the liquidity portfolio by focussing on high quality UK Government issued debt 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.

7.0 Leverage ratio

The CRD IV regulations include the introduction of a new capital leverage ratio defined as the ratio of Tier 1 capital to total exposure. This metric is a non-risk based measure used to manage the risk of excessive leverage. The leverage ratio is subject to an observation period by the European Banking Authority (EBA) from the 1 January 2013 until 1 January 2017. Following this a binding requirement will be finalised for implementation on 1 January 2018.

In January 2014 the Basel Committee set out a revised definition of the leverage ratio. We have applied this definition to calculate the leverage ratio. The tables below set out the leverage ratio for the prudential group and the individual group under the CRD IV transitional rules and fully loaded definition.

	Transitional CRD IV		**Fully Loaded CRD IV**	
Prudential Consolidation Group	**31.12.2014 £m**	**1.1.2014[1] £m**	**31.12.2014 £m**	**1.1.2014[1] £m**
Total Tier 1 capital:	**1,012.3**	869.3	**946.0**	801.5
Total balance sheet assets	15,797.6	14,310.1	15,797.6	14,310.1
Derivatives (note 2)	(65.0)	(80.3)	(65.0)	(80.3)
Securities Financing Transactions (SFTs) (note 3)	36.5	83.0	36.5	83.0
Regulatory adjustments (note 4)	27.4	10.8	27.4	10.8
Leverage exposure: (note 5)	**15,796.5**	14,323.6	15,796.5	14,323.6
Leverage ratio	**6.4%**	6.1%	**6.0%**	5.6%

Notes
1. The comparative figures have been restated from those disclosed in Section 8, CRD IV, in the 2013 document, due to a change in accounting policy relating to the FSCS levy and a revised interpretation of the CRD IV regulations. See sections 3 and 4 for further details.
2. Exposure values associated with derivatives have been adjusted to comply with the current CRD IV regulations. For the purpose of the leverage ratio, the derivative measure is calculated as the replacement cost for the current exposure plus an add-on for potential future exposure.
3. The exposure values associated with SFTs have been adjusted to comply with the current CRD IV regulations.
4. These are adjustments for cash flow hedge reserve, goodwill, intangible assets, AVA, mortgage pipeline, non drawn down intra group funding and current tax. These adjustments are made to ensure the denominator balance meets CRD IV regulations and those released in January 2014 by the BCBS.
5. The exposure values used for the leverage ratio differ to those used for credit risk exposures for undrawn credit facilities. Such facilities may be cancelled unconditionally at any time allowing credit conversion factors, subject to a floor of 10% to be applied to these items in accordance with the leverage ratio CRD IV rules.

The total asset balance shown in the table above is the position for the prudential group and will therefore be different to the balance in the Statement of Financial Position in the 2014 Annual Report and Accounts which is based on the full Group.

8.0 Remuneration

The Directors Remuneration Report which is set out on pages 56 to 65 of the Group's Annual Report and Accounts which are published on the Society's website www.skipton.co.uk sets out the policies and procedures for determining the remuneration policy of the Society and the link between pay and performance including the performance pay plans. The disclosures in this document below refer to SFS and SIL.

8.1. Remuneration committees

Details of the Board Remuneration Committee are set out in section 2.12

SFS and SIL have their own Remuneration Committees which oversee remuneration practices in their respective businesses and ensure that they comply with the Group remuneration principles.

The SFS Remuneration Committee, which comprises one Non Executive Director, the Managing Director, Finance Director, Distribution Director, Marketing & Technical Director plus the Group's Chief Human Resource Officer and Human Resource Manager, met four times in 2014. Its remit is to ensure that remuneration policies and practices enable SFS to attract, retain and reward people with the right skills, experience, knowledge and behaviours to support the achievement of business goals and objectives, that they support the right culture and adhere to group remuneration principles and conduct risk appetite. The remuneration of the Board members is approved by the Chairman of SFS's Remuneration Committee and overseen by the Society Remuneration Committee.

The SIL Remuneration Committee is made up of three Non-Executive Directors (of SIL) and two Shareholder Directors. The Committee met twice in 2014, firstly to approve the 2013 bonus payment and 2014 salary and secondly to agree the 2015 bonus scheme and to implement CRD IV remuneration principles.

8.2 Material risk takers (MRTs)

In 2014, in accordance with CRD IV, criteria for the identification of 'Code staff', now referred to as Material Risk Takers (MRTs), the Society carried out a review to ascertain which group subsidiary companies fall within scope of the new regulations. The review identified two subsidiary companies, falling within the scope of the regulations, SFS and SIL. SIL is based in the Channel Islands and is regulated by the Guernsey Financial Services Commission. The Board of SIL agreed in 2014 to follow the UK implementation of the new CRD IV remuneration requirements and to identify Material Risk Takers.

The PRA's 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 and other subsidiaries in scope of the PRA regulations are grouped in Tier 3 with banks and building societies with total assets averaging less than £15bn over the last three financial years.

8.2.1 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. 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 each business. The Society's MRTs are set out in the 2014 Group Annual Reports and Accounts.

SFS and SIL operate their own independent bonus schemes. SFS has two annual bonus schemes which apply to their MRT population which follow similar principles and are weighted 50% on financial metrics and 50% on commercial, employee, customer and quality measures. The maximum does not exceed 50% of basic salary for either scheme.

The SFS MRTs who are part of the Company's Senior Management Group are also eligible to participate in a Medium Term Incentive Plan (MTI). The plan is based 50% on the achievement of financial measures (Group contribution over the three year period) and 50% on business quality and customer strategy measures. The two measures operate independently but there is an 85% threshold on the financial element. The payments, which are subject to performance, are made 50% in year one and 25% in years two and three following the end of the performance period.

The SIL Annual Bonus Scheme is based on a mixture of corporate objectives including financial, commercial and audit quality measures. The remainder of the bonus award is based on performance against personal objectives which is assessed through the annual appraisal process. In 2014, bonus payments to SIL MRTs did not exceed 41% of base salary.

The table below sets out the aggregate remuneration for MRTs in each business for the year ended 31 December 2014.

2014	**Number of beneficiaries**	**Fixed Remuneration £000**	**Variable Remuneration Current year annual performance pay (1) £000**	**Total £000**
Material Risk Takers (SFS)	7	894	474	1,368
Material Risk Takers (SIL)	8	545	162	707
	15	**1,439**	**636**	**2,075**

Note

1. Awards for the SFS 2014-2016 MTI scheme are included in the above disclosures at the maximum amounts payable (i.e. 50% of base salary). Payments from the scheme, which are subject to performance, are due to be made in 2017, 2018 and 2019.

9.0 Asset encumbrance

Encumbrance occurs through the pledging of assets to secured creditors; such assets become unavailable for other purposes. The Society may encumber assets for a number of reasons, including 1) to attain short / long term funding through repo/securities lending arrangements including the Bank of England's Sterling Monetary Framework and the Funding for Lending Scheme; 2) attain long term funding through secured funding transaction, such as securitisations; and 3) to collateralise derivative exposures through credit support annexes (CSAs) with counterparts and in future through centralised derivative clearing.

The Society's Treasury department use repurchase agreements/securities lending transactions as an everyday liquidity tool and has a range of counterparties whereby assets may be encumbered in order to raise funding. Typically these encumbered assets are Treasury instruments, but may also include mortgage assets to act as collateral. Treasury regularly test the liquidity of certain instruments by entering into such transactions.

Mortgage assets are also used in long term secured funding transactions. To date, the Group has completed three securitisation transactions, whereby the beneficial interest in certain mortgages are transferred to special purpose vehicles (SPVs). The securitisation enables a subsequent issuance of debt, by the SPVs, to investors who gain the security of the underlying assets as collateral. 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.

The Group has an asset encumbrance limit which is set by the Board of Directors and reviewed on a regular basis.

The following tables have been compiled in order to comply with the European Banking Authority's guidelines on disclosure of encumbered and unencumbered assets, as adopted by the Prudential Regulation Authority under CP18/14. The Group is not required to provide details about collateral received.

Prudential Group at 31 December 2014

Assets

£m		**Carrying amount of encumbered assets**	**Fair value of encumbered assets**	**Carrying amount of unencumbered assets**	**Fair value of unencumbered assets**
EBA reference number		**010**	**040**	**060**	**090**
010	Assets of the reporting institution	2,158.6	-	13,613.8	-
030	Equity instruments	-	-	1.7	1.7
040	Debt securities	213.9	213.9	937.1	938.3
120	Other assets[1]	1,944.7	-	12,675.1	-

Notes

1. Other assets include loans and advances (inc. mortgages) and other balance sheet items not listed above.

Encumbered assets/collateral received and associated liabilities

£m		Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
EBA reference number		**010**	**030**
010	Carrying amount of selected financial liabilities	1,670.5	2,558.2

Individual Group at 31 December 2014

Assets

£m		Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
EBA reference number		**010**	**040**	**060**	**090**
010	Assets of the reporting institution	2,159.6	-	12,789.2	-
030	Equity instruments	-	-	1.7	1.7
040	Debt securities	214.9	214.9	893.5	894.8
120	Other assets[1]	1,944.7	-	11,894.1	-

Notes

1. Other assets include loans and advances (inc. mortgages) and other balance sheet items not listed above.

Encumbered assets/collateral received and associated liabilities

£m		Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
EBA reference number		**010**	**030**
010	Carrying amount of selected financial liabilities	1,757.7	2,645.5

Glossary

Set out below are the definitions of terms used within the Pillar 3 disclosures 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.
Basel II	Basel II is 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.
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.
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.
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.
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.
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.
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.
Internal 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.
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 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.
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.
Member	A person who has a share investment or a mortgage loan with the Society.
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.
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.
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.
Residential loans	Mortgage lending secured against residential property.
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.
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.

Appendix 1: Own funds disclosure template

The table below shows the own funds position of the individual and the prudential consolidation group in line with Annex IV to Annex VII of the EBA Technical Standards on disclosure for own funds by institutions under Article 437(2) and 492(5) of the Capital Requirements Regulation. This has been shown on both the transitional and the fully loaded basis to show the current own funds position and the position once all of the regulations have been phased in and implemented.

		Prudential Group				Individual Group			
		Current Rules		Full Impact		Current Rules		Full Impact	
		2014 £m	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m
Common Equity Tier 1 (CET1) Capital: Instruments and Reserves									
1	Capital instruments and the related share premium accounts	**-**	-	**-**	-	**-**	-		-
	of which: Instrument type 1	**-**	-	**-**	-	**-**	-	**-**	-
	of which: Instrument type 2	**-**	-	**-**	-	**-**	-	**-**	-
	of which: Instrument type 3	**-**	-	**-**	-	**-**	-	**-**	-
2	Retained Earnings	**820.3**	769.6	**823.4**	773.8	**789.3**	735.9	**792.3**	741.0
3	Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards)	**-**	(5.5)	**2.6**	(5.5)	**-**	(5.5)	**2.6**	(5.5)
3a	Funds for general banking risk	**-**	-	**-**	-	**-**	-	**-**	-
4	Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET1	**-**	-	**-**	-	**-**	-	**-**	-
	Public sector capital injections grandfathered until 1 January 2018	**-**	-	**-**	-	**-**	-	**-**	-

		Prudential Group				Individual Group			
		Current Rules		Full Impact		Current Rules		Full Impact	
		2014 £m	1.1.14 £m	2014 £m	1.1.14 £m	2014 £m	1.1.14 £m	2014 £m	1.1.14 £m
Common Equity Tier 1 (CET1) Capital: Instruments and Reserves (cont.)									
5	Minority Interests (amount allowed in consolidated CET1)	**-**	-	**-**	-	**-**	-	**-**	-
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	**126.8**	53.0	**126.8**	53.0	**132.8**	55.7	**132.8**	55.7
6	**Common Equity Tier 1 (CET1) capital before regulatory adjustments**	**947.1**	817.1	**952.8**	821.3	**922.1**	786.1	**927.7**	791.2
Common Equity Tier 1 (CET1) Capital: Regulatory Adjustments									
7	Additional value adjustments (negative amount)	**(0.9)**	(1.1)	**(0.9)**	(1.1)	**(0.9)**	(1.0)	**(0.9)**	(1.0)
8	Intangible assets (net of related tax liability) (negative amount)	**(11.2)**	(29.7)	**(11.2)**	(29.7)	**(1.7)**	(1.5)	**(1.7)**	(1.5)
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38(3) are met) (negative amount)	**-**	-	**-**	-	**-**	-	**-**	-
11	Fair value reserves related to gains or losses on cash flow hedges	**5.3**	11.0	**5.3**	11.0	**5.3**	11.0	**5.3**	11.0
12	Negative amounts resulting from the calculation of expected loss amounts	**-**	-	**-**	-	**-**	-	**-**	-
13	Any increase in equity that results from securitised assets (negative amount)	**-**	-	**-**	-	**-**	-	**-**	-
14	Gains or losses on liabilities valued at fair resulting from changes in own credit standing	**-**	-	**-**	-	**-**	-	**-**	-
15	Defined-benefit pension fund assets (negative amount)	**-**	-	**-**	-	**-**	-	**-**	-
16	Direct and indirect holdings by an institution of own fund CET1 instruments (negative amount)	**-**	-	**-**	-	**-**	-	**-**	-
17	Holdings of the CET1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution	**-**	-	**-**	-	**-**	-	**-**	-

		Prudential Group				Individual Group			
		Current Rules		Full Impact		Current Rules		Full Impact	
		2014 £m	1.1.14 £m	2014 £m	1.1.14 £m	2014 £m	1.1.14 £m	2014 £m	1.1.14 £m
Common Equity Tier 1 (CET1) Capital: Regulatory Adjustments (cont.)									
18	Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	-	-	-	-	-	-
19	Direct and indirect synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	-	-	-	-	-	-
20a	Exposure amount of the following items which qualify for a RW of 1250%, where the institution opts for the deduction alternative	-	-	-	-	-	-	-	-
20b	of which: qualifying holdings outside the financial sector (negative amount)	-	-	-	-	-	-	-	-
20c	of which: securitisation positions (negative amount)	-	-	-	-	-	-	-	-
20d	of which: free deliveries (negative amount)	-	-	-	-	-	-	-	-
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the conditions in 38 (3) are met) (negative amount)	-	-	-	-	-	-	-	-
22	Amount exceeding the 15% threshold (negative amount)	-	-	-	-	-	-	-	-
23	of which: direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities	-	-	-	-	-	-	-	-
25	of which: deferred tax assets arising from temporary differences	-	-	-	-	-	-	-	-
25a	Losses for the current financial year (negative amount)	-	-	-	-	-	-	-	-
25b	Foreseeable tax charges relating to CET1 items (negative amount)	-	-	-	-	-	-	-	-

		Prudential Group				Individual Group			
		Current Rules		Full Impact		Current Rules		Full Impact	
		2014 £m	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m
Common Equity Tier 1 (CET1) Capital: Regulatory Adjustments (cont.)									
26	Regulatory adjustments applied to Common Equity Tier 1 in respect of amounts subject to pre-CRR treatment	**-**	-	**-**	-	**-**	-	**-**	-
26a	Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468	**-**	-	**-**	-	**-**	-	**-**	-
	of which: … filter for unrealised loss 1	**-**	-	**-**	-	**-**	-	**-**	-
	of which: … filter for unrealised loss 2	**-**	-	**-**	-	**-**	-	**-**	-
	of which: … filter for unrealised gain 1	**-**	-	**-**	-	**-**	-	**-**	-
	of which: … filter for unrealised gain 2	**-**	-	**-**	-	**-**	-	**-**	-
26b	Amount to be deducted from or added to Common Equity Tier 1 capital with regard to additional filters and deductions required pre CRR	**-**	-	**-**	-	**-**	-	**-**	-
	of which: ...	**-**	-	**-**	-	**-**	-	**-**	-
27	Qualifying AT1 deductions that exceed the AT1 capital of the institution (negative amount)	**-**	-	**-**	-	**-**	-	**-**	-
28	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**(6.8)**	(19.8)	**(6.8)**	(19.8)	**2.7**	8.5	**2.7**	8.5
29	**Common Equity Tier 1 (CET1) capital**	**940.3**	797.3	**946.0**	801.5	**924.8**	794.6	**930.4**	799.7
Additional Tier 1 (AT1) Capital: Instruments									
30	Capital instruments and the related share premium accounts	**-**	-	**-**	-	**-**	-	**-**	-
31	of which: classified as equity under the applicable accounting standards	**-**	-	**-**	-	**-**	-	**-**	-
32	of which: classified as liabilities under the applicable accounting standards	**-**	-	**-**	-	**-**	-	**-**	-
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	**72.0**	72.0	**-**	-	**72.0**	72.0	**-**	-

		Prudential Group				Individual Group			
		Current Rules		Full Impact		Current Rules		Full Impact	
		2014 £m	1.1.14 £m	2014 £m	1.1.14 £m	2014 £m	1.1.14 £m	2014 £m	1.1.14 £m
Additional Tier 1 (AT1) Capital: Instruments (cont.)									
	Public sector capital injections grandfathered until 1 January 2018	-	-	-	-	-	-	-	-
34	Qualifying Tier 1 Capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties	-	-	-	-	-	-	-	-
35	of which: instruments issued by subsidiaries subject to phase out	-	-	-	-	-	-	-	-
36	**Additional Tier 1 (AT1) capital before regulatory adjustments**	**72.0**	72.0	-	-	**72.0**	72.0	-	-
Additional Tier 1 (AT1) Capital: Regulatory Adjustments									
37	Direct and indirect holdings by an institution of own fund AT1 instruments (negative amount)	-	-	-	-	-	-	-	-
38	Holdings of the AT1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution	-	-	-	-	-	-	-	-
39	Direct and indirect holdings of the AT1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	-	-	-	-	-	-
40	Direct and indirect synthetic holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	-	-	-	-	-	-
41	Regulatory adjustments applied to additional tier 1 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013) (i.e. CRR residual amounts)	-	-	-	-	-	-	-	-
41a	Residual amounts deducted from Additional Tier 1 capital with regard to deduction from Common Equity Tier 1 capital during the transitional period pursuant to article 472 of Regulation (EU) No 575/2013	-	-	-	-	-	-	-	-

		Prudential Group				Individual Group			
		Current Rules		Full Impact		Current Rules		Full Impact	
		2014 £m	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m
Additional Tier 1 (AT1) Capital: Regulatory Adjustments (cont.)									
	of which items to be detailed line by line, e.g. Material net interim losses, intangibles, shortfall of provisions to expected losses etc	**-**	-	**-**	-	**-**	-	**-**	-
41b	Residual amounts deducted from Additional Tier 1 capital with regard to deduction from Tier 2 capital during the transitional period pursuant to article 475 of Regulation (EU) No 575/2013	**-**	-	**-**	-	**-**	-	**-**	-
	of which items to be detailed line by line e.g. Reciprocal cross holdings in Tier 2 instruments, direct holdings of non-significant investments in the capital of other financial sector entities, etc	**-**	-	**-**	-	**-**	-	**-**	-
41c	Amount to be deducted from or added to Additional Tier 1 capital with regard to additional filters and deductions required pre-CRR	**-**	-	**-**	-	**-**	-	**-**	-
	of which: … possible filter for unrealised losses	**-**	-	**-**	-	**-**	-	**-**	-
	of which: … possible filter for unrealised gains	**-**	-	**-**	-	**-**	-	**-**	-
	of which: …	**-**	-	**-**	-	**-**	-	**-**	-
42	Qualifying T2 deductions that exceed the T2 capital of the institution (negative amount)	**-**	-	**-**	-	**-**	-	**-**	-
43	**Total regulatory adjustments to Additional Tier 1 (CET1)**	**-**	-	**-**	-	**-**	-	**-**	-
44	**Additional Tier 1 (AT1) capital**	**72.0**	72.0	**-**	-	**72.0**	72.0	**-**	-
45	**Tier 1 capital (T1 = CET1 + AT1)**	**1,012.3**	869.3	**946.0**	801.5	**996.8**	866.6	**930.4**	799.7
Tier 2 (T2) Capital: Instruments and Provisions									
46	Capital instruments and the related share premium accounts	**22.4**	24.4	**44.4**	46.4	**22.4**	24.4	**44.4**	46.4
47	Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	**33.3**	47.7	**-**	-	**33.3**	47.7	**-**	-

		Prudential Group				Individual Group			
		Current Rules		Full Impact		Current Rules		Full Impact	
		2014 £m	1.1.14 £m	2014 £m	1.1.14 £m	2014 £m	1.1.14 £m	2014 £m	1.1.14 £m
Tier 2 (T2) Capital: Instruments and Provisions (cont.)									
48	Qualifying Tier 1 Capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties	**-**	-	**-**	-	**-**	-	**-**	-
49	of which: instruments issued by subsidiaries subject to phase out	**-**	-	**-**	-	**-**	-	**-**	-
50	Credit risk adjustments	**-**	-	**-**	-	**-**	-	**-**	-
51	**Tier 2 (T2) capital before regulatory adjustments**	**55.7**	72.1	**44.4**	46.4	**55.7**	72.1	**44.4**	46.4
Tier 2 (T2) Capital: Regulatory Adjustments									
52	Direct and indirect holdings by an institution of own T2 instruments and subordinated loans (negative amounts)	**-**	-	**-**	-	**-**	-	**-**	-
53	Holdings of the T2 instruments and subordinated loans of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution	**-**	-	**-**	-	**-**	-	**-**	-
54	Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	**-**	-	**-**	-	**-**	-	**-**	-
54a	of which new holdings not subject to transitional arrangements	**-**	-	**-**	-	**-**	-	**-**	-
54b	of which holdings existing before 1 January 2013 and subject to transitional arrangements	**-**	-	**-**	-	**-**	-	**-**	-
55	Direct and indirect holdings by the institution of the T2 instruments of subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	**-**	-	**-**	-	**-**	-	**-**	-

		Prudential Group				Individual Group			
		Current Rules		Full Impact		Current Rules		Full Impact	
		2014 £m	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m
Tier 2 (T2) Capital: Regulatory Adjustments (cont.)									
56	Regulatory adjustments applied to tier 2 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts)	**-**	-	**-**	-	**-**	-	**-**	-
56a	Residual amounts deducted from Tier 2 capital with regard to deduction from Common Equity Tier 1 capital during the transitional period pursuant to article 472 of Regulation (EU) No 575/2013.	**-**	-	**-**	-	**-**	-	**-**	-
	of which items to be detailed line by line e.g. material interim net losses, intangibles, shortfall of provisions to expected losses, etc.	**-**	-	**-**	-	**-**	-	**-**	-
56b	Residual amounts deducted from Tier 2 capital with regard to deduction from Additional Tier 1 capital during the transitional period pursuant to article 475 of Regulation (EU) No 575/2013	**-**	-	**-**	-	**-**	-	**-**	-
	of which items to be detailed line by line, e.g. reciprocal holdings in AT 1 instruments, direct holdings of non significant investments in the capital of other financial sector entities, etc	**-**	-	**-**	-	**-**	-	**-**	-
56c	Amount to be deducted from or added to Tier 2 capital with regard to additional filters and deductions required pre CRR.	**-**	-	**-**	-	**-**	-	**-**	-
	of which: … possible filter for unrealised losses	**-**	-	**-**	-	**-**	-	**-**	-
	of which: … possible filter for unrealised gains	**-**	-	**-**	-	**-**	-	**-**	-
	of which: …	**-**	-	**-**	-	**-**	-	**-**	-
57	**Total regulatory adjustments to Tier 2 (T2) capital**	**-**	-	**-**	-	**-**	-	**-**	-
58	**Tier 2 (T2) capital**	**55.7**	72.1	**44.4**	46.4	**55.7**	72.1	**44.4**	46.4
59	**Total Capital (TC = T1 + T2)**	**1,068.0**	941.4	**990.4**	847.9	**1,052.5**	938.7	**974.8**	846.1

		Prudential Group				Individual Group			
		Current Rules		Full Impact		Current Rules		Full Impact	
		2014 £m	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m
Tier 2 (T2) Capital: Regulatory Adjustments (cont.)									
59a	Risk weighted assets in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts)	**-**	-	**-**	-	**-**	-	**-**	-
	Of which: … items not deducted from CET1 (Regulation (EU) No 575/2013 residual amounts) (items to be detailed line by line e.g. Deferred tax assets that rely on future profitability net of related tax liability, indirect holdings of own CET1, etc)	**-**	-	**-**	-	**-**	-	**-**	-
	Of which: ... items not deducted from AT1 items (Regulation (EU) No 575/2013 residual amounts) (items to be detailed line by line, e.g. Reciprocal cross holdings in T2 instruments, direct holdings of non-significant investments in the capital of other financial sector entities, etc)	**-**	-	**-**	-	**-**	-	**-**	-
	Items not deducted from T2 items (Regulation (EU) No 575/2013 residual amounts) (items to be detailed line by line, e.g. Indirect holdings of own T2 instruments, indirect holdings of non significant investments in the capital of other financial sectors entities, indirect holdings of significant investments in the capital of other financial sector entities etc)	**-**	-	**-**	-	**-**	-	**-**	-
60	**Total risk weighted assets**	**5,828.0**	5,627.5	**5,828.0**	5,627.5	**5,664.3**	5,459.7	**5,664.3**	5,459.7
Capital Ratios and Buffers									
61	Common Equity Tier 1 (as a percentage of risk exposure amount)	**16.13%**	14.17%	**16.23%**	14.24%	**16.33%**	14.55%	**16.43%**	14.65%
62	Tier 1 (as a percentage of risk exposure amount)	**17.37%**	15.45%	**16.23%**	14.24%	**17.60%**	15.87%	**16.43%**	14.65%
63	Total capital (as a percentage of risk exposure amount)	**18.33%**	16.73%	**16.99%**	15.07%	**18.58%**	17.19%	**17.21%**	15.50%

		Prudential Group				Individual Group			
		Current Rules		Full Impact		Current Rules		Full Impact	
		2014 £m	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m
Capital Ratios and Buffers (cont.)									
64	Institution specific buffer requirement (CET1 requirement in accordance with Article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount)	**-**	-	**-**	-	**-**	-	**-**	-
65	of which: capital conservation buffer requirement	**-**	-	**-**	-	**-**	-	**-**	-
66	of which: countercyclical buffer requirement	**-**	-	**-**	-	**-**	-	**-**	-
67	of which: systemic buffer requirement	**-**	-	**-**	-	**-**	-	**-**	-
67a	of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer	**-**	-	**-**	-	**-**	-	**-**	-
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**16.13%**	14.17%	**16.23%**	14.24%	**16.33%**	14.55%	**16.43%**	14.65%
Amounts Below the Thresholds for Deduction (Before Risk Weighting)									
72	Direct and indirect holdings of the capital of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	**-**	-	**-**	-	**-**	-	**-**	-
73	Direct and indirect holdings by the institution of the capital of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	**-**	-	**-**	-	**86.8**	106.6	**86.8**	106.6
75	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the conditions in 38 (3) are met)	**-**	-	**-**	-	**-**	-	**-**	-
Applicable Caps on the Inclusion of Provisions in Tier 2									
76	Credit risk adjustments included in T2 in respect of exposures subject to standardized approach (prior to the application of the cap)	**-**	-	**-**	-	**-**	-	**-**	-

		Prudential Group				Individual Group			
		Current Rules		Full Impact		Current Rules		Full Impact	
		2014 £m	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m	**2014 £m**	1.1.14 £m
Applicable Caps on the Inclusion of Provisions in Tier 2 (cont.)									
77	**Cap on inclusion of credit risk adjustments in T2 under standardised approach**	**68.3**	66.1	**68.3**	66.1	**67.6**	66.7	**67.6**	66.7
78	**Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)**	**-**	-	**-**	-	**-**	-	**-**	-
79	**Cap for inclusion of credit risk adjustments in T2 under internal- ratings based approach**	**-**	-	**-**	-	**-**	-	**-**	-
Capital Instruments Subject to Phase-Out Arrangements (Only Applicable Between 1 Jan 2013 and 1 Jan 2022)									
80	**Current cap on CET1 instruments subject to phase out arrangements**	**-**	-	**-**	-	**-**	-	**-**	-
81	**Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)**	**-**	-	**-**	-	**-**	-	**-**	-
82	**Current cap on AT1 instruments subject to phase out arrangements**	**72.0**	72.0	**-**	-	**72.0**	72.0	**-**	-
83	**Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)**	**-**	-	**-**	-	**-**	-	**-**	-
84	**Current cap on T2 instruments subject to phase out arrangements**	**151.1**	151.1	**-**	-	**151.1**	151.1	**-**	-
85	**Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)**	**-**	-	**-**	-	**-**	-	**-**	-

Appendix 2: Capital instruments key features

The table below shows the capital instruments currently held by the Group with the key details of these capital instruments. These have been disclosed in line with Annex III of the EBA Technical Standards on disclosure for own funds by institutions under Article 437(2) and 492(5) of the Capital Requirements Regulation.

1	Issuer	Skipton Building Society	Skipton Building Society (Scarborough Building Society)	Skipton Building Society (Scarborough Building Society)	Skipton Building Society (Scarborough Building Society)	Skipton Building Society	Skipton Building Society
2	**ISIN**	GB008194119	GB00B1VYCN43	GB004440623	XS0236960885	XS0148344608	Private Loan Facility
3	**Gov. law(s)**	English	English	English	English	English	English
Regulatory treatment							
4	**Trans. CRR rules**	Additional Tier 1 up to headroom	Additional Tier 1 up to headroom	Additional Tier 1 up to headroom	Tier 2	Tier 2	Tier 2
5	**Post-transitional CRR rules**	Tier 2	Ineligible	Tier 2	Ineligible	Ineligible	Tier 2
6	**Eligible at Prudential Group (PG), Individual Consolidated (IC) or Society (S)**	PG; IC; S	PG; IC; S	PG; IC; S	PG; IC; S	PG; IC; S	PG; IC; S
7	**Instrument type (types to be specified by each jurisdiction)**	PIBS	PIBS	PIBS	Subordinated Debt	Subordinated Debt	Subordinated Debt
8	**Regulatory capital value (£m)**	25,000,000	50,000,000	15,000,000	3,300,000	30,000,000	4,600,000
9	**Nominal amount of instrument**	25,000,000	50,000,000	15,000,000	18,000,000	30,000,000	10,000,000
9a	**Issue px**	100.476	99.239	100	99.55	98.728	100
9b	**Redemption px**	100	100	100	100	100	100
10	**Accounting classification**	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost
11	**Date of issue**	05/03/1992	13/04/2007	26/04/2000	01/12/2005	30/05/2002	27/03/1997
12	**Perpetual or dated**	Perpetual	Perpetual	Perpetual	Dated	Dated	Dated
13	**Original maturity**	n/a	n/a	n/a	01/12/2015	30/05/2022	27/03/2017
14	**Issuer call**	No	Yes	No	Yes	Yes	Yes
15	**Optional call date, contingent call dates and redemption amount**	No Issuer call; regulatory call; winding up call	Call date 13/04/2017; regulatory call; winding up call	No Issuer call; regulatory call; winding up call.	Call date 01/12/2010 and on each Interest Payment Date thereafter; Tax call; Par	Call date 30/05/2017 and on each Interest Payment Date thereafter; Tax call; Par	Call date 27/03/2012; default call; winding up call

16	**Subsequent call dates, if applicable**	n/a	On each quarterly Interest Payment Date after 13/04/2017	n/a	Annually	Quarterly	Semi-annually
Coupons / dividends							
17	**Fixed or floating dividend/coupon**	Fixed	Fixed-to-Float	Fixed	Fixed	Fixed-to-Float	Fixed
18	**Coupon rate and any related index**	12.875%	6.875%	8.500%	4.168%	6.750%	4.027%
19	**Existence of a dividend stopper**	Yes[1]	Yes[1]	Yes[1]	No	No	No
20a/b	**Fully discretionary, partially or mandatory (in terms of timing)**	Partially Discretionary	Partially Discretionary	Partially Discretionary	n/a	n/a	n/a
21	**Existence of step up or other incentive to redeem**	No	Yes, step up to LIBOR +265bps	No	Yes	Yes	Yes
22	**Noncumulative or cumulative**	Noncumulative	Noncumulative	Noncumulative	n/a	n/a	n/a
23	**Convertible or non-convertible**	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible
24	**If convertible, conversion trigger(s)**	n/a	n/a	n/a	n/a	n/a	n/a
25	**If convertible, fully or partially**	n/a	n/a	n/a	n/a	n/a	n/a
26	**If convertible, conversion rate**	n/a	n/a	n/a	n/a	n/a	n/a
27	**If convertible, mandatory or optional conversion**	n/a	n/a	n/a	n/a	n/a	n/a
28	**Specify output instrument**	n/a	n/a	n/a	n/a	n/a	n/a
29	**Specify issuer of output instrument**	n/a	n/a	n/a	n/a	n/a	n/a
30	**Write-down features**	None contractual, statutory via bailin	None contractual, statutory via bailin	None contractual, statutory via bailin	None contractual, statutory via bailin	None contractual, statutory via bailin	None contractual, statutory via bailin
31-34	**If w/d, trigger(s), full/partial, PWD/TWD**	n/a	n/a	n/a	n/a	n/a	n/a
35	**Instrument type immediately senior**	Subordinated debt	Subordinated debt	Subordinated debt	Senior Unsecured	Senior Unsecured	Senior Unsecured
36	**Non-compliant transitioned features**	Yes	Yes	Yes	Yes	Yes	No
37	**If yes, specify non-compliant features**	No conversion to CET1	Step-up reset rate	No conversion to CET1	Step-up reset rate	Step-up reset rate	n/a

[1] This is not a typical stopper since, if the Society has cancelled a payment on a more senior ranking instrument (i.e. a deposit or share investment other than a deferred share investment), it cannot pay on any of these PIBS

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