Pillar 3 Disclosures
2016

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1 INTRODUCTION

This document presents the consolidated Pillar 3 disclosures of the Skipton Building Society Group (the 'Group') as at 31 December 2016.

1.1 Background

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

Some of the regulations introduced under CRD IV are being phased in over the period to 1 January 2022 under transitional arrangements. These arrangements impact the eligibility of some of the Group's capital instruments which is set out in detail in section 4.

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

1.2 Pillar 3 Policy

The Board has adopted a formal policy for the production of the Pillar 3 disclosures. The policy sets out the principles which ensure that the Pillar 3 disclosures satisfy the regulatory reporting requirements in respect of the basis, frequency, verification and appropriateness of disclosures.

1.3 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 2016, unless otherwise stated. The frequency of disclosure has been assessed in accordance with EBA guidelines and disclosures will be issued on an annual basis in conjunction with the publication of the Group's Annual Report and Accounts, unless there is a material change to the Group's risk profile or regulatory change, when disclosures will be made more frequently.

1.4 Media and location of publication

These Pillar 3 disclosures, and those from previous years, are published on Skipton Building Society's website (www.skipton.co.uk/about-us/pillar-3-disclosure).

1.5 Verification of disclosure

The design of specific controls surrounding the preparation of these disclosures has been independently reviewed and independent external advice on compliance with regulatory reporting requirements has been applied. 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 2016 Annual Report and Accounts which are externally audited.

1.6 Scope of application

The balances within the Group's 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 set out in Appendix 1.

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 2016, the individual consolidation group comprised the following entities:

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

At 31 December 2016 the prudential consolidation group comprised the following entities:

- Skipton Building Society (Society)
- Amber Homeloans Limited (Amber)
- North Yorkshire Mortgages Limited (NYM)
- Darrowby No. 2 plc
- Darrowby No. 3 plc
- Darrowby No. 4 plc
- Beckindale No. 2 Limited
- Skipton Financial Services Limited (SFS)
- Skipton Business Finance Limited (SBF)
- Skipton International Limited (SIL)
- Skipton Investments Limited
- Skipton Group Holdings Limited

During 2016 we integrated within the Society our financial advice service, previously undertaken by SFS.

SIL is based in Guernsey and is regulated by the Guernsey Financial Services Commission (GFSC).

The following entities are included in the accounting group but are specifically excluded from the individual and prudential consolidation groups:

- Connells Limited and its subsidiaries
- Skipton Trustees Limited
- Jade Software Corporation Limited
- Northwest Investments NZ Limited

1.6.1 Disclosure levels

In accordance with Article 13 of the CRR, key information has been disclosed at both a prudential and an individual consolidation group level. However, in accordance with Article 432 of the CRR, where the difference between the two consolidation groups is immaterial, the granular analysis has been disclosed at a prudential group level only.

The Group's exposure to foreign currency risk leads to an immaterial capital requirement, see section 6.3.1 for further detail. An overview of our approach to interest rate risk is set out in section 7.5, however certain specific details concerning our calculations and assumptions in respect of interest rate risk have been omitted on the basis of their proprietary nature.

In accordance with Article 440 of the CRR regarding the Countercyclical Capital Buffer disclosure we have disclosed a geographical breakdown of the obligors of various exposure types in Appendix 6. For reasons of both clarity and materiality, only those countries where the own fund requirement is material or where the countercyclical buffer rate[1] is non-zero are listed. Exposures in countries where those criteria are not met have been presented as 'other countries'.

There have been no other omissions on the basis of materiality, proprietary or confidentiality.

1.7 Scope of permission of Internal Ratings Based Approach

In 2016, the Prudential Regulation Authority (PRA) granted the Society permission to apply the Internal Ratings Based (IRB) Approach to credit risk exposures. The IRB Approach has been applied to the residential mortgages, equity and non-credit obligation exposures of the Society and its subsidiary companies Amber and NYM. The Standardised Approach continues to apply to all other exposures and operational risk.

The 2015 comparative information presented in this document is all based on the Standardised Approach. A summary of the 2016 position under the Standardised Approach is set out in section 3.4 for comparison purposes.

The IRB Approach allows the Society to calculate capital requirements using internally developed models rather than the standardised percentages set out in the CRR. The IRB models are subject to a robust monitoring process on an ongoing basis to ensure that they reflect regulatory and economic developments and are in line with industry best practice. See section 6.1.4 for further detail on the IRB models and the associated governance framework.

1.8 Transferability of capital

In order to ensure the greatest degree of flexibility in the allocation of capital, the Board aims to retain the optimal level of capital in the prudential consolidation group and individual consolidation group – the regulated entities. This general 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 SIL to the Society as the parent entity.

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[1] The countercyclical buffer rate is a percentage, set by the regulator of the jurisdiction within which the exposure sits e.g. the Financial Policy Committee sets the rate for UK exposures, which is required to be applied to a firm's risk weighted assets to calculate a countercyclical capital buffer requirement.

2 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, market risk, pension obligation risk, conduct risk, operational risk, model risk, interest rate risk, equity risk and liquidity risk. These risks are explained in detail in sections 6 and 7 of these disclosures and in the Risk Management Report of the Annual Report and Accounts, pages 53 to 59.

2.2 Risk appetite

As a mutual organisation the 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, leverage ratio, 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.

A key objective of the Society is to maintain strong capital and liquidity levels. These measures are monitored on an ongoing basis to ensure that the minimum regulatory requirement is met and that the Group has sufficient levels of capital and liquidity for current and projected future activities, as well as potential stress scenarios.

The risks associated with the Group are overseen by the Board as well as the Board Risk Committee and various sub-committees as set out in section 2.5.

2.3 Group risk management framework

Through the Board Risk Committee approved risk management framework and governance structure, the Group has a formal mechanism for identifying and managing risks throughout the business. This framework is designed to deliver the corporate plan in line with the Board's overall risk appetite and is based upon the best practice 'Three Lines of Defence' model which operates 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 & 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 sub-committees of the Board Risk Committee, namely, 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 in sections 2.5.1 to 2.5.4. 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 Chairman is responsible for maintaining the independence of the second line of defence to ensure there are no obstacles to its independent challenge of first line operations.

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

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.

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 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 to, 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. This ensures a balance of authority such that no single individual has unfettered powers. It has clear lines of sight into activities to enable challenge and oversight, allowing the Board to obtain assurance over the integrity of reporting, 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 supported by timely and transparent reporting.

This framework identifies, assesses, manages and monitors risk on an ongoing basis. 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.

To support delivery of this, it has established a framework of authorities that 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 in the following pages. 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.

The Board consider that the risk management systems in place are adequate and aligned to the profile and strategy of the Group. The Directors' Report on Corporate Governance and the Risk Management Report in the Annual Report and Accounts, see pages 42 and 53 respectively, include declarations to this effect and provide further detail on the Board's review of the framework of internal control and compliance with the UK Corporate Governance Code.

2.4.1 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.

2.4.2 Board members

Details of the Board members' other directorships can be found in the Annual Report and Accounts on pages 170 to 172. The recruitment policy for Board members and the diversity policy with respect to all employees including directors and senior managers can also be found in the Annual Report and Accounts on pages 17, 44 and 45 respectively.

2.5 Board Risk Committee

To enable appropriate focus on risk matters, the Board has delegated oversight of risk management to the Board Risk Committee (BRC) although ultimate responsibility for risk management continues to reside with the Board.

The members of the Board Risk Committee during the period were:

Mr R D East, Non-Executive Director (Committee Chairman)
Mr M J Lund, Non-Executive Director (appointed 1 October 2016)
Mr G E Picken, Non-Executive Director
Ms H C Stevenson, Non-Executive Director

BRC is responsible for considering and recommending the Group's risk appetite and 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, managed and reported on.

In accordance with the Capital Requirements Directive (CRD) regulations, the Committee's membership comprises only Non-Executive Directors. The Committee receives regular reports from the Chief Financial Risk Officer and Chief Conduct Risk Officer and Secretary. These reports direct the Committee's attention to those matters which the risk officers believe warrant further consideration, enabling a challenge of first line management on the actions being taken to mitigate the risks.

The Board Risk Committee met five times in the year. 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.

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 2.5.1 to 2.5.4 below.

2.5.1 Conduct and Operational Risk Committee

The Conduct and Operational Risk Committee (CORC) develops and maintains the Group conduct and operational risk frameworks to ensure that robust processes are in place to deliver great service and good outcomes to customers.

2.5.2 Asset and Liability Committee

The Asset and Liability Committee (ALCO) develops and maintains policies on structural risk management, liquidity, funding and wholesale credit risk to ensure the prudential strength of the Group.

2.5.3 Retail Credit Committee

The Retail Credit Committee (RCC) develops and maintains policies on credit quality of retail loan books and monitors implementation to ensure that the Group's lending does not create credit risk outside agreed appetite.

2.5.4 Model Governance Committee

The Model Governance Committee (MGC) develops and maintains model build standards and reviews key models against these to ensure that the output from models can be relied on in decision making.

2.6 Executive Committee

The Executive Committee is responsible for ensuring that the Group meets its strategic and operational objectives as defined in the corporate plan.

2.7 Audit Committee

The Audit Committee is appointed by the Board and the members during the year were:

Ms M Cassoni, Non-Executive Director (Committee Chairman)
Mrs C Black, Non-Executive Director (resigned 25 April 2016)
Mrs D P Cockrem, Non-Executive Director
Mr G E Picken, Non-Executive Director
Mr P J S Thompson, Non-Executive Director (resigned 25 April 2016)

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 April 2016. The Committee's primary responsibilities are:

- To keep under review the effectiveness of the Group'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 recommending the Group's annual and interim financial statements to the Board for approval, 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 to the Board on whether the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for members to assess the Group's strategy, business model and performance;

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

- To review the effectiveness of the Internal Audit and Compliance Monitoring functions, approve their annual plans, review performance against these plans on a quarterly basis, review their material findings and instigate plans to remedy any shortcomings; and

- To report to the Board on how the Committee has discharged its responsibilities.

2.8 Remuneration Committee

The purpose of the Remuneration Committee is to determine, on behalf of the Board, the Remuneration Policy and to:

- Ensure that remuneration policies, principles and practices are appropriate to enable the business to attract, retain and reward people with the right skills, experience, knowledge and behaviours to support achievement of business goals and objectives;

- Maintain policies which are compliant with governing laws and regulations;

- Ensure that remuneration arrangements support and encourage desired behaviours and culture; and

- Ensure appropriate governance of remuneration practices across the Society and its subsidiary companies and exercise effective oversight of these.

Among its other duties, the Committee specifically:

- Determines and agrees, on behalf of the Board, the Society's Remuneration Principles and Policy and its associated costs;

- Determines and agrees remuneration for the Chairman of the Society Board and Society Executive Directors;

- Receives recommendations from the Group Chief Executive for approval of the remuneration for Senior Executives;

- Determines the policy, term, objectives and content of Society Executive Directors and Society Senior Executive service contracts; and

- Reviews and approves new Remuneration policies for senior managers who have a material impact on the Society's risk profile, (Material Risk Takers or MRTs).

The Committee has established clear remuneration principles for the Society and its Group subsidiaries. For those businesses regulated by the Prudential Regulated Authority (PRA) and the Financial Conduct Authority (FCA), 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 annual reports from the Group Remuneration Oversight Committee and 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 full terms of reference of the Remuneration Committee and the remuneration principles are available on request from the Group Secretary. The terms of reference are also available online at www.skipton.co.uk.

The members of the Remuneration Committee during 2016 were:

Ms H Stevenson, Non-Executive Director (Chairman of the Committee from 26 April 2016)
Mr P J S Thompson, Non-Executive Director (Chairman of the Committee until 25 April 2016)
Mrs C Black, Non-Executive Director (resigned 25 April 2016)
Mrs D P Cockrem, Non-Executive Director (appointed 25 April 2016)
Mr R D East, Non-Executive Director (appointed 25 April 2016)

Miss A Burton joined the Committee on 1 January 2017.

The Chairman, Group Chief Executive, Chief Conduct Risk Officer and Secretary and Chief Human Resources Officer regularly attend meetings by invitation and representatives from PwC, the Committee's external advisers are invited to attend meetings as and when appropriate. PwC were appointed as the Committee's advisers in early 2015, to provide independent advice on regulatory matters and remuneration policy.

The Remuneration Committee met five times during 2016. In discharging its duties, the Committee reviews and takes into account independently produced data in relation to similar Financial Services organisations.

Details of remuneration arrangements for the Society's Executive Directors are set out in detail in the Directors' Remuneration Report on pages 60 to 73 of the 2016 Annual Report and Accounts. Remuneration arrangements for other Material Risk Takers (MRTs) and the link between pay and performance are set out in section 9 of this document.

2.9 Non-Executive Directors' Remuneration Committee

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

3 Summary of Key Disclosures

This section summarises the key quantitative disclosures reported in this document.

3.1 Capital

The table below sets out the capital adequacy as at 31 December 2016 under CRD IV applying both the transitional rules and the CRD IV end-point or 'fully loaded' position for the prudential consolidation group. 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 under CRD IV are excluded in full (namely a £50m tranche of Permanent Interest Bearing Shares (PIBS) and £30m of subordinated debt instruments).

	Transitional		Fully Loaded	
	2016	2015*	2016	2015*
Prudential consolidation group	£m	£m	£m	£m
Total Common Equity Tier 1	1,136.6	1,054.3	1,136.6	1,054.3
Additional Tier 1 capital	54.0	63.0	-	-
Total Tier 2 capital	66.4	59.4	40.4	42.4
Total own funds	1,257.0	1,176.7	1,177.0	1,096.7
Risk weighted assets				
IRB Approach	3,128.0	-	3,128.0	-
Standardised Approach	1,635.2	6,276.4	1,635.2	6,276.4
Total risk weighted assets (RWAs)	4,763.2	6,276.4	4,763.2	6,276.4
Pillar 1 capital requirement (RWAs x 8%)	381.1	502.1	381.1	502.1
Excess capital over minimum Pillar 1 requirement	875.9	674.6	795.9	594.6
Capital ratios (as a percentage of RWAs)				
Common Equity Tier 1 (%)	23.86	16.80	23.86	16.80
Tier 1 (%)	25.00	17.80	23.86	16.80
Total capital (%)	26.39	18.75	24.71	17.47

*The comparative figures are reported under the Standardised Approach (SA).

During 2016 the total capital of the Group increased by £80.3m due primarily to a corresponding increase in retained profits (see section 4.5 and the regulatory capital flow statement for more details). The Common Equity Tier 1 (CET1) ratio has also increased to 23.9% during the year. This increase is driven by an increase in profit during the year combined with the impact of the transition to the IRB Approach for the calculation of some of our capital requirements. Less Pillar 1 capital is required to be held for the Society's mortgage exposures under the Society's IRB Approach which determines a lower risk than the Standardised Approach associated with these exposures. Further detail on the Group's capital position including a comparison of the Standardised and IRB Approaches is set out in sections 3 to 6 in this document.

3.2 Leverage ratio

The leverage ratio is a non-risk adjusted measure of how much capital the Group maintains against its exposures. The table below shows the leverage ratio for the prudential group under both the transitional and fully loaded CRD IV rules

	Transitional		Fully Loaded	
	2016	2015*	2016	2015*
	£m	£m	£m	£m
Total Tier 1 capital	1,190.6	1,117.3	1,136.6	1,054.3
Total exposure	19,304.8	17,150.7	19,304.8	17,150.7
Leverage ratio	6.2%	6.5%	5.9%	6.1%

* The comparative figure has been restated to reflect a change to the way the leverage ratio exposure measure is calculated. In accordance with CRD IV rules as amended on 10 October 2014 by the European Commission delegated regulation on leverage ratio, a reduction in exposures has been made for collateral the Society has provided against derivative liabilities.

The decrease in the ratio during the year is due to the transition to the IRB Approach. The IRB impact is partially off-set by a positive movement driven by the increase in profits during the year, showing that whilst the Group has increased lending throughout 2016, it has also increased its capital base. Key differences to the calculation of the leverage ratio under the IRB Approach compared to the Standardised Approach are:

- The treatment of off-balance sheet exposures in relation to undrawn credit commitments. Under the Standardised Approach these are subject to a standard conversion factor based on the level of risk associated with them which is determined by the terms and conditions of the commitment. Under the IRB Approach these exposures are subject to a credit conversion factor which is determined based on historical data relating to the likelihood of these commitments converting into mortgages. The IRB Approach has resulted in an increase in the exposure value.
- The recognition of expected loss rather than accounting impairment which reduces the Tier 1 capital and the exposure value. See section 3.4.1 for further detail regarding the calculation of expected loss.

Further detail on the Group's leverage ratio is set out in section 8 and Appendix 4 of this document.

3.3 Encumbrance

An asset becomes encumbered when part or all of its value is pledged to another party to secure, collateralise or credit enhance a financial transaction from which it cannot be freely withdrawn. The Group encumbers assets for short and long term funding reasons and the level of encumbrance is set and monitored by BRC. The current level of encumbrance is within our appetite.

The following table shows the median level of encumbrance within the Group for the year ended 31 December 2016.

	Carrying amount of encumbered assets £m	Carrying amount of unencumbered assets £m
Assets	2,974.2	15,764.1

Further detail on asset encumbrance is set out in Appendix 5.

3.4 Impact of Internal Ratings Based Approach

3.4.1 Capital adequacy

The table below provides a comparison between the Standardised and IRB Approach of the current year capital resources and capital resource requirements on a transitional basis.

Prudential consolidation group	SA 2016 £m	Adjustments 2016 £m	IRB and SA 2016 £m
Total Common Equity Tier 1 (Standardised	1,164.8		
Excess of expected loss over impairment provisions		(28.2)	
Total Common Equity Tier 1 (IRB Approach)			1,136.6
Additional Tier 1 capital	54.0	-	54.0
Total Tier 2 capital	66.4	-	66.4
Total own funds	1,285.2	**(28.2)**	1,257.0
Risk weighted assets			
Credit risk - residential mortgage exposures	5,404.4	(2,253.1)	3,151.3
Credit risk - commercial mortgage exposures	307.9	-	307.9
Credit risk - treasury exposures	268.1	-	268.1
Credit risk - other	375.7	270.6	646.3
Credit valuation adjustment risk	22.3	-	22.3
Operational risk	367.3	-	367.3
Market risk	-	-	-
Total risk weighted assets (RWAs)	6,745.7	**(1,982.5)**	4,763.2
Pillar 1 capital requirement (RWAs x 8%)	539.7	(158.6)	381.1
Excess capital over minimum Pillar 1 requirement	745.5	130.4	875.9
Capital ratios (as a percentage of RWAs)			
Common Equity Tier 1 (%)	17.27	6.59	23.86
Tier 1 (%)	18.07	6.93	25.00
Total capital (%)	19.05	7.34	26.39

Key variances between the two approaches are summarised below:

Excess of expected loss over impairment
This deduction represents an adjustment for all future possible losses calculated using the IRB models less impairment provisions calculated under IFRS Accounting Standards. Under the Standardised Approach only accounting impairments are deducted.

Credit risk – Residential mortgage exposures
The IRB models are used to calculate the risk weight percentages for the residential mortgage exposures of the Society, Amber and NYM rather than the standardised risk weights previously applied. The IRB Approach determines a lower requirement for the Society exposures compared to the Standardised Approach. In addition, under the IRB Approach exposures to undrawn credit commitments are subject to a credit conversion factor which is determined based on historical data relating to the likelihood of these commitments converting into mortgages compared to a standard conversion factor under the Standardised Approach based on the terms and conditions of the commitment. This has resulted in an increase in the risk weighted assets under the IRB Approach.

Credit risk - Other
The key drivers for the difference in the requirement under IRB relate to:

- The capital required for the Society's investment in subsidiary companies outside the regulatory group. Under the IRB Approach the Society applies the simple method to calculate the capital requirement in accordance with Article 155 of the CRR; this applies a 370% risk weight percentage. Under the Standardised Approach a risk weight percentage of 100% is applied in accordance with Article 133. This accounts for £207.3m of the adjustment figure.

- The treatment of the fair value adjustments associated with hedged assets. Under the IRB Approach a risk weight percentage of 100% is applied in accordance with Article 156 of the CRR. Under the Standardised Approach, the risk weight percentage that is consistent with that of the underlying mortgage exposure is applied in accordance with Article 111. This accounts for £63.3m of the adjustment figure.

3.4.2 Capital required for IRB residential mortgage exposures

The table below provides a breakdown of the capital requirement for the residential mortgage exposures to which the IRB Approach applies

Portfolio Comparison (IRB) Mortgage portfolio	IRB mortgage exposure [1] £m	% of total IRB mortgage exposures %	Portfolio average risk weight percent %	Risk weighted assets £m
Society	13,591.9	92.2	12.5	1,697.5
Amber Homeloans	741.8	5.0	95.1	705.6
North Yorkshire Mortgages	419.5	2.8	75.8	317.9
Total	14,753.2	100.0		2,721.0

Notes
1. The exposure value includes undrawn credit commitments and is not adjusted for impairment in accordance with Article 166.

The table shows that 92% of our mortgage exposures are within the Society and attract a risk weight of 12.5% reflecting the Society's cautious approach to lending and risk management. The remaining 8% of the mortgage exposures are within Amber and NYM which have been closed to new lending since 2008. Under the Society's IRB Approach these mortgage books attract a higher risk weight percentage than that determined using the Standardised Approach.

3.4.3 Leverage ratio

The table below provides a comparison between the Standardised and the IRB Approaches of the leverage ratio components on a fully loaded basis

Prudential consolidation group	Notes	2016 £m
Total Tier 1 capital (Standardised Approach)		1,164.8
Excess of expected loss over impairment provisions	1	(28.2)
Total Tier 1 capital (IRB Approach)		**1,136.6**
Total exposure (Standardised Approach)		18,467.7
Change in treatment of commitment to lend	2	865.3
Excess of expected loss over impairment provisions	1	(28.2)
Total exposure (IRB Approach)		**19,304.8**
Leverage ratio (Standardised Approach)		**6.3%**
Leverage ratio (IRB Approach)		**5.9%**

Notes

1 The Tier 1 capital figure and total exposure value are reduced by the excess of expected losses over impairments see section 3.4.1 for further detail.

2 The treatment of undrawn credit commitments within the exposure calculation is different under the IRB Approach. Under the Standardised Approach a 10% conversion factor is applied to these exposures in accordance with Article 429 of the CRR. Under the IRB Approach the conversion factor is determined by historical trend analysis in accordance with article 182.

4 CAPITAL RESOURCES

4.1 Total capital resources

The following tables show the capital resources as at 31 December 2016 applying both the transitional rules and the CRD IV fully loaded position for both the prudential and the individual consolidation group.

		Transitional		Fully Loaded	
		2016	2015	2016	2015
Prudential consolidation group	Notes	£m	£m	£m	£m
Common Equity Tier 1					
Reserves		1,178.6	1,059.4	1,178.6	1,059.4
Prudential adjustments	1	(0.8)	(0.9)	(0.8)	(0.9)
Deductions from Common Equity Tier 1 capital		(9.7)	(7.4)	(9.7)	(7.4)
Deduction of cash flow hedging reserve		(3.3)	3.2	(3.3)	3.2
Excess expected loss over impairment provisions	2	(28.2)	-	(28.2)	-
Total Common Equity Tier 1 capital		**1,136.6**	1,054.3	**1,136.6**	1,054.3
Additional Tier 1					
Permanent Interest Bearing Shares	3	54.0	63.0	-	-
Total Tier 1 capital		**1,190.6**	1,117.3	**1,136.6**	1,054.3
Tier 2					
Subordinated liabilities		30.4	32.4	0.4	2.4
Permanent Interest Bearing Shares		36.0	27.0	40.0	40.0
Total Tier 2 capital		66.4	59.4	40.4	42.4
Total own funds		**1,257.0**	1,176.7	**1,177.0**	1,096.7

Notes

1. Prudential adjustments include deductions to capital for 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.
2. Expected losses are the forecast losses for exposures likely to default in the next twelve months as calculated by the IRB models. Excess expected loss is the difference between the expected losses calculated under the IRB Approach and the amount of accounting provisions held for those exposures. The excess expected loss is deducted from CET 1 capital in accordance with Article 159 of the CRR.
3. On 22 February 2017, the Society issued notice that it will repay £50m of PIBS on their first call date of 13 April 2017. See section 4.3 for further detail.

		Transitional		Fully Loaded	
		2016	2015	2016	2015
Individual consolidation group	Notes	£m	£m	£m	£m
Common Equity Tier 1					
Reserves		1,147.4	1,037.7	1,147.4	1,037.7
Prudential adjustments	1	(0.8)	(0.9)	(0.8)	(0.9)
Deductions from Common Equity Tier 1 capital		(2.6)	(1.1)	(2.6)	(1.1)
Deduction of cash flow hedging reserve		(3.3)	3.2	(3.3)	3.2
Excess expected loss over impairment provisions	2	(28.2)	-	(28.2)	-
Total Common Equity Tier 1 capital		**1,112.5**	1,038.9	**1,112.5**	1,038.9
Additional Tier 1					
Permanent Interest Bearing Shares	3	54.0	63.0	-	-
Total Tier 1 capital		**1,166.5**	1,101.9	**1,112.5**	1,038.9
Tier 2					
Subordinated liabilities		30.4	32.4	0.4	2.4
Permanent Interest Bearing Shares		36.0	27.0	40.0	40.0
Total Tier 2 capital		**66.4**	59.4	**40.4**	42.4
Total own funds		**1,232.9**	1,161.3	**1,152.9**	1,081.3

Notes

1. Prudential adjustments include deductions to capital for 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.
2. Expected losses are the forecast losses for exposures likely to default in the next twelve months as calculated by the IRB models. Excess expected loss is the difference between the expected losses calculated under the IRB Approach and the amount of accounting provisions held for those exposures. The excess expected loss is deducted from CET1 capital in accordance with Article 159 of the CRR.
3. On 22 February 2017, the Society issued notice that it will repay £50m of PIBS on their first call date of 13 April 2017. See section 4.3 for further detail.

4.2 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 cash flow hedging reserve is removed from Common Equity Tier 1. Prudential adjustments include deductions to capital for 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. Goodwill and intangible assets are also deducted from regulatory capital in accordance with CRD IV.

Expected loss is the forecast loss for accounts that are likely to default over the next 12 months. The extent by which this exceeds the impairment amounts derived by the IFRS accounting regulations is called the 'excess expected loss' and is deducted from CET1 in accordance with CRD IV.

Under CRD IV, a deduction to capital resources is required if a firm's significant investments in financial sector entities exceed a certain threshold. An assessment of the Society's position against this requirement has been carried out and confirmed that the threshold is not met and therefore no deduction is made.

4.3 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 be eligible for regulatory capital[2]. 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.

For capital purposes PIBS and subordinated liabilities are 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.

4.4 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 were revised under CRD IV. Where a capital instrument fails to satisfy the CRD IV criteria it is treated in one of the following ways depending on the terms associated with the instrument:

- The instrument is 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 the period to 2022 (or less if maturity occurs before this).

This treatment is referred to as ‘grandfathering’.

Of the £30.4m of regulatory capital at 31 December 2016 (nominal value £40m), £0.4m is fully eligible for regulatory capital and £30.0m 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 64 of CRR.

Appendix 2 shows the key features of the subordinated liabilities issued by the Society.

[2] On 22 February 2017, the Society issued notice that it will repay these PIBS on the first call date.

4.5 Regulatory capital flow statement

The table below shows the flow of regulatory capital and associated movements that have occurred from 31 December 2015 to 31 December 2016. This shows an increase in CET1 due to profits generated during the year. This year a deduction has also been made for excess expected loss which is an additional requirement under the IRB Approach. 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.

Prudential consolidation group	Notes	£m
Common Equity Tier 1 capital at 1 January (Standardised Approach)		**1,054.3**
Profit for the year		129.2
Actuarial loss on retirement benefit obligation		(26.7)
Movement in available for sale reserve		2.4
Tax on items taken directly to reserves		6.5
Net increase in intangible assets		(2.3)
Reduction in AVA		0.1
Movement in fair value for PIBS and subordinated liabilities	1	1.3
Excess expected loss over impairment provisions	2	(28.2)
Common Equity Tier 1 capital at 31 December (IRB Approach)		**1,136.6**
Additional Tier 1 capital at 1 January (Standardised Approach)		**63.0**
Phasing of PIBS from Tier 1 to Tier 2 capital		(9.0)
Additional Tier 1 capital at 31 December (IRB Approach)		**54.0**
Tier 2 capital at 1 January (Standardised Approach)		**59.4**
Amortisation of Tier 2 subordinated liabilities		(2.0)
Phasing of PIBS from Tier 1 to Tier 2 capital		9.0
Tier 2 capital at 31 December (IRB Approach)		**66.4**
Total own funds at 1 January (Standardised Approach)		**1,176.7**
Total own funds at 31 December (IRB Approach)		**1,257.0**

Notes

1. For capital purposes PIBS and subordinated liabilities are disclosed at par value and the associated merger fair value adjustments are included in the general reserve.
2. Expected losses are the forecast losses for exposures likely to default in the next twelve months as calculated by the IRB models. Excess expected loss is the difference between the expected losses calculated under the IRB Approach and the amount of accounting provisions held for those exposures. The excess expected loss is deducted from CET1 capital in accordance with Article 159 of the CRR.

The table above shows how the Group's strong financial performance has strengthened our capital position.

5 CAPITAL ADEQUACY

5.1 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 following approaches to calculate the minimum regulatory capital resource requirement for credit risk:

- IRB Approach for:
  - Residential mortgage exposures within the Society and its subsidiary companies Amber and NYM
  - Fair value adjustments for hedged assets associated with underlying exposures measured under the IRB Approach
  - Cost of investment in subsidiary companies outside the regulatory group
  - Property, plant and equipment
  - Cash in hand
- Standardised Approach for:
  - Residential mortgage exposures within SIL
  - Commercial mortgage exposures
  - Equity release mortgage exposures
  - Wholesale credit exposures
  - Other assets including prepayments and fair value adjustments for hedged assets associated with underlying exposures measured under the Standardised Approach

Operational risk is calculated under the Standardised Approach.

Market risk has been calculated in accordance with Article 83 of CRD IV. Foreign exchange risk is the only Pillar 1 market risk incurred by the individual and prudential groups. The Group's exposure to foreign currency risk is immaterial.

Section 6 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.

	Transitional		Fully Loaded	
	2016	2015	2016	2015
Prudential consolidation group	£m	£m	£m	£m
Total Common Equity Tier 1	1,136.6	1,054.3	1,136.6	1,054.3
Additional Tier 1 capital	54.0	63.0	-	-
Total Tier 2 capital	66.4	59.4	40.4	42.4
Total own funds	1,257.0	1,176.7	1,177.0	1,096.7
Risk weighted assets				
IRB Approach				
Credit risk - residential mortgage exposures	2,721.0	-	2,721.0	-
Credit risk - other	407.0	-	407.0	-
Standardised Approach				
Credit risk - residential mortgage exposures	430.3	4,941.7	430.3	4,941.7
Credit risk - commercial mortgage exposures	307.9	334.0	307.9	334.0
Credit risk - treasury exposures	268.1	280.2	268.1	280.2
Credit risk - other	239.3	321.5	239.3	321.5
Credit valuation adjustment risk	22.3	52.7	22.3	52.7
Operational risk	367.3	346.3	367.3	346.3
Market risk	-	-	-	-
Total risk weighted assets (RWAs)	4,763.2	6,276.4	4,763.2	6,276.4
Pillar 1 capital requirement (RWAs x 8%)	381.1	502.1	381.1	502.1
Excess capital over minimum Pillar 1 requirement	875.9	674.6	795.9	594.6
Capital ratios (as a percentage of RWA's)				
Common Equity Tier 1 (%)	23.86	16.80	23.86	16.80
Tier 1 (%)	25.00	17.80	23.86	16.80
Total capital (%)	26.39	18.75	24.71	17.47

	Transitional		Fully Loaded	
	2016	2015	2016	2015
Individual consolidation group	£m	£m	£m	£m
Total Common Equity Tier 1	1,112.5	1,038.9	1,112.5	1,038.9
Additional Tier 1 capital	54.0	63.0	-	-
Total Tier 2 capital	66.4	59.4	40.4	42.4
Total own funds	1,232.9	1,161.3	1,152.9	1,081.3
Risk weighted assets				
IRB Approach				
Credit risk - retail exposures	2,721.0	-	2,721.0	-
Credit risk - other	611.0	-	611.0	-
Standardised Approach				
Credit risk - residential mortgage exposures	74.6	4,640.5	74.6	4,640.5
Credit risk - commercial mortgage exposures	307.9	334.0	307.9	334.0
Credit risk - treasury exposures	242.3	265.4	242.3	265.4
Credit risk - other	209.4	509.4	209.4	509.4
Credit valuation adjustment risk	31.8	58.7	31.8	58.7
Operational risk	283.8	260.4	283.8	260.4
Market risk	-	-	-	-
Total risk weighted assets (RWA)	4,481.8	6,068.4	4,481.8	6,068.4
Pillar 1 capital requirement (RWA x 8%)	358.5	485.5	358.5	485.5
Excess capital over minimum Pillar 1 requirement	874.4	675.8	794.4	595.8
Capital ratios (as a percentage of RWA's)				
Common Equity Tier 1 (%)	24.82	17.12	24.82	17.12
Tier 1 (%)	26.03	18.16	24.82	17.12
Total capital (%)	27.51	19.14	25.72	17.82

Despite an increase of £1.4bn in residential mortgage balances (at a prudential group level) in 2016 the capital required for credit risk has reduced significantly as a result of the Society's implementation of the IRB Approach. Under the IRB Approach less capital is required to be held for the Society's mortgage exposures due to the Society's IRB Approach determining a lower risk associated with these exposures than the Standardised Approach.

The operational risk capital requirement increased in 2016 as a result of an increase in business volumes across the Group rather than any significant changes in the operating or control environment.

Capital ratios remain strong at both a prudential and individual group level reflecting a surplus of capital resources during 2016.

5.1.1 Individual consolidation group disclosures

The difference between the total own funds figure and capital requirements for the individual consolidation group and the prudential consolidation group is £24.1m and £22.6m respectively at a transitional and fully loaded level. As these differences are not significant, we have not presented any further information at the individual consolidation group level within these disclosures.

5.2 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 on a monthly basis along with forecast positions.

5.3 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 7 sets out the additional risks considered in the Pillar 2 assessment.

6 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.

6.1 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 / invoice discounting); and
- Wholesale counterparties (including other financial institutions). Credit risk within our treasury portfolio arises from the investments held by the Group in order to meet liquidity requirements and for general business purposes.

Changes in the credit quality and the recoverability of loans and amounts due from counterparties influence the Group's exposure to credit risk. The Group's strategy is to maintain a cautious approach to credit risk and new lending. Adverse changes in the credit quality of counterparties, collateral values or deterioration in the wider economy, including rising unemployment, changes in interest rates, deterioration in household finances and any contraction in the UK property market leading to falling property values, could affect the recoverability and value of the Group's assets and influence its financial performance. An economic downturn and falls in house prices and commercial property values would affect the level of impairment losses.

The controlled management of credit risk is critical to the Group's overall strategy and there has been continued investment in the Credit Risk function during the year. The Group has embedded a comprehensive risk management framework with clear lines of accountability and oversight as part of its overall governance framework.

The Group has processes and policies to monitor, control, mitigate and manage credit risk within the Group's credit risk appetite. The Retail Credit Committee and the Group Wholesale Credit Committee provide oversight to the effectiveness of all credit management across the Group and the controls in place ensure lending is within the Board approved credit risk appetite. The reporting structure ensures timely and accurate reporting of all substantive risk matters to the Board and the Board Risk Committee. The Board receives monthly updates on the credit risk profile of the Group.

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

The following tables detail the minimum capital requirements for credit risk for the prudential consolidation group as at 31 December 2016 broken down by exposure class:

Prudential consolidation group	Notes	Exposure value(Note 1) £m	Risk Weighted Assets £m	Capital Requirement £m
IRB exposure classes				
Secured by mortgages on immovable property		14,622.5	2,248.2	179.9
Exposures in default	2	130.6	472.8	37.8
Equity	3	75.0	277.6	22.2
Non-credit obligation assets	4	129.4	129.4	10.4
Total IRB exposures		**14,957.5**	**3,128.0**	**250.3**
Standardised exposure classes				
Secured by mortgages on immovable property		1,851.7	853.5	68.3
Exposures in default	2	2.2	2.0	0.2
Corporates	5	119.6	61.5	4.9
Retail		1.6	0.9	0.1
Central governments or central bank		1,611.4	14.1	1.1
Multilateral Development Banks		154.9	-	-
Institutions		478.4	148.9	11.9
Covered Bonds		39.2	3.9	0.3
Claims on institutions and corporates with a short-term credit assessment	6	205.4	76.7	6.1
Securitisation positions	7	191.6	38.3	3.1
Credit Valuation Adjustment	8	73.4	22.3	1.8
Other Items		43.9	45.8	3.6
Total Standardised exposures		4,773.3	1,267.9	101.4
Total		**19,730.8**	**4,395.9**	**351.7**

Notes

1. The exposure value includes items which are off balance sheet, such as our undrawn credit commitments which have a capital requirement but do not appear in the accounting balance sheet of the regulated group. Derivatives and repos are adjusted in accordance with regulatory requirements. The exposure balance is also adjusted for credit risk mitigation techniques such as netting, for further details see sections 6.1.10 to 6.1.12.
2. Exposures in default refers to those accounts greater than or equal to three months in arrears It also takes into account potential indications that the borrower is unlikely to pay such as the borrower being made bankrupt.
3. Equity relates to investments in subsidiary companies outside the regulatory group.
4. Non-credit obligation assets relate to Property Plant and Equipment and fair value adjustments for hedged assets associated with underlying exposures measured under the IRB Approach.
5. Corporates relate mainly to debt factoring and invoice discounting in Skipton Business Finance.
6. This balance relates to exposures to institutions and corporates with a maturity of less than three months and a short-term credit rating.
7. This balance relates to purchased Residential Mortgage Backed Securities (RMBSs) excluding retained holdings.
8. 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 following table sets out exposure classes by geographic distribution based on the location of the underlying asset/counterparty. This shows that the majority of the Group's exposures are in the UK. Further regional breakdowns are provided for our mortgage lending in sections 6.1.3 and 6.1.5.

Prudential consolidation group	UK £m	Channel Islands £m	EU £m	Rest of World £m	Total Exposure Value £m
Secured by mortgages on immovable property	15,608.5	865.7	-	-	**16,474.2**
Exposures in default	132.8	-	-	-	**132.8**
Equity	75.0	-	-	-	**75.0**
Non-credit obligation assets	128.9	0.5	-	-	**129.4**
Corporates	119.6	-	-	-	**119.6**
Retail	1.6	-	-	-	**1.6**
Central governments or central bank	1,606.4	-	5.0	-	**1,611.4**
Multilateral Development Banks	-	-	154.9	-	**154.9**
Institutions	378.8	-	31.2	68.4	**478.4**
Covered Bonds	39.2	-	-	-	**39.2**
Claims on institutions and corporates with a short-term credit assessment	93.7	-	85.2	26.5	**205.4**
Securitisation positions	191.6	-	-	-	**191.6**
Credit Valuation Adjustment	42.2	-	14.8	16.4	**73.4**
Other Items	43.6	0.3	-	-	**43.9**
Total exposures	**18,461.9**	**866.5**	**291.1**	**111.3**	**19,730.8**

The following table sets out exposure classes by maturity. The maturity profile reflects the inherent nature of long term mortgage lending and shorter term wholesale lending and bonds.

Prudential consolidation group	On call and at short notice £m	< three months £m	3mth to 1 year £m	1 to 5 years £m	In more than five years £m	Total Exposure Value £m
Secured by mortgages on immovable property	2.2	37.7	89.1	1,374.7	14,970.5	**16,474.2**
Exposures in default	-	0.4	0.8	4.3	127.3	**132.8**
Equity	-	-	-	-	75.0	**75.0**
Non-credit obligation assets	-	-	-	96.6	32.8	**129.4**
Corporates	98.0	1.7	-	14.1	5.8	**119.6**
Retail	1.6	-	-	-	-	**1.6**
Central governments or central bank	1,207.1	35.6	32.8	116.2	219.7	**1,611.4**
Multilateral Development Banks	-	-	5.4	128.9	20.6	**154.9**
Institutions	343.2	-	49.9	74.5	10.8	**478.4**
Covered Bonds	-	-	-	39.2	-	**39.2**
Claims on institutions and corporates with a short-term credit assessment	-	205.2	-	0.2	-	**205.4**
Securitisation positions	-	-	47.3	144.3	-	**191.6**
Credit Valuation Adjustment	-	0.7	4.6	51.4	16.7	**73.4**
Other Items	3.7	13.6	-	10.0	16.6	**43.9**
Total exposures	**1,655.8**	**294.9**	**229.9**	**2,054.4**	**15,495.8**	**19,730.8**

6.1.1 Credit risk weighted assets flow statement

The table below sets out the movement in risk weighted assets over the course of the reporting period. The flows have been calculated by applying standard volume rate analysis at a total book or asset category level.

	Retail and Commercial Mortgages £m	Total Wholesale Credit Exposures £m	Total Other £m	Total £m
Credit Risk RWAs at 31 December 2015	**5,375.1**	**343.9**	**211.1**	**5,930.1**
(Reduction) / Increase in RWA volume	456.1	(15.0)	33.3	**474.4**
(Improvement) / Deterioration in RWA quality	(1.6)	(24.7)	0.2	**(26.1)**
(Reduction) / Increase due to use of IRB Approach	(2,253.1)	-	270.6	**(1,982.5)**
Credit Risk RWAs at 31 December 2016	**3,576.5**	**304.2**	**515.2**	**4,395.9**

The increase in the volume of mortgage RWAs is primarily due to the growth of the Society's mortgage book. The reduction in the volume of wholesale credit RWAs is due to the use of central clearing counterparties for derivative exposures.

The improvement in RWA quality for wholesale credit exposures is mainly driven by lower risk weights that are now applied to our derivative exposures following the increased use of central clearing counterparties.

The movement due to the use of the IRB Approach reflects the move of the residential mortgage portfolios in the Society, Amber and NYM as well as equity exposures and other non-credit obligation assets to an IRB Approach following receipt of PRA permission in December. This has significantly reduced the average risk weights associated with the Society residential lending portfolio which has resulted in a reduction in risk weighted assets. This reduction is however off-set somewhat by an increase in the RWAs associated with the Amber and NYM portfolios, equity exposures and some non-credit obligation assets. In addition, under the IRB Approach exposures to undrawn credit commitments are subject to a credit conversion factor which is determined based on historical data relating to the likelihood of these commitments converting into mortgages compared to a standard conversion factor under the Standardised Approach based on the terms and conditions of the commitment. This has resulted in an increase in the risk weighted assets under the IRB Approach.

Further detail of the impact of the use of the IRB Approach can be found in section 3.4.

6.1.2 Credit risk exposures

The balances in the following sections represent the accounting balances for the prudential consolidation group 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. The average exposure is based on the average of the last two reporting positions.

Loans and advances to customers	Average 15/16 £m	2016 £m	2015 £m
Total residential mortgages	14,402.5	15,062.7	13,742.4
Commercial loans	340.4	326.7	354.0
Debt factoring loans	73.5	75.4	71.6
Other loans	46.8	49.0	44.5
Gross balances	**14,863.2**	**15,513.8**	14,212.5
Impairment provisions	(59.3)	(56.8)	(61.8)
Fair Value Adjustments for hedged risk	282.9	340.8	224.9
Total	**15,086.8**	**15,797.8**	14,375.6

The commercial loans balance includes £30.7m of exposures identified as being to Small and Medium Enterprises (SMEs). The debt factoring loans balance also has an exposure to SMEs of £1.6m. The Group has increased its overall lending throughout the year with both the Society and SIL growing their mortgage books whilst the Amber and NYM mortgage books continue to run-off.

6.1.3 Retail credit risk

The Group currently lends in the prime residential UK mortgage market, including buy-to-let, through the Society, whilst SIL lends in the Channel Islands and in the UK. The Board's credit risk appetite defines a number of limits regarding customer and collateral credit quality to which all lending activity must adhere.

The credit decision process utilises automated credit scoring and policy rules with lending policy criteria supporting manual underwriting. All aspects of the credit decision process are subject to regular independent review and development ensuring they support decisions in line with the Board's credit risk appetite.

The Group also has credit exposures through Amber 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. The performance of these portfolios has continued to improve over the reporting period. The retail lending to customers in the Society includes the equity release mortgage portfolio.

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

The balances below are reported gross of impairment

Lending analysis	2016 £m	2016 %	2015 £m	2015 %
Prime:				
Residential	11,315.6	75.2	10,189.5	74.1
Buy-to-let	2,617.8	17.4	2,323.1	16.9
Self build	52.4	0.3	58.4	0.4
Fast track	56.8	0.4	69.2	0.5
Self certified	500.4	3.3	555.9	4.1
Sub-Prime:				
Residential	49.4	0.3	55.3	0.4
Buy-to-let	40.6	0.3	48.3	0.4
Self build	0.5	-	0.5	-
Self certified	154.9	1.0	169.2	1.2
Equity release	274.3	1.8	273.0	2.0
Total	15,062.7	100.0	13,742.4	100.0

Prime mortgages are those granted to the most credit worthy category of borrower. Sub-prime mortgages are 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.

The mortgage book predominantly contains 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.

The table below provides a geographical breakdown of the mortgage book based on the location of the property.

Geographical analysis	2016 £m	2016 %	2015* £m	2015* %
North	585.8	3.9	498.2	3.6
Yorkshire	1,528.1	10.2	1,424.6	10.4
East Midlands	1,084.0	7.2	978.0	7.1
East Anglia	548.7	3.6	532.8	3.9
London	1,884.5	12.5	1,686.2	12.3
South East	2,918.2	19.3	2,723.7	19.8
South West	1,434.6	9.5	1,249.2	9.1
West Midlands	1,037.8	6.9	883.7	6.4
North West	1,427.6	9.5	1,307.1	9.5
Wales	499.5	3.3	417.8	3.0
Scotland	1,212.8	8.1	1,195.3	8.7
Northern Ireland	42.2	0.3	50.1	0.4
Channel Islands	858.9	5.7	795.7	5.8
Total	15,062.7	100.0	13,742.4	100.0

The 2015 comparative figures have been represented due to changes made to the geographical boundaries during 2016 as defined by the Halifax Price Index.

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 region.

The table below sets out the loan-to-value analysis for the prudential consolidation group's residential loan portfolio

	2016		2015	
Indexed loan-to-value analysis	£m	%	£m	%
<40%	2,286.1	15.2	2,007.3	14.6
40% - 50%	1,762.5	11.7	1,478.7	10.8
50% - 60%	2,521.0	16.7	2,190.9	15.9
60% - 70%	3,264.4	21.7	3,049.6	22.2
70% - 80%	2,868.6	19.0	2,884.0	21.0
80% - 90%	1,832.4	12.2	1,664.9	12.1
90% - 100%	452.7	3.0	386.4	2.8
>100%	75.0	0.5	80.6	0.6
Total	15,062.7	100.0	13,742.4	100.0

The indexed loan-to-value is updated on a quarterly basis to reflect changes in the house price index which is applied to the portfolio on a regional basis. The new lending policy is currently a maximum loan-to-value ratio of 90% for residential mortgages and 75% for buy-to-let lending.

At 31 December 2016, the average indexed loan-to-value of prudential consolidation group residential mortgages was 47.9% (2015: 48.5%).

6.1.4 IRB rating system

A rating system has been developed for the Society, Amber and NYM residential mortgage portfolios in line with the IRB Approach to credit risk. This is applied at customer account level and is used to assess the credit risk exposure and level of regulatory capital required for each of the portfolios on a monthly basis. All mortgage portfolios measured using the IRB Approach are or were originated in the UK and relate to UK properties.

The capital requirements for equity exposures and non-credit obligation assets are determined using the simplified IRB Approach with the remaining residential mortgage books, commercial lending and all other exposure classes remaining on the Standardised Approach for calculating capital requirements.

The IRB rating system is made up of the following models.

6.1.4.1 Probability of default (PD) model

To determine the risk of a customer defaulting on their mortgage repayments the Society uses a point-in-time PD model. The PD model defines a default as being greater than or equal to three months in arrears over a twelve month period. It also takes into account potential indications that the borrower is unlikely to pay such as the borrower being made bankrupt.

The PD model uses internal data about the property and the borrower combined with external data from credit bureau information to derive a credit score for each borrower. This score is then calibrated to a PD prediction.

For accounts less than three months old the application score is used instead of the PD model and is calibrated to a PD prediction in the same way.

6.1.4.2 Exposure at default (EAD) model

To determine the amount that the customer would owe in the event of default the Society uses an EAD model. The model conservatively adjusts the current balance to take account of the additional interest and fees that would be added to the balance prior to default as well as any payments that would be expected to occur before the account reaches default.

6.1.4.3 Loss given default (LGD) model

The LGD model calculates a potential loss, as a percentage of the EAD, that would result if the customer was to default.

The LGD model consists of a number of models which were built using internal data from the last downturn in the economy. These models assess the likelihood of repossession once an account defaults, the forced sale discount that is forecast to be experienced in selling a repossessed property and the amount of loss that the Society would incur. A house price adjustment is also applied that is equivalent to the reduction experienced from a peak in house prices to an eventual low point (peak-to-trough) following a period of reduction.

6.1.4.4 IRB rating system outputs

The expected loss for each customer account is calculated by multiplying together the PD, EAD and LGD. The risk weight for each customer account is calculated using a formula prescribed by the PRA, this in turn is used to calculate the capital requirement.

6.1.4.5 IRB summary table

The following tables show a summary of the outputs of the IRB models giving an indication of the distribution of the accounting balances by PD band for each of our mortgage portfolios to which we apply the IRB Approach.The table below relates to the Society mortgage portfolio

PD band	Exposure £m	Undrawn Commitments £m	Weighted average PD %	Weighted average LGD %	Weighted average risk weight %
0.00% < Pd <= 0.10%	6,702.6	87.9	0.05	20.16	3.12
0.10% < Pd <= 0.325%	4,096.4	433.6	0.18	25.88	10.33
0.325% < Pd <= 0.96%	2,127.1	335.6	0.54	29.16	25.34
0.96% < Pd <= 1.90%	458.7	82.0	1.29	32.59	50.88
1.90% < Pd <= 2.90%	72.9	16.6	2.28	31.14	69.56
2.90% < Pd <= 4.60%	25.1	4.5	3.59	30.14	87.69
4.60% < Pd <= 7.20%	10.4	1.0	5.65	27.83	103.24
7.20% < Pd <= 12.00%	6.9	0.1	9.27	26.86	124.51
12.00% < Pd <= 17.60%	3.0	0.1	14.18	27.96	151.94
17.60% < Pd <= 32.00%	1.9	-	22.21	24.95	150.94
32.00% < Pd <= 99.99%	2.4	-	41.08	25.98	148.95
1 month in arrears	24.5	-	35.07	21.66	132.08
2 months in arrears [1]	10.4	-	65.15	21.70	87.86
Default	49.6	-	100.00	30.57	303.50
Total	**13,591.9**	**961.4**			**12.50**

The following table relates to the Amber portfolio which was closed to new lending in 2008.

PD band	Exposure £m	Undrawn Commitments £m	Weighted average PD %	Weighted average LGD %	Weighted average risk weight %
0.00% < Pd <= 0.10%	22.6	-	0.07	23.82	4.65
0.10% < Pd <= 0.325%	135.5	-	0.21	35.64	16.01
0.325% < Pd <= 0.96%	196.9	-	0.60	39.29	36.57
0.96% < Pd <= 1.90%	138.7	-	1.33	41.31	65.87
1.90% < Pd <= 2.90%	58.3	-	2.33	43.26	98.12
2.90% < Pd <= 4.60%	37.8	-	3.64	43.40	127.28
4.60% < Pd <= 7.20%	18.1	-	5.69	43.01	159.55
7.20% < Pd <= 12.00%	15.7	-	9.04	43.40	199.46
12.00% < Pd <= 17.60%	7.2	-	14.21	41.71	227.54
17.60% < Pd <= 32.00%	5.5	-	22.47	39.03	235.55
32.00% < Pd <= 99.99%	3.2	-	46.20	42.66	234.47
1 month in arrears	29.8	-	47.00	38.63	214.00
2 months in arrears [1]	15.5	-	74.00	40.77	128.06
Default	57.0	-	100.00	44.12	409.38
Total	**741.8**	-			**95.1**

The following table relates to the NYM portfolio which was closed to new lending in 2008.

PD band	Exposure £m	Undrawn Commitments £m	Weighted average PD %	Weighted average LGD %	Weighted average risk weight %
0.00% < Pd <= 0.10%	9.1	-	0.08	20.20	4.11
0.10% < Pd <= 0.325%	84.7	-	0.21	30.19	13.43
0.325% < Pd <= 0.96%	117.7	-	0.60	31.54	29.11
0.96% < Pd <= 1.90%	70.9	-	1.33	33.33	53.12
1.90% < Pd <= 2.90%	31.2	-	2.33	34.19	77.50
2.90% < Pd <= 4.60%	19.3	-	3.69	33.41	98.77
4.60% < Pd <= 7.20%	12.5	-	5.61	32.66	120.54
7.20% < Pd <= 12.00%	12.9	-	8.97	33.57	153.75
12.00% < Pd <= 17.60%	4.2	-	14.21	36.96	201.19
17.60% < Pd <= 32.00%	4.2	-	21.89	33.35	200.27
32.00% < Pd <= 99.99%	1.0	-	39.03	36.97	218.60
1 month in arrears	19.9	-	39.00	32.55	194.13
2 months in arrears [1]	7.9	-	73.00	32.91	106.92
Default	24.0	-	100.00	36.87	374.81
Total	**419.5**	-			**75.8**

Notes

1. The risk weight for accounts 2 months in arrears is less than that for accounts 1 month in arrears due to the way the RWA calculation works for accounts with very high PD’s, it takes into consideration the relatively high impairment that will already be held for these accounts.

6.1.4.6 Controls and governance

Monitoring and oversight

The models that are used to estimate IRB parameters have been reviewed and approved by the PRA. Subsequent material changes to IRB models are also subject to regulatory approval by the PRA.

The performance and accuracy of models is critical both in terms of effective risk management and the determination of IRB risk parameters.

Monitoring of the IRB models is the responsibility of the Society's Credit Risk Modelling team who assess the performance of the models using various statistical techniques. This assessment is then reviewed and challenged by the Modelling Committee prior to being submitted to the Model Governance Committee (MGC) for final review and, if appropriate, approval.

Monitoring reports include an assessment of performance against trigger limits. If appropriate, the Modelling Team will make recommendations for amendments or updates to the models based on the information reported. Any changes to the models require approval from MGC which is chaired by the Chief Financial Risk Officer. All significant amendments, updates and any new models are also reviewed by the Society's independent Model Validation Team.

Independent validation

The Society has an independent Model Validation Team which provides MGC with an annual review of all of the IRB models. This team:

- Reviews the frequency, quality and appropriateness of the monitoring reports.
- Reviews the appropriateness of the modelling team's own analysis and conclusions about model performance.
- Provides comment and independent assessment on changes to models recommended by the Society's Credit Risk Modelling team.
- Comments on the documentation surrounding all aspects of the models.

6.1.4.7 IRB model performance

This section provides an analysis of the performance of the IRB models over the year to December 2016.

PD and LGD predictions against actual results are shown below.

IRB Retail Mortgages	Predicted Probability of Default [1] %	Observed Probability of Default %	Predicted Loss Given Default %	Observed Loss Given Default %
Society	0.38	0.19	21.20	8.80
Amber	5.75	1.70	37.80	17.00
NYM	4.98	1.53	31.20	12.10

Notes

1. The predicted probability of default shows the prediction for defaults from accounts that were up-to-date in December 2015 with the observed probability of default showing the actual default rate at December 2016 for those accounts. A separate roll-rate model is used to predict default from accounts already in arrears.

The predicted probability of default and loss given default were both higher than the observed results as arrears and losses within the Society have remained low throughout 2016, reflecting both the benign economic environment and a prudent risk appetite. The models used are conservative in order to meet all regulatory requirements and ensure that we hold a prudent level of capital. A conversion factor is used to forecast the level of completions expected from firm mortgage offers issued. At December 2015 this was set at 75% but it has risen over the year so at December 2016 was set at 80%. This exceeds the observed conversion rate to ensure we hold a prudent level of capital for pipeline business. The Amber and NYM portfolios do not have conversion factors as these portfolios are closed to new lending.

6.1.4.8 IRB comparison to impairment

There are material differences between the methodologies and underlying principles for calculating expected loss in accordance with regulatory requirements and accounting standards. These include timing differences with regard to default and impairment, and cyclicality as regulatory models take account of long-run average or downturn estimates over an economic cycle.

The following table sets out a comparison of expected loss to impairment provisions as at year 31 December 2016

IRB Residential Mortgages	Expected Loss £m	Provisions £m
Society	16.7	5.1
Amber	21.9	10.8
NYM	8.7	3.2
Total	**47.3**	**19.1**

IFRS 9 will replace the existing requirements in IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The Group currently plans to apply IFRS 9 initially on 1 January 2018.

The Group is in the process of assessing the potential impact of IFRS 9 application for regulatory capital purposes. This requires a detailed technical assessment of the initial one-off impact on transition to IFRS 9, as well as consideration of the ongoing impact of this change. The supervisory bodies are currently consulting on possible capital treatments following IFRS 9 adoption, including transitional arrangements, and we await confirmation of the final rules. The actual impact of adopting IFRS 9 for capital planning purposes is not yet known and cannot be reliably estimated. The quantitative effect will depend on, inter alia, the actual impact of adopting IFRS 9 on the Group's consolidated financial statements and also the final capital rules.

6.1.4.9 Use of IRB models

As well as being used to calculate capital requirements the IRB models are also used within the Society for the following purposes:

- Pricing the credit risk into mortgage products
- Providing insight into the credit risk of the IRB mortgage portfolios that is used to inform new lending policy and collections activity
- To determine projected capital requirements in various forward looking scenarios included in the Society's planning and ICAAP processes

We will continue to enhance our IRB credit risk models to ensure effective pricing, provisioning and use of capital. These models, along with others such as application scorecards, an affordability model and forecasting models, provide us with the tools to measure and understand the credit dynamics of our existing loan books and of new lending proposals. This has enabled us to make improvements in a number of areas including our pricing capability and the effective deployment of credit management strategies. Managing loan impairment losses in our mortgage portfolios remains a key priority and we continue to monitor and manage mortgages that have fallen into arrears, supporting our customers wherever possible, and ensuring fair outcomes for our borrowers whilst protecting the business against financial losses for the benefit of all our members.

6.1.5 Commercial credit risk

The Society's commercial mortgage portfolio was closed to new lending in November 2008. We have retained a team of people to manage and monitor the performance of these loans.

For commercial mortgage exposures, an impairment model based on a set of assumptions is applied but, due to the non-standard nature of the properties, each account is also individually reviewed on a monthly basis and suitably qualified commercial underwriters objectively assess additional impairment provisions as required. However, one assumption contained within the commercial impairment model is an assumed forced sale discount, and the impact of an additional 5% discount compared to that assumed (for example, from a forced sale discount assumption of 25% to 30%) would be to increase the total impairment provision by £0.6m (2015: £0.5m).

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

	2016		2015	
Commercial lending	£m	%	£m	%
Leisure and hotel	34.1	10.4	39.1	11.0
Retail	11.4	3.5	12.9	3.6
Nursing / residential homes	15.0	4.6	16.7	4.7
Offices	5.6	1.7	8.9	2.5
Commercial investment and industrial units	251.1	76.9	265.8	75.2
Miscellaneous	9.5	2.9	10.6	3.0
Total	326.7	100.0	354.0	100.0

The table below provides a geographical breakdown of the commercial mortgage book based on the location of the property

	2016		2015*	
Geographical analysis	£m	%	£m	%
North	16.3	5.0	17.4	4.9
Yorkshire	27.6	8.4	31.9	9.0
East Midlands	23.7	7.3	25.0	7.1
East Anglia	7.2	2.2	8.4	2.4
London	79.5	24.3	84.0	23.7
South East	62.3	19.1	69.5	19.6
South West	40.2	12.3	43.4	12.3
West Midlands	23.5	7.2	25.2	7.1
North West	32.0	9.8	34.1	9.6
Wales	9.2	2.8	9.7	2.8
Scotland	5.2	1.6	5.4	1.5
Total	326.7	100.0	354.0	100.0

*The 2015 comparative figures have been re-presented due to changes made to the geographical boundaries during 2016 as defined by the Halifax Price Index.

An analysis of the commercial loan portfolio by loan-to-value is set out as below

	2016		2015	
Loan to value analysis	£m	%	£m	%
<40%	46.6	14.3	46.6	13.1
40% - 50%	44.4	13.6	39.4	11.1
50% - 60%	52.4	16.0	52.4	14.8
60% - 70%	66.2	20.2	68.6	19.4
70% - 80%	34.6	10.6	42.8	12.1
80% - 90 %	25.4	7.8	28.3	8.0
90% - 100 %	15.3	4.7	17.9	5.1
>100%	41.8	12.8	58.0	16.4
Total	326.7	100.0	354.0	100.0

At 31 December 2016, the average loan-to-value of commercial loans was 54.1% (2015: 56.1%). The average loan-to-value is based on the latest external valuation of the properties within the portfolio.

6.1.6 Debt factoring / invoice discounting

This relatively small portfolio of loans relates to loans made by our factored debt and invoice discounting business, Skipton Business Finance Limited (SBF), which continues to be managed by appropriately skilled teams.

The credit and operational risk associated with SBF activities is managed through a framework of robust corporate governance with credit committee approval and review processes being followed (for new and modified agreements) in accordance with SBF credit policy. Risks are further mitigated by regular client audits and ongoing operational risk monitoring. Credit risk in relation to debtors is mitigated by individual exposure monitoring (concentration limits) and credit assessment via third party credit reference agencies to set appropriate debtor exposure limits.

The SBF Board, which includes executives from the Society, is responsible for developing and maintaining credit policy, monitoring and controlling the risk to the business arising from the credit quality of its clients and clients' debtors, recommending changes to this policy and monitoring implementation of changes to ensure that SBF operates within risk limits. In addition to the executive management oversight and corporate governance, SBF are subject to regular internal audits on a scheduled basis as determined by the Society. Summary reports are also submitted to the Society's RCC on a monthly basis.

6.1.7 Wholesale lending credit risk

Wholesale credit risk arises from the wholesale investments held by the Society's Treasury function which is responsible for managing this aspect of credit risk in line with the Board approved credit risk appetite and wholesale credit policies. Wholesale counterparty limits are reviewed monthly by the Group Wholesale Credit Committee based on analyses of counterparties' financial performance, ratings and other market information to ensure that limits remain within our risk appetite. The allocation of credit limits uses a composite of external credit ratings alongside an internal credit assessment to assign limits based upon a percentage of the Group's capital. The processes for limit allocation and credit assessment are documented within the Treasury Policy. We regularly review and closely monitor the number of counterparties to whom we will lend and, for those counterparties whom we have lent to; we review both the amount and duration of any limits.

ALCO provides oversight to the effectiveness of wholesale credit risk management. Changes to wholesale credit risk are monitored by the Group Wholesale Credit Committee through the review of financial performance and changes in external credit ratings. The performance of mortgages underlying securitisation positions is also monitored monthly against a series of triggers, including total losses, defaults and reserve funds. Trigger levels are reviewed and updated semi-annually. Impairment testing and more severe stress testing is regularly performed using several different severity levels.

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

Netting and collateralisation agreements are used to reduce credit exposure, these are discussed further in section 6.1.12 and 6.1.13. The exposure values shown in this section are net of these credit risk mitigation techniques. The following table sets out the liquidity book by industry sector / asset class as at 31 December 2016. The average exposure is based on the average of the last two reporting positions.

Asset class	Notes	Average 15/16	2016 £m	2015 £m
Cash in hand and balances with Bank of England		1,196.7	1,212.7	1,180.8
Loans and advances with Banks and Building Societies		383.0	387.8	378.3
Gilts		351.7	377.5	325.8
Certificates of deposit		287.8	232.9	342.7
Fixed rate bonds		169.9	183.8	156.0
Floating rate bonds		60.1	30.1	90.1
Residential mortgage backed securities	1	181.1	191.6	170.5
Covered Bonds		29.2	39.2	19.3
Total		2,659.5	2,655.6	2,663.5

Notes

1. Residential mortgage backed securities, as shown in the table above, represent investments in unconsolidated structured entities, and are treated as available for sale assets. Further detail and accounting treatments and policies can be found in note 1b) Basis of Consolidation, Unconsolidated structured entities and note 1d) Financial Assets, Available-for-sale in the Annual Report and Accounts.

The table below sets out the capital held for the liquidity book by credit rating. The capital requirement is equal to the risk weighted asset multiplied by 8%.

Liquidity by credit rating	Exposure Value £m	Risk weighted Assets £m	Capital Requirement £m
Aaa / AAA	367.7	42.1	3.4
Aa1 / AA+	28.7	0.1	-
Aa2 / AA	1,593.6	0.3	-
Aa3 / AA-	266.5	53.3	4.3
A1 / A+	150.7	49.8	4.0
A2 / A	132.7	66.3	5.2
A3 / A-	4.1	2.0	0.2
Baa1 / BBB+	80.8	40.4	3.2
Unrated:			
Building societies	1.8	6.5	0.5
Other	29.0	1.2	0.1
Total	**2,655.6**	**262.0**	**20.9**

The Group's treasury investments are held to provide liquidity. As at 31 December 2016, at a prudential consolidation group level, 98.8% (99.9%: 2015) of these investments are investment grade (i.e. are rated Baa3 / BBB- or better), the Society did not have any rated exposures below Baa1 / BBB+.

The Group's policy is that initial investments in treasury assets must be investment grade or above. If the credit rating for an exposure is downgraded such that it is no longer investment grade then the Group Wholesale Credit Committee will consider the circumstances behind the change in risk; the maturity and value of the outstanding exposure; and whether the exposure could be reduced or mitigated.

To obtain the risk weights and hence calculate the minimum credit risk capital requirement for wholesale lending exposures, the Society continues to use Moody's and Fitch as External Credit Assessment Institutions (ECAIs). The lower of Moody's or Fitch ratings is applied if both agencies rate the same asset.

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 (including covered bonds and RMBSs), 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, the risk weightings and the corresponding capital requirement (equal to the exposure multiplied by the risk weighting percentage multiplied by 8%) 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 lowest credit rating from either Moody's or Fitch.

Exposure Type	Credit quality step	Maturity	Risk Weight Percent	Lowest External Credit Rating	Exposure £m	Req'ment £m
Central governments and central banks	1	All	0%	Aaa to Aa3 / AAA to AA-	**1,597.4**	**-**
Multilateral development banks	1	All	0%	Aaa to Aa3 / AAA to AA-	**155.0**	**-**
Financial institutions	1	All	20%	Aaa to Aa3 / AAA to AA-	267.8	4.3
	2	Residual / original maturity < 3 months	20%	A1 to A3 / A+ to A-	94.3	1.5
	2	Residual / original maturity < 3 months	50%	A1 to A3 / A+ to A-	118.6	4.7
	2	Original maturity > 3 months	50%	A1 to A3 / A+ to A-	80.1	3.2
	3	Original maturity > 3 months	50%	Baa1 to Baa3 / BBB+ to BBB-	80.8	3.2
	Unrated	All	4%	Unrated	29.0	0.1
	Unrated	All	370%	Unrated	1.8	0.5
Covered Bonds	1	All	10%	Aaa to Aa3 / AAA to AA-	39.2	0.3
Residential Mortgage Backed Securities	1	All	20%	Aaa to Aa3 / AAA to AA-	**191.6**	**3.1**
Total					**2,655.6**	**20.9**

6.1.8 Concentration risk

Concentration risk is the risk that the Group suffers losses from being over-exposed to counterparty, 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 Credit Risk team.

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 BRC) 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.

6.1.9 Impairment provisions

The Group carries out an assessment of impairment of loans and advances to customers at each reporting date. Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession or where fraud or negligence has been identified. Objective evidence of impairment may include indications that the borrower or group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, or the debt being renegotiated to reduce the burden on the borrower. The key drivers influencing this objective evidence predominantly relate to affordability issues driven by unemployment and increased costs of living. Based upon these assessments an individual impairment provision is made in one of two ways.

For properties that are either in possession or where sufficient information is available to calculate a specific provision on an account-by-account basis (for example, accounts that are on a defined 'watch list'), the provision is calculated as the difference between the existing carrying value and the present value of the estimated future cash flows, discounted at the asset's original effective interest rate. Alternatively, for other individual loans that have reached the point at which an impairment provision is needed but where it is not possible to specifically determine the amount ultimately likely to be received, assumptions are used from groups of loans with similar characteristics, based on historical data including the probability of possession given default and average forced sale discounts, and a provision calculated accordingly against this group of loans.

In addition, a collective impairment provision is made against the remaining portfolio of loans and advances where objective evidence indicates that credit losses have been incurred but not yet identified at the reporting date. The impairment value is calculated by applying various factors to pools within the Group's mortgage portfolio that have similar characteristics. These factors take into account the Group's experience of default rates, loss emergence periods, the effect of regional movements in house prices based on a recognised index, as well as adjustments to allow for ultimate forced sales values and realisation costs.

The impairment model also 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.

In certain circumstances, the Group renegotiates loans to customers in financial difficulties (referred to as 'forbearance' activities) to maximise collection opportunities, minimise the risk of default and ensure the best outcome for the customer. Under the Group's forbearance policy, loan forbearance is granted on a selective basis if the customer is currently in default on their debt or if there is a high risk of default, there is evidence that the customer made all reasonable efforts to pay under the original contractual terms and the customer is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity of the loan, changing the timing of interest payments or amending the terms of loan covenants. Both retail and commercial loans are subject to the forbearance policy. The RCC regularly reviews reports on forbearance activities.

Detail on the policies relating to the impairment of goodwill and of investments in subsidiaries can be found in Note 1 of the Group's Annual Report and Accounts.

6.1.9.1 Residential impairment provisions

The table below provides further information on residential loans and advances by payment due status. The sub prime loans relate to the Amber and NYM portfolios which have been closed to new lending since 2008. There are no sub prime loans in the Society's portfolio.

	Residential		Buy-to-let		Other [1]		Total	
	Prime £m	Sub Prime £m	Prime £m	Sub Prime £m	Prime £m	Sub Prime £m	Prime £m	Sub Prime £m
Neither past due nor individually impaired	11,493.1	38.5	2,598.4	38.5	548.6	109.5	**14,640.1**	**186.5**
Past due but not impaired: Up to 3 months	47.7	4.7	9.7	1.6	28.4	20.1	**85.8**	**26.4**
	11,540.8	**43.2**	**2,608.1**	**40.1**	**577.0**	**129.6**	**14,725.9**	**212.9**
Individually impaired:								
Low risk	31.0	3.4	3.2	0.2	12.6	10.4	**46.8**	**14.0**
High risk	17.0	2.7	5.1	0.3	18.3	14.8	**40.4**	**17.8**
Possessions	1.1	0.1	1.4	-	1.7	0.6	**4.2**	**0.7**
Total	**11,589.9**	**49.4**	**2,617.8**	**40.6**	**609.6**	**155.4**	**14,817.3**	**245.4**
Collective impairment	(30.9)	(0.2)	(0.8)	(0.1)	(2.0)	(1.0)	**(33.7)**	**(1.3)**
Individual impairment	(2.8)	(0.4)	(1.4)	(0.1)	(4.1)	(3.1)	**(8.3)**	**(3.6)**
Total lending to individuals	**11,556.2**	**48.8**	**2,615.6**	**40.4**	**603.5**	**151.3**	**14,775.3**	**240.5**

Notes

1. 'Other' relates to self build, self certified and fast track mortgages.

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 table below sets out exposures and corresponding impairments by region for the residential loans.

Geographical analysis	Neither past due nor individually impaired £m	Past due but not individually impaired £m	Individually impaired £m	Total £m
North	576.5	4.5	4.8	**585.8**
Yorkshire	1,503.5	12.1	12.5	**1,528.1**
East Midlands	1,067.1	7.9	9.0	**1,084.0**
East Anglia	537.2	5.3	6.2	**548.7**
London	1,855.5	14.2	14.8	**1,884.5**
South East	2,871.9	22.4	23.9	**2,918.2**
South West	1,418.1	8.0	8.5	**1,434.6**
West Midlands	1,019.8	8.3	9.7	**1,037.8**
North West	1,400.6	13.3	13.7	**1,427.6**
Wales	487.4	5.5	6.6	**499.5**
Scotland	1,195.5	7.7	9.6	**1,212.8**
Northern Ireland	35.5	2.1	4.6	**42.2**
Channel Islands	858.0	0.9	-	**858.9**
Total	**14,826.6**	**112.2**	**123.9**	**15,062.7**

The table below provides further information on residential mortgages at 31 December 2016 by the type of account renegotiations applied to customers over the last two years. For clarity, this table includes all accounts where the terms have been renegotiated 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, but does not include accounts where terms have not been renegotiated in the last two years which may still be on renegotiated terms from a previous arrangement prior to this two year period. The total column relates to total loans to customers including those that have not been renegotiated.

Account renegotiations	Total £m	Capitali-sation £m	Reduced payment £m	Transfer to interest only £m	Term extension £m	Total renego-tiations £m	%
Neither past due nor impaired	14,826.6	3.6	42.2	32.6	11.0	89.4	0.6
Past due but not impaired:							
Up to 3 months	112.2	0.1	14.2	1.5	0.2	16.0	14.3
	14,938.8	3.7	56.4	34.1	11.2	105.4	0.7
Individually impaired:							
Low risk	60.8	0.6	14.5	3.7	0.3	19.1	31.4
High risk	58.2	0.3	10.3	1.4	0.3	12.3	21.1
Possessions	4.9	-	0.5	-	-	0.5	10.2
	15,062.7	4.6	81.7	39.2	11.8	137.3	0.9
Collective impairment	(35.0)	-	(0.3)	-	-	(0.3)	0.9
Individual impairment	(11.9)	-	(2.0)	(0.1)	(0.1)	(2.2)	18.5
	15,015.8	4.6	79.4	39.1	11.7	134.8	0.9

We consider forbearance options on a case-by-case basis in line with industry guidance and best practice. The impact of any such forbearance is recognised within our provisioning policy. The proportion of renegotiated mortgage accounts within the portfolios has reduced during the year to the end of 2016, a trend that is in line with the overall reduction in mortgage arrears.

Where a loan is not recoverable, it is written off against the related provision for loan impairment once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the Income Statement.

The table below shows the impairment charges for the year to the Income Statement for residential lending and other loans for the prudential consolidation group

	Loans fully secured on residential property £m	Other loans £m	Total £m
At 1 January 2016			
Individual impairment	16.2	0.6	16.8
Collective impairment	33.0	-	33.0
	49.2	**0.6**	**49.8**
Amounts written off during the year, net of recoveries			
Individual impairment	(3.3)	(0.1)	(3.4)
Collective impairment	(0.1)	-	(0.1)
	(3.4)	**(0.1)**	**(3.5)**
Income statement			
Impairment losses on loans and advances			
Individual impairment	(0.6)	0.1	(0.5)
Collective impairment	2.1	-	2.1
	1.5	**0.1**	**1.6**
Adjustment to impairment losses on loans and advances resulting from recoveries during the year			
Individual impairment	(0.4)	-	(0.4)
Charge for the year	**1.1**	**0.1**	**1.2**
At 31 December 2016			
Individual impairment	11.9	0.6	12.5
Collective impairment	35.0	-	35.0
	46.9	**0.6**	**47.5**

The collective impairment includes £27.7m 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 (for more detail see Note 15 of the Group's Annual Report and Accounts). The no negative equity guarantee provided to equity release customers is accounted for as an embedded derivative due to the economic characteristics (as described in note 37b) of the Annual Report and Accounts). The losses on this portfolio represent the fair value movement of these embedded derivatives and are a function of the actual and projected interrelationship between market-wide long term house prices and retail price inflation and the specific behaviour of this portfolio.

During the year the Directors have assessed the fair value of these embedded derivatives, based on the performance of the wider economy and management's assessment of the specific characteristics of the portfolio, resulting in a charge of £3.8m to the Income Statement (2015: £6.5m).

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 inflation, mortality rates and estimated redemption profiles.

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 reduction in impairment held for these portfolios compared with the prior year.

6.1.9.2 Residential lending credit risk mitigation

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. This includes the use of application scorecards, income verification and an affordability model. The credit risk of the mortgage portfolios is controlled using the suite of models previously described in section 6.1.14.

Where appropriate for customers, the Group applies a policy of forbearance. This may be applied where the actual or apparent financial stress of the customer is considered to be short term with a potential to be recovered. Forbearance may involve arrears capitalisation, a reduction in the monthly payment (known as a concession), a conversion to interest only or a mortgage term extension. Forbearance is undertaken in order to achieve the best outcome for both the customer and the business through dealing with repayment difficulties at an early stage.

Possession balances represent loans against which the Group has taken ownership of properties pending their sale. Possession is generally considered only as a last resort, once all other options for the customer have been exhausted. As at 31 December 2016 the balance of residential loans where the property in question has been taken into possession represents less than 0.1% of total outstanding loans for the Group (2015: less than 0.1%), and less than 0.1% of total outstanding loans for the Society (2015: less than 0.1%). The Group does not occupy repossessed properties for business use or use such assets acquired in its operations. All customer accounts are monitored to ensure that these strategies remain appropriate.

Typically residential lending secured against a property is only permitted if the property is insured for normal property damage perils.

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.

6.1.9.3 Commercial impairment provisions

Individual impairment provisions are made to reduce the carrying value of commercial mortgages to the present value of the amount the Directors consider 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 generally based on the most recent external valuation of the mortgaged property or, where one is not available, calculated using third party valuation indices. The valuation is discounted further to assume a forced sale value in addition to default propensity modelling.

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

	Leisure and Hotel £m	Retail £m	Nursing /Residential Homes £m	Offices £m	Commercial investment and Industrial £m	Misc £m	Total £m
Neither past due nor impaired	32.9	11.1	15.0	5.6	245.9	6.8	**317.3**
Past due but not impaired:							
Up to 3 months	0.9	-	-	-	2.5	2.2	**5.6**
	33.8	**11.1**	**15.0**	**5.6**	**248.4**	**9.0**	**322.9**
Individually impaired:							
Low risk	-	-	-	-	-	0.5	**0.5**
High risk	0.3	0.3	-	-	2.7	-	**3.3**
Total	**34.1**	**11.4**	**15.0**	**5.6**	**251.1**	**9.5**	**326.7**
Collective impairment	(0.1)	-	(0.1)	-	(0.7)	-	**(0.9)**
Individual impairment	(1.5)	(0.1)	-	-	(6.2)	(0.6)	**(8.4)**
Total Commercial Lending	**32.5**	**11.3**	**14.9**	**5.6**	**244.2**	**8.9**	**317.4**

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 table below sets out the geographic breakdown of impairments for the Group's lending against commercial properties.

Geographical analysis	Neither past due nor individually impaired £m	Past due but not individually impaired £m	Individually impaired £m	Total £m
North	16.0	-	0.3	**16.3**
Yorkshire	27.3	-	0.3	**27.6**
East Midlands	21.1	2.6	-	**23.7**
East Anglia	7.2	-	-	**7.2**
London	77.9	1.4	0.2	**79.5**
South East	61.2	1.1	-	**62.3**
South West	37.7	0.4	2.1	**40.2**
West Midlands	23.5	-	-	**23.5**
North West	31.1	-	0.9	**32.0**
Wales	9.2	-	-	**9.2**
Scotland	5.1	0.1	-	**5.2**
Total	**317.3**	**5.6**	**3.8**	**326.7**

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

The table below provides further information on commercial mortgages at 31 December 2016 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, but does not include accounts where terms have not been renegotiated in the last two years which may still be on renegotiated terms from a previous arrangement prior to this two year period.

Account renegotiations	Total £m	Capita-lisation £m	Reduced payment £m	Transfer to interest only £m	Total renego-tiations £m	%
Neither past due nor individually impaired	**317.3**	1.7	0.2	11.0	**12.9**	4.1
Past due but not impaired:						
Up to 3 months	**5.6**	-	2.6	1.7	**4.3**	76.8
	322.9	**1.7**	**2.8**	**12.7**	**17.2**	**5.3**
Individually impaired:						
Low risk	**0.5**	-	-	0.3	**0.3**	60.0
High risk	**3.3**	-	-	2.6	**2.6**	78.8
	326.7	**1.7**	**2.8**	**15.6**	**20.1**	**6.2**
Collective impairment	**(0.9)**	-	-	-	**-**	-
Individual impairment	**(8.4)**	(0.9)	(0.6)	(2.6)	**(4.1)**	48.8
	317.4	**0.8**	**2.2**	**13.0**	**16.0**	**5.0**

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The table below shows the impairment charges for commercial lending for the year to the income statement for the prudential consolidation group.

	Loans fully secured on land £m
At 1 January 2016	
Individual impairment	11.4
Collective impairment	0.6
	12.0
Amounts written off during the year, net of recoveries	
Individual impairment	(1.2)
Collective impairment	-
	(1.2)
Income statement	
Impairment losses on loans and advances	
Individual impairment	(1.8)
Collective impairment	0.3
	(1.5)
Adjustment to impairment losses on loans and advances resulting from recoveries during the year	
Individual impairment	-
Charge / (Credit) for the year	**(1.5)**
At 31 December 2016	
Individual impairment	8.4
Collective impairment	0.9
	9.3

6.1.9.4 Commercial lending credit risk mitigation

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 set out in the EU Capital Requirements Regulation 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.

6.1.10 Impairment of treasury assets

As at 31 December 2016, none of the Group's treasury portfolio exposure was either past due or impaired (2015: £2.5m); as such, no provision (2015: £2.5m) is held for impaired treasury assets. In assessing the potential impairment of its treasury assets, the Group considers, amongst other factors, objective evidence of deterioration in the counterparty's financial health, the normal volatility in valuation, as well as industry and sectoral performance.

6.1.11 Wholesale counterparty credit risk mitigation

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

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

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 and covered bonds 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.

6.1.12 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 to hedge risk exposures. The principal derivatives used by the Group are interest rate contracts, commonly known as interest rate swaps, interest rate options and foreign exchange contracts.

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 2016 was:

Exposure to Derivative Counterparty Credit Risk	Prudential Consolidation Group £m
Interest rate contracts	154.4
Other contracts	13.7
Gross positive fair value of contracts	168.1
Netting benefits and potential credit add-ons	(94.8)
Netted current credit exposure	73.3
Collateral held	(23.1)
Net derivative credit exposure	50.2

Note 13 of the Group’s Annual Report and 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.

If the Society is downgraded, there would be no impact on the collateral required to be posted in relation to existing swap and repo agreements. 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 as it only accepts cash as collateral.

The Group does not currently use credit derivatives for risk mitigation. The Society does hold a £7.5m fixed rate bond issued by a financial institution in 2012 which is guaranteed by the UK Government up to its maturity.

The credit ratings of the Society are assigned by two major credit rating agencies, Fitch and Moody’s. During the year our credit ratings were upgraded by Fitch and our outlook changed from stable to positive by Moody’s. The Society’s long and short term credit ratings as at 31 December 2016 were as follows:

	Long term	Short term	Outlook	Date of last rating action / confirmation
Finch	A-	F1	Stable	26/05/2016
Moody’s	Baa2	P-2	Positive	05/10/2016

6.1.13 Securitisation and Term Secured Wholesale Funding

The Group carries out securitisation and term secured wholesale funding transactions of its own mortgage assets as well as acquiring mortgage backed securities from other third parties.

This following section discusses securitisation and term secured wholesale funding activity concerning mortgage assets owned by the Group and subject to the issue of securitisation notes or other secured funding. For information about the Group's exposure to purchased Mortgage Backed Securities see section 6.1.8.

The Group has securitised certain residential mortgage loans by the transfer of the beneficial interest in such loans to three (as at 31 December 2016) special purpose vehicles (SPVs). The legal title to the mortgages remains with the Group and would only transfer to the SPVs in limited circumstances, including the insolvency of the Society. The securitisation and term secured wholesale funding transactions enables a subsequent raising of debt to investors or lenders 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 31 December 2016, the SPVs named, Darrowby No. 2 plc (Darrowby 2), Darrowby No. 3 plc (Darrowby 3) and Darrowby No. 4 plc (Darrowby 4), constituted wholesale funding of £519.6m (net of amortised costs). Securitisations and term secured funding transaction capability allows the Group to access this source of funding and provides further opportunity for wholesale funding in the future.

The table below sets out the roles that the Society takes in relation to each of the securitisation transactions. The Society retains the first loss element:

Society's role in the securitisation process

Securitisation Company	Originator, Seller, Administrator, Cash Manager	Subordinated Loan Provider	Holder of AAA rated Notes	Holder of Class B Notes
Darrowby 2	✓	Repaid		✓
Darrowby 3	✓	Repaid		✓
Darrowby 4	✓	✓	✓	✓

The securitisation and term secured wholesale funding transactions activity is conducted for financing purposes and is only conducted on mortgage assets held by the Group. As there is not considered to be a transfer of significant credit risk, the Society does not calculate specific risk weighted exposure amounts for any positions it holds in the securitisation, or assets awaiting securitisation and these continue to be calculated in line with capital requirements consistent with other mortgage assets.

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 2016, rated debt securities totalled £122m.

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 2016, rated debt securities totalled £181m.

Darrowby 4 was incorporated in September 2015. In February 2016, Darrowby 4 issued £450m of AAA rated debt securities. The notes are rated by both Fitch and Moody's. As at 31 December 2016, rated debt securities totalled £328m of which £109m was held by the Group.

The performance of the securitisations term secured wholesale funding transactions is monitored on a monthly basis by the Society's Secured Funding Group. Further details on the securitisation companies are shown in the following tables:

31 December 2016

Securitisation Company	Type	Gross Assets Securitised £m	Notes held by third parties[1] £m	Notes held by the Group[1,2] £m	Underlying assets in arrears[3] £m
Darrowby 1[4]	Residential Mortgage Backed Securities	-	-	-	-
Darrowby 2	Residential Mortgage Backed Securities	187.1	121.7	71.0	1.3
Darrowby 3	Residential Mortgage Backed Securities	223.9	180.5	47.0	1.0
Darrowby 4	Residential Mortgage Backed Securities	347.2	218.5	146.2	0.5

31 December 2015

Securitisation Company	Type	Gross Assets Securitised £m	Notes held by third parties[1] £m	Notes held by the Group[1,2] £m	Underlying assets in arrears[3] £m
Darrowby 1	Residential Mortgage Backed Securities	404.1	160.1	251.2	5.5
Darrowby 2	Residential Mortgage Backed Securities	245.9	184.3	71.0	2.3
Darrowby 3	Residential Mortgage Backed Securities	283.8	244.2	47.0	0.7

Notes
1. Excludes accrued interest.
2. Class B notes and Retained rated Class A Notes (and those partially pledged in a repurchase agreement).
3. A mortgage account where one or more monthly payments have become due and remain unpaid.
4. Darrowby 1 was liquidated during 2016 following repayment of all of its notes.

6.2 Operational risk

6.2.1 Operational risk definition and approach

As a business with a retail franchise in financial services, the management of operational risk (the Group's definition of operational risk includes Conduct risk) is key to the ongoing success of the Group. Central to managing this risk is maintenance of a robust product governance framework to ensure that we develop and market products and services designed to meet the needs of our target market, maintain strong control over providing advice and have efficient administration services.

As well as the core business providing advice on mortgages and general insurance, the Group owns a large estate agency business also providing advice on mortgages and general insurance, and a Financial Advice Division (integrated into the Society) which provides pensions and investment advice. Alert to the loss of customer trust experienced by financial services firms as a result of mis-selling scandals, the Group continues to invest in and develop its operational risk management processes and oversight arrangements.

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

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

6.2.1.1 Risk mitigation

CORC ensures that an appropriate framework is in place to manage, control and mitigate the operational risks that could impact the ability of the Group to meet its business objectives and serve our customers. CORC also monitors whether Group businesses are operating within the Board-approved operational risk appetite.

Through the Operational Risk Framework, the management and oversight of the key risk exposures facing the Group are sub-divided into the following risk categories:

- Operational Resilience
- Change Management
- Customer Risk
- Financial Management and Management Information
- Financial Crime
- Information Security
- Information Technology
- Legal and Regulatory
- People and Culture
- Premises and Facilities
- Processes
- Supplier Risk

The Group's Operational Risk Framework sets out the strategy for identifying, assessing and managing these risk categories. Senior management is responsible for understanding the nature and extent of the impact on each business area and for embedding appropriate controls to mitigate those risks. The framework is updated periodically to take account of changes in business profile, new product development and the external operating environment.

CORC provides oversight and assesses the Group's exposure to operational risks based on both quantitative and qualitative considerations. The crystallisation of risks is captured through the recording and analysis of customer outcomes, operational risk events and operational losses (and near misses) which are used to identify any potential systemic weaknesses in operating processes.

The Group has adopted the standardised approach to calculate the Pillar 1 capital requirement for operational risk, compliant with the requirements of CRD IV.

6.2.2 Operational Risk Management Framework

Operational Risk Management is integrated with both strategic and routine business decisions across the Group. The Operational Risk Framework is in place to assist achievement of the Group Corporate Plan by ensuring fair customer outcomes, protecting income and profit generation, meeting regulatory and legislative requirements and protecting the Group's reputation through:

- Identifying risks and taking proactive steps to prevent risks materialising, avoiding repeated mistakes and minimising operational losses.

- Understanding and ensuring appropriate customer outcomes throughout the customer lifecycle.

- Ensuring a suitable level of controls and procedures are in place to minimise and mitigate the Group's exposure to operational risks and to protect the confidentiality, integrity and availability of information, detecting and managing any failure in these mechanisms.
- Undertaking appropriate monitoring activity supported by an embedded approach to continuous improvement.
- Improving operational efficiency, avoiding overlaps in activity and excessive or obsolete control measures.
- Understanding and managing the relationship between risk and reward.
- Ensuring that appropriate contingency arrangements are in place supported by robust testing.
- Ensuring that an appropriate level of capital is held in support of the Group's operational risks.

The following principles underpin effective Operational Risk Management across the Group:

- A proportionate approach is undertaken to risk management.
- Ownership and understanding of risks is embedded.
- Flexible and dynamic approaches are in place to continuously improve.
- Both historical and forward looking data are used to assess the risk.
- Risk management is integrated into decision making.
- Strong risk culture and behaviours are in place to ensure fair outcomes and protect Prudential requirements.
- Timely reporting of risk exposures are in place.

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

The Group calculates the Pillar 1 capital requirement for operational risk using the Standardised Approach. This applies published regulatory risk factors, known as 'beta factors' to the sum of the average of three years' net income, segmented by business line.

As at 31 December 2016 this approach resulted in the Pillar 1 minimum risk weighted assets as follows:

	Prudential consolidation group	
	2016 £m	2015 £m
Operational Risk Weighted Asset (RWA)	367.3	346.3
Operational Risk Capital Requirement (RWA x 8%)	29.4	27.7

The Operational Risk Capital Requirement increased in 2016 as a result of an increase in business volumes across the Group rather than any significant changes in the operating or control environment.

6.3 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. Currency risk is included in the Society's Pillar 1 capital requirement calculations, the other market risks are considered under Pillar 2 capital requirements in sections 7.5 and 7.6. 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 7.4) 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 within the operational limits set out in the Group's Treasury Policy. The Market & 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 and meet on a regular basis with the Treasury function to ensure they measure the continued effectiveness of the hedges.

ALCO recommends the Group's Treasury Policy to the Board for approval on an annual basis. ALCO and BRC receives regular information on all relevant aspects of market risk exposure, including the continuing effectiveness of hedges.

Market risk also exists within the Group's defined benefit pension schemes and is managed by the Trustees of the schemes, working closely with the sponsoring employers, Skipton Building Society and Connells. Pension obligation risk is covered in more detail in section 7.4.

6.3.1 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 has investments in its subsidiary undertakings Jade Software Corporation Limited and Northwest Investments NZ Limited, and its equity share investment in Wynyard Group Limited (however, this investment was fully written down during 2016), which are denominated in New Zealand Dollars. The foreign currency fluctuations in relation to these investments are not hedged, but are recognised in the Group's translation reserve. These entities sit outside the prudential group; however the prudential group does have an exposure totalling £2.0m, which represents the cost of investment in these entities. Jade is held as a subsidiary investment and a 56.4% stake is held. Jade also provides the technology which supports the Society's core IT platform. The Group owns 17.7% of Wynyard Group Limited, a provider of software development services that was spun out of Jade Software Corporation and floated on the New Zealand stock exchange in July 2013. In October 2016, Wynyard was placed into voluntary administration, and subsequently entered liquidation in February 2017. The Group recognised a loss of £15.0m during 2016 on Wynyard related activities, including a £10.6m impairment charge against the whole of its investment.

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 2016, the capital required for the foreign currency risk was immaterial at both the prudential and individual consolidation levels and disclosures in relation to this have been omitted in accordance with Article 432 regarding the disclosure of non-material information.

The own funds requirement for foreign-exchange risk, calculated using guidance in CRR Article 352, is below 2% of total own funds. Since this is below the threshold set out in Article 351 of the CRR, there is no need to report the Group's foreign exchange exposures.

7 Other risks faced by the business

This section sets out the other risks faced by the business above and beyond the Pillar 1 risks set out in section 6. These risks are considered under Pillar 2 of the risk management framework.

7.1 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. Potential sources of business risk include revenue volatility due to factors such as macro-economic conditions, inflexible cost bases, structural inefficiencies or new market entrants with lower cost structures or innovative service propositions. Delay or inability to respond to changing customer behaviours presents itself as a clear risk as customers' preferred means of accessing financial services evolves in a rapidly changing digital environment. 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 assess the potential impact on the Group of a stressed business environment such as a severe economic downturn. This enables the Committee to monitor the risk impact of business strategies and to determine whether changes to these may be required to protect the sustainability of the Group.

7.2 Reputational risk

Reputational risk is the risk to earnings, liquidity or capital arising from negative market or public opinion. Such risk effectively arises through the poor management of risks generally. The consequences would adversely impact the future prospects of the Group and could expose it to litigation and financial loss. This risk is managed by:

- Maintaining and investing in control structures;
- Continuing to focus on customer outcomes;
- Promoting the Society through marketing and external communications; and
- Working within the risk management framework which has reputational risk as a key consideration.

7.3 Model risk

Model risk is the risk that, as a 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 the Model Governance Committee (MGC) provides a formal forum for managing and assessing model risk in the Society, ensuring that all material models:

- Go through a formal review and approval process;
- Have a strict change control process;
- Undergo a consistent model, development and validation process;
- Are monitored routinely and reviewed periodically in line with a risk based timetable; and
- Undergo a pre-determined model development and validation process.

7.4 Pension obligation risk

Pension obligation 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 schemes are also exposed to possible changes in pensions legislation.

The Group had, as at 31 December 2016, funding obligations for two defined benefit schemes which carried funding deficits. The schemes were closed to new entrants and to future accrual of benefit by 31 December 2009.

To manage the Group's exposure to pension obligation risk:

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

The Group also performs stress testing on the pension scheme liabilities and assets as part of the pension risk metrics for the Board Risk Committee and also in its capital planning methodologies articulated in the ICAAP. Note 28 in the Annual Report and Accounts outlines the steps management have undertaken to manage the Group's pension risk exposure.

7.5 Interest rate risk

Interest rate risk arises from the mortgages, savings and other financial products we offer. This risk is managed through the use of appropriate financial instruments, including derivatives used to hedge exposures, with established risk limits, reporting lines, mandates and other control procedures.

Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between market rates), are also monitored closely and regularly reported to the ALCO, BRC and the Board. This risk is also managed, where appropriate, through the use of derivatives, with established risk limits and other control procedures.

Derivatives are only used to limit the extent to which the Group will be affected by changes in interest rates, foreign exchange rates or other indices which affect fair values or cash flows. Derivatives are therefore used exclusively to hedge risk exposures. The principal derivatives used by the Group are interest rate contracts such as interest rate swaps. The effectiveness of these hedges is monitored monthly. The Group holds capital to absorb potential losses for any risks that are unable to be mitigated through the use of derivatives.

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.

7.5.1 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.

7.5.2 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 stochastic 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 2016 were as follows:

	As at 31 December £m	Average £m	High £m	Low £m
Static Earnings-at-risk	3.2	5.2	8.6	2.2
Historical Value-at-risk	1.5	1.5	2.6	0.5
-2% Parallel Interest rate shift	9.5	(1.6)	9.9	(14.6)
+2% Parallel interest rate shift	(3.0)	0.5	4.4	(3.0)

Notes

1. Only GBP exposures are shown above, as there were no material exposures in other currencies.
2. The negative values are gains.

7.6 Equity risk

This is the risk of loss due to adverse 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 2016 the Group had £36m of equity related savings balances which were appropriately hedged.

The Group also holds a 17.7% stake in Wynyard Group Limited, which is listed on the New Zealand Stock Exchange. During the year Wynyard entered into voluntary administration and the Group's investment in Wynyard was fully impaired to £nil.

7.7 Liquidity Risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost. It is an inherent part of the Group's business as long term mortgages are funded by short term retail customer balances. Mortgages typically have a contractual maturity date of around 25 years but in practice are frequently repaid early; conversely retail deposits, nominally repayable on demand or with short notice periods, actually remain with the Group beyond their contractual notice. It is this mismatch in the maturity profiles of retail assets and liabilities that creates liquidity risk.

The Group's liquidity policy is designed to ensure the maintenance of sufficient liquid assets to cover statutory, regulatory and operational requirements. This is achieved through maintaining a prudent level of liquid assets in realisable form to ensure the Group is able to meet its liabilities as they arise and to absorb potential cash flow requirements created by the maturity mismatches referred to above or by a liquidity stress scenario. ALCO manages liquidity under delegated authority, within risk appetite limits established by the Board, and also monitors the composition of liquidity in line with risk management objectives.

The management of the Group's liquidity is as follows:

- The Board establishes limits over the quantity and quality of the Group's portfolio of liquid assets. The portfolio is managed by the Treasury function, monitored by the Market & Liquidity Risk function and overseen by ALCO under a series of delegated authorities;
- The Group's Market & Liquidity Risk function conducts a series of daily, weekly and monthly stress tests that are designed to ensure that the Group's liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding; and
- Under the regulatory liquidity regime, the Group is required to hold highly liquid assets (such as government and supranational debt securities and cash) to satisfy the Liquidity Coverage Ratio (LCR).

There are two key measures that the Group considers key to monitoring its liquidity position:

- LCR – which analyses daily the amount of high quality liquidity that it is necessary to hold; and
- Liquidity stress tests – where, as noted above, the Group models how far its liquid asset holdings would fall under a number of different stress scenarios.

The LCR is a new regulatory measure of liquidity introduced as part of the recent CRD IV regulatory changes, from which the Net Stable Funding Ratio (NSFR) is also expected to be enacted from 2018.

Our LCR, a measure designed to ensure that financial institutions have sufficient high quality liquid assets available to meet their liquidity needs for a 30 day liquidity stress scenario, was 170% at 31 December 2016 (2015: 201%), well above regulatory requirements.

The NSFR is a longer term stable funding metric, which measures the sustainability of the Group's long-term funding and is expected to be implemented from 2018. The calculation of the NSFR is subject to change so there remains some uncertainty over its final definition. However, based on the Group's own calculation using the most up to date guidance, its NSFR is in excess of 100% and the Group holds sufficient stable funding to meet the new requirement.

The LCR is monitored daily by the Society whilst the NSFR, which is due to come into force in January 2018, is currently measured on a monthly basis using the latest available guidance.

The Group's main source of funding is retail deposits (excluding SIL) which, at 31 December 2016, accounted for 89.6% (2015: 87.8%) of our total funding.

The Group regularly conducts an Internal Liquidity Adequacy Assessment Process (ILAAP) in accordance with the PRA liquidity guidelines and the Board remains satisfied that the Group has sufficient liquid assets at its disposal in order to meet its obligations as they fall due.

8 Leverage ratio

The leverage ratio is 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.

The leverage ratio is monitored on an ongoing basis to ensure that the expected minimum regulatory requirement is satisfied and that the Group has sufficient levels of capital for current and projected activities.

The table below sets out the leverage ratio for the prudential consolidation group under the CRD IV transitional and fully loaded definition as at 31 December.

	Notes	Transitional 2016 £m	Transitional 2015 [1] £m	Fully Loaded 2016 £m	Fully Loaded 2015 [1] £m
Total Tier 1 capital		1,190.6	1,117.3	1,136.6	1,054.3
Total Balance Sheet Assets		18,777.6	17,332.3	18,777.6	17,332.3
Derivatives	2	(374.9)	(258.6)	(374.9)	(258.6)
Securities Financing Transactions	3	2.0	-	2.0	-
Regulatory Adjustments	4	900.1	77.0	900.1	77.0
Total exposure		19,304.8	17,150.7	19,304.8	17,150.7
Leverage ratio		6.2%	6.5%	5.9%	6.1%

Notes

1. The comparative figure has been restated to reflect a change to the way the leverage ratio exposure measure is calculated. In accordance with CRD IV rules as amended on 10 October 2014 by the European Commission delegated regulation on leverage ratio, a reduction in exposures has been made for collateral the Society has provided against derivative liabilities.
2. Exposure values associated with derivatives have been adjusted in accordance with regulatory requirements. For the leverage ratio, the derivative measure is calculated as the replacement cost less cash collateral for the current exposure plus an add-on for potential future exposure.
3. The exposure values associated with securities financing transactions have been adjusted in accordance with regulatory requirements.
4. These are adjustments for the cash flow hedge reserve, goodwill, intangible assets, AVA, undrawn credit commitments, non drawn down intra group funding, current tax and excess expected loss. These adjustments are made to ensure the denominator balance meets regulatory requirements. The exposure values used for the leverage ratio differ to those used for credit risk exposures for undrawn credit commitments.

During the year the leverage ratio decreased from 6.1% to 5.9% on a fully loaded basis and reduced from 6.5% to 6.2% on a transitional basis. The decrease is driven by the transition to IRB and the recognition of expected losses as calculated by the IRB models rather than impairment calculated using the accounting standards (see section 4.2 for further detail). The comparable figure under the Standardised Approach on a fully loaded basis is 6.3% which shows an increase in the ratio due to ongoing strong profitability while still increasing our lending levels.

A detailed breakdown of the leverage ratio is set out in Appendix 4.

9 Remuneration

Remuneration in the Society is subject to the PRA and FCA Remuneration Codes and the European banking Authority (EBA) guidelines and technical standards relating to remuneration. The Remuneration Codes include the principle of proportionality and in 2016, the Society (and the subsidiary businesses in scope of the regulations) moved from proportionality level three to level two, grouped with banks and building societies with total group assets averaging more than £15bn (but less than £50bn) over the last three financial years. This means that additional requirements such as deferral of incentive pay and clawback arrangements may apply to remuneration awarded from 2016 onwards.

In accordance with the EBA criteria, Material Risk Takers (MRTs) were identified in the core Society, Skipton Financial Services (SFS) and Skipton International Ltd (SIL). Although SIL is based in the Channel Islands and is regulated by the Guernsey Financial Services Commission, the Board of SIL has agreed to follow the UK implementation of the CRD IV requirements for remuneration.

9.1 Decision Making

As outlined in section 2.8, the Remuneration Committee is responsible for establishing clear Remuneration Principles and standards for the governance of remuneration which are adopted by the subsidiary businesses. SIL has its own Remuneration Committee which oversees its remuneration practices and ensures compliance with the Remuneration Principles and policies adopted by the SIL Board. The SIL Remuneration Committee, which comprises three Non-Executive Directors and two Skipton Building Society Shareholder Directors, met twice in 2016, firstly to approve the 2015 bonus payments and 2016 salary increases and secondly to agree the 2017 bonus scheme and approve the 2016 list of MRTs.

Due to its regulatory position, the remuneration of the SIL MRTs is approved by the SIL Remuneration Committee, in accordance with the Remuneration Principles, and is reported to the Remuneration Committee.

Until the integration of its advice giving services into the Society on 1 August 2016, SFS also operated its own Remuneration Committee. The SFS Remuneration Committee comprised one Non Executive Director (until 25 April 2016), the Society's Distribution and Financial Services Director, three members of the SFS Senior Management Group (including the Head of Risk), plus the Group's Chief Human Resource Officer and SFS Human Resources Manager. The Committee met three times prior to integration with the Society on 1 August 2016. Its remit was to ensure that remuneration policies and practices enabled 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 the Group Remuneration Principles and conduct risk appetite.

Up until 1 August 2016 the remuneration of SFS Board members was approved by the Distribution and Financial Services Director and overseen by the Remuneration Committee.

9.2 Remuneration arrangements for Material Risk Takers

MRTs receive a basic salary, benefits (including pension, car/car allowance and healthcare) and variable pay. The basic salary of MRTs (other than Non-Executive Directors) 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.

Non-Executive Directors receive fees which are reviewed annually by the Non-Executive Directors Remuneration Committee and which are agreed by the Board. An additional fee is paid to the Chairmen of the Board Audit, Board Risk and Remuneration Committees. The Society Chairman's fees are reviewed and approved by the Remuneration Committee.

9.2.1 Variable Pay (MRTs excluding Non-Executive Directors)

Incentive awards for MRTs are designed to achieve an appropriate balance between the fixed and variable elements of remuneration, to support a high performance culture and also to encourage the right behaviours leading to sustainable performance within the Society's agreed risk appetite.

The Remuneration Principles cap overall variable pay at 100% of fixed remuneration for all MRTs but scheme maximums do not exceed 50% of basic salary. A review is conducted, one year post award, to ensure that performance has been sustained at the expected level. If it hasn't, subsequent awards may be reduced by up to 25% subject to the discretion of the Remuneration Committee.

With the exception of the Executive Committee who have 50% of their variable awards from 2016 automatically deferred for five years, a proportion of variable pay is deferred for all MRTs when remuneration for the current year exceeds the de minimis level. The retained amount cannot increase or attract interest payments during the retention or deferral periods.

Performance measures and the design of variable pay arrangements vary slightly between different businesses; an overview of the key features of the schemes is set out below:

9.2.2 The Society

Members of the Executive Committee (who are not Executive Directors) participate in the same Single Variable Pay Arrangement (SVPA) as the Executive Directors, which is outlined in detail in the Directors' Remuneration Report in the Annual Report and Accounts. The maximum opportunity for these participants is 40% of basic salary rather than 50% as it is for the Executive Directors. The SVPA is based 50% on financial measures (Group and Mortgage and Savings division profit and Management Expenses Ratio), 30% on Team KPIs (which include customer, risk and people metrics) and 20% on personal objectives. For participants in second and third line functions (Risk, Compliance and Audit), the weighting for profit and personal objectives is reversed. As already indicated, 50% of the award from the scheme is automatically deferred for a period of five years unless a greater proportion or longer period is required by regulation.

Until 2016, the Society operated an MTIP scheme for Executives based 50% on Group profit and 50% on customer metrics measured over a three year performance cycle. The final awards to be made under this plan will vest in 2018 but deferred payments will continue to be made until 2020.

The Senior Leadership Team (SLT) scheme, which typically includes Heads of Department, is based on similar metrics to the SVPA scheme with the exception that financial measures are focussed on Mortgage and Savings Division profit and team key performance indicators (KPIs) include a measure for Mortgage and Savings Book volumes. Maximum opportunity varies depending upon level but does not exceed 50% of basic salary.

A very small number of MRTs, who are not part of the Senior Leadership Team, participate in the All Employee Annual Incentive Scheme which is based 50% on the achievement of profit and 50% on the achievement of agreed customer measures. The maximum payment from this scheme in 2016 was 10% of basic salary.

9.2.3 SFS

Until 1 August 2016, SFS operated its own independent bonus schemes and had two annual bonus schemes which applied to different members of the MRT population. Both schemes follow similar principles and in 2016, were weighted 50% on financial metrics, 30% on commercial, employee, and customer measures and 20% on personal objectives. The maximum award does not exceed 50% of basic salary for either scheme. For the five months post integration, the MRTs in the Financial Advice Division participated in the Society SLT scheme.

In addition to the bonus schemes outlined above, an additional bonus in respect of the successful integration of SFS into the Society was paid to two MRTs and is reflected in the annual performance pay shown in the Society and SFS tables below.

9.2.4 SIL

The SIL Management Committee Bonus Scheme is based on a mix 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 2016, bonus payments to SIL MRTs were capped at 50% of basic salary. The Managing Director's bonus is paid 60% in year one and 40% in year two in accordance with the scheme rules (unless his remuneration exceeds de minimis limits in which case deferral would be for five years in line with regulation).

Until 2016, SIL operated a Medium Term Incentive (MTI) scheme which the Managing Director was eligible to participate in based on a two and three year performance cycle ending in December 2016 for the two year cycle and 2017 for the three year cycle. The plan was based 60% on the achievement of financial measures and 40% on commercial and risk measures.

Payments will be phased 60% in 2017 and 20% in 2019 and 2020. The final awards to be made under this plan (for the three year performance period ending December 2017) will be made in 2018 but deferred payments will continue to be made until 2020.

9.2.5 Risk/Performance Adjustment

The potential risk implications of MRT remuneration are managed in a number of ways including the core design of the schemes, the monitoring of business performance against risk appetite, risk profile and the requirement for agreed capital thresholds to be met or exceeded for payments to be made.

On an annual basis, the Remuneration Committee seeks confirmation from the Board Risk Committee of how the Society and Executive Directors have performed in relation to the risk objectives, risk profile and risk appetites set for the performance year, taking into account the context and impact of operational decisions. The Committee also considers the Board Risk and Audit Committees' views on whether there are any material issues to consider, e.g. a significant risk failing, regulatory breach or material error which may trigger malus or an adjustment to the outcome of the SVPA.

In such situations, the Remuneration Committee has the discretion to postpone, reduce or cancel current year or deferred payments or to claw back payments already made.

The SIL Remuneration Committee considers whether risk adjustment should be applied to incentive outcomes for SIL in line with the Risk Adjustment policy. The Remuneration Committee is kept informed of the deliberations and the outcome of discussions.

9.2.6 Aggregate quantitative information on remuneration

As outlined above, MRTs have been identified in the core Society, SIL and SFS (until 1 August). Post integration, roles in the Financial Advice Function (formerly within SFS) were assessed in the context of the Society structure and the MRTs identified are included in the Society MRT figures below.

The tables below show the aggregate quantitative information on remuneration broken down by business area for 2016 and 2015. The senior management figures include Non-Executive Directors however performance related pay is not relevant to these individuals.

2016 Group[1]	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released £000
Senior management (including Executive and Non-Executive Directors)	18	3,088	1,081	**4,169**	106
Other material risk takers [2]	47	4,715	904	**5,619**	-
	65	**7,803**	**1,985**	**9,788**	**106**

Notes

1. The Group table includes aggregate remuneration for MRTs in the Society (including the Financial Advice Division from 1 August 2016) SFS and SIL.
2. The members of the SFS and SIL Management Committees are included in the category 'Other Material Risk Takers'. Four MRTs from SFS transferred to the Society on 1 August 2016 and are therefore counted in both the SFS and the Society tables.

2016 Society (including Financial Advice Division from 1 August)	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay[2] £000	Total £000	Prior years' deferred performance pay now released £000
Senior management (including Executive and Non-Executive Directors)	18	3,088	1,081	**4,169**	106
Other material risk takers[1]	36	3,197	653	**3,850**	-
	54	**6,285**	**1,754**	**8,019**	**106**

Notes

1. Four of the SFS MRTs transferred to the Society and are included in the above tables.
2. The total includes a one off cash award and MTI awards made as compensation for remuneration forfeited by a new joiner on leaving his previous employer. The MTI payments will be phased over a three year period ending in 2019 for the 2014 – 2016 scheme and in 2020 for the 2015 – 2017 scheme.

2016 SFS (to 31 July)	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released £000
Senior management (including Non-Executive Directors) [1]	7	865	96	**961**	-
	7	**865**	**96**	**961**	**-**

Notes

1. The Material Risk Takers in SFS are all members of the SFS Senior Management team.

2016 SIL	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay [2] £000	Total £000	Prior years' deferred performance pay now released £000
Senior management (including Non-Executive Directors) [1]	8	653	155	**808**	-
	8	**653**	**155**	**808**	**-**

Notes

1. The Material Risk Takers in SIL are all members of the Management Committee (for SIL).
2. The MTI for the Managing Director was included in the 2015 disclosures and is not reflected in the table above.

2015 Group[1]	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released £000
Senior management (including Executive and Non-Executive Directors)	16	2,436	1,340	**3,776**	111
Other material risk takers	35	4,452	1,033	**5,485**	-
	51	**6,888**	**2,373**	**9,261**	**111**

Notes

1. The Group table includes aggregate remuneration for MRTs in the Society, SFS and SIL.
   The members of the SIL Management Committee are included in the category 'Other Material Risk Takers'.

2015 Society	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay [1] £000	Total £000	Prior years' deferred performance pay now released £000
Senior management (including Executive and Non-Executive Directors)	16	2,436	1,340[2]	**3,776**	111
Other material risk takers	27	2,625	588	**3,213**	-
	43	**5,061**	**1,928**	**6,989**	**111**

Notes

1. Awards for the 2015/2017 MTI scheme are included in the above disclosures at the maximum award (50%). MTI scheme awards are not paid until after the end of the three year performance period. Payment is based on the extent to which performance conditions are met overall and can result in zero payments.
2. The variable pay amount has been re-stated to include £27,758 awarded to an MRT in respect of the 2014 – 2016 MTI scheme which he became eligible to participate in from the date of his promotion in 2015.

2015 SFS (Full year)	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay [1] £000	Total £000
Senior management (including Non-Executive Directors) [2]	**8**	**1,208**	**230**	**1,438**

Notes

1. The above table includes £37,344 in respect of the final payment of the 2015 MTIP. We disclosed the maximum values of the 2014 MTIP (£259,035) in 2014 but a one off payment of £57,454 will be made in respect of settlement of the 2014 scheme. The total of these sums (£94,799) will be paid to the remaining three participants in 2016.
2. All but one of the Material Risk Takers in SFS are members of the Management Body (for SFS).

2015 SIL	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay [2] £000	Total £000
Senior management (including Non-Executive Directors) [1]	**8**	**619**	**215**	**834**

Notes

1. The Material Risk Takers in SIL are all members of the Management Body (for SIL).
2. Awards for the 2015-2017 MTI scheme (for the Managing Director) are included in the above disclosures at the maximum i.e. 40% of salary. However, this may change as payments from the scheme will be based on the extent to which performance conditions are met at the end of the two and three year cycle. Once agreed, payments will be phased over a three year period.

Appendix 1 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 2016. The regulatory capital figures are shown on a transitional basis in accordance with Annex I of the European Commission Implementing Technical Standard on disclosure of own funds under Article 437 (1) (a) of the CRR. In the table below the numbered rows match those in the Own Funds disclosure template required under Article 437 (1) (d) and (e) and 492 (3) of the CRR.

	Reconciliation from Accounting Balance sheet to Regulatory Own Funds	Accounting Balance Sheet Value 2016 £m	Adjustments and adjusted accounting value 2016 £m	Own Funds Value 2016 £m
Members' interests				
	General Reserve	1,236.6	-	-
	Available-for-Sale Reserve	32.0	-	-
	Cash flow hedging reserve	3.3	-	-
	Translation reserve	6.6	-	-
	Attributable to members of Skipton Building Society	**1,278.5**	-	-
	Non-Controlling interests	(1.0)	-	-
	Total members' interests	**1,277.5**	-	-
Less:	Reserves attributable to non regulatory subsidiaries	-	(98.9)	-
	Accounting Balance Sheet value after adjustments	-	**1,178.6**	-
Common Equity Tier 1 (CET1) Capital: instruments and reserves				-
2	Retained Earnings	-	-	**1,171.7**
3	Accumulated other comprehensive income (and other reserves), to include unrealised gains and losses under the applicable accounting standards	-	-	**6.9**
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments			**1,178.6**
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
7	Additional value adjustments (negative amount)	-	-	**(0.8)**
	Intangible Assets (per the Accounting Balance Sheet)	(164.8)	-	-
Less:	Intangible Assets attributable to non regulatory subsidiaries	-	155.1	-

Accounting Balance Sheet value after adjustments	-	**(9.7)**	-
8 Intangible assets (net of related tax liability) (negative amount)	-	-	**(9.7)**
Cashflow hedging reserve (per the Accounting Balance Sheet)	(3.3)	-	-
Less: Cashflow hedging reserve attributable to non regulatory subsidiaries	-	-	-
Accounting Balance Sheet value after adjustments	-	**(3.3)**	-
11 Fair value reserves related to gains or losses on cash flow hedges	-	-	**(3.3)**
12 Negative amounts resulting from the calculation of expected loss amounts	-	-	**(28.2)**
28 **Total regulatory adjustments to Common Equity Tier 1 (CET1)**	-	-	**(42.0)**
29 **Common Equity Tier 1 (CET1) capital**			**1,136.6**
Liabilities eligible for Regulatory Own Funds			
Subscribed Capital	92.6	-	-
Less: Removal of accrued interest	-	(2.3)	-
Removal of fair value adjustment for hedged risk	-	(0.6)	-
Removal of Fair Value of PIBS	-	0.3	-
Transfer of PIBS to Tier 2 capital	-	(36.0)	-
Accounting Balance Sheet value after adjustments	-	**54.0**	-
Additional Tier 1 (AT1) capital: instruments			
33 Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	-	-	**54.0**
36 **Additional Tier 1 (AT1) capital before regulatory adjustments**			**54.0**
Additional Tier 1 (AT1) capital: regulatory adjustments			
39 Direct and indirect 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)	-	-	-
43 Total regulatory adjustments to Additional Tier 1 (CET1)	-	-	-
44 Additonal Tier 1 (AT1) capital	-	-	**54.0**
45 Tier 1 capital (T1 = CET1 + AT1)			**1,190.6**
Liabilities eligible for Regulatory Own Funds			
Subordinated Liabilities	77.2	-	-
Removal of accrued interest	-	(1.4)	-
Removal of fair value adjustment for hedged risk	-	(0.6)	-
Reversal of amortised discount on issue	-	0.2	-

	Amortisation of subordinated liabilities with less than five years to maturity	-	(9.7)	-
	Subordinated liabilities not eligible for regulatory capital	-	(35.3)	-
	Transfer of PIBS to Tier 2 capital	-	36.0	-
	Accounting Balance Sheet value after adjustments	-	**66.4**	-
Tier 2 (T2) capital: instruments and provisions				
46	Capital instruments and the related share premium accounts	-	-	**36.4**
47	Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	-	-	**30.0**
51	**Tier 2 (T2) capital before regulatory adjustments**			**66.4**
Tier 2 (T2) capital: regulatory adjustments				
57	**Total regulatory adjustments to Tier 2 (T2) capital**	-	-	-
58	**Tier 2 (T2) capital**	-	-	**66.4**
59	**Total capital (TC = T1 + T2)**	-	-	**1,257.0**

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 European Commission Implementing Technical Standards on disclosure for own funds by institutions under Article 437(1) and 492(3) of the Capital Requirements Regulation. The terms and conditions of these capital instruments can be found at www.skipton.co.uk/investorrelations.

1	Issuer	Skipton 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	XS0148344608	Private Loan Facility
3	Gov. law(s)	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
5	Post-transitional CRR rules	Tier 2	Ineligible	Tier 2	Ineligible	Tier 2
6	Eligible at Solo/Sub-consolidated/Solo & Sub-consolidated	Solo	Solo	Solo	Solo	Solo
7	Instrument type (types to be specified by each jurisdiction)	PIBS	PIBS	PIBS	Subordinated Debt	Subordinated Debt
8	Regulatory capital value (£m)	25,000,000*	50,000,000*[1]	15,000,000*	30,000,000	400,000
9	Nominal amount of instrument	25,000,000	50,000,000	15,000,000	30,000,000	10,000,000
9a	Issue px	100.476	99.239	100.000	98.728	100.000
9b	Redemption px	100.000	100.000	100.000	100.000	100.000
10	Accounting classification	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	30/05/2002	27/03/1997
12	Perpetual or dated	Perpetual	Perpetual	Perpetual	Dated	Dated
13	Original maturity	No maturity	No maturity	No maturity	30/05/2022	27/03/2017
14	Issuer call	No	Yes	No	Yes	Yes

15	Optional call date, contingent call dates and redemption amount	No Issuer call	Issuer call date 13/04/2017 (par)	No Issuer call	Issuer call date 30/05/2017 (par)	Issuer call date 27/03/2012 (par)
16	Subsequent call dates, if applicable	n/a	On each Quarterly Interest Payment Date after 13/04/2017	n/a	On each Quarterly Interest Payment Date after 30/05/2017	On each semi-annually Interest Payment Date after 27/03/2012
Coupons / dividends						
17	Fixed or floating dividend/coupon	Fixed	Fixed-to-Float	Fixed	Fixed-to-Float	Fixed
18	Coupon rate and any related index	12.875%	6.875%	8.500%	6.750%	4.027%
19	Existence of a dividend stopper	Yes[2]	Yes[2]	Yes[2]	No	No
20a/b	Fully discretionary, partially or mandatory (in terms of timing)	Partially Discretionary	Partially Discretionary	Partially Discretionary	n/a	n/a
21	Existence of step up or other incentive to redeem	No	Yes	No	Yes	Yes
22	Noncumulative or cumulative	Noncumulative	Noncumulative	Noncumulative	n/a	n/a
23	Convertible or non-convertible	Nonconvertible	Nonconvertible	Nonconvertible	Nonconvertible	Nonconvertible
24	If convertible, conversion trigger(s)	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
26	If convertible, conversion rate	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
28	Specify output instrument	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

30	Write-down features	None contractual, statutory via bail-in	None contractual, statutory via bail-in	None contractual, statutory via bail-in	None contractual, statutory via bail-in	None contractual, statutory via bail-in
31-34	If w/d, trigger(s), full/partial, PWD/TWD	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
36	Non-compliant transitioned features	Yes	Yes	Yes	Yes	No
37	If yes, specify non-compliant features	No conversion to CET1	No conversion to CET1	No conversion to CET1	Step-up reset rate	n/a

[1]On 22 February 2017, the Society issued notice that it will repay these PIBS on the call date.

[2]These are not typical stoppers 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

* As at 31 December 2016, 40% of the regulatory capital value of these instruments is classified as Tier 2 under the transitional CRR rules.

Appendix 3 Own funds disclosure template

The table below shows the own funds position of the prudential consolidation group in line with Annex VI to Annex VII of the European Commission Implementing Technical Standard on disclosure of own funds by institutions under Article 437(1) (d) and (e) and 492(3) of the Capital Requirements Regulation. This has been shown on the transitional basis (Column A) to show the current own funds position and the adjustments that would be required (Column C) once all of the regulations have been phased in and implemented.

	Own Funds Disclosure Template	(A) Amount at Disclosure date 2016 £m	2015 £m	(C) Amounts to be subject to Pre-CRR treatment or CRR prescribed residual amount* 2016	2015
Common Equity Tier 1 (CET1) Capital: instruments and reserves					
1	Capital instruments and the related share premium accounts	-	-	-	-
2	Retained Earnings	1,171.7	1,062.6	-	-
3	Accumulated other comprehensive income (and other reserves), to include unrealised gains and losses under the applicable accounting standards	6.9	(3.2)	-	-
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	-	-	-	-
5	Minority Interests (amount allowed in consolidated CET1)	-	-	-	-
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	-	-	-	-
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	1,178.6	1,059.4	-	-
Common Equity Tier 1 (CET1) capital: regulatory adjustments					
7	Additional value adjustments (negative amount)	(0.8)	(0.9)	-	-
8	Intangible assets (net of related tax liability) (negative amount)	(9.7)	(7.4)	-	-
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	(3.3)	3.2	-	-
12	Negative amounts resulting from the calculation of expected loss amounts	(28.2)	-	-	-
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	-	-	-	-
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)	-	-	-	-
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 - Available For Sale Reserve	-	-	-	-
	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)**	(42.0)	(5.1)	-	-
29	**Common Equity Tier 1 (CET1) capital**	1,136.6	1,054.3	-	-
Additional Tier 1 (AT1) capital: instruments					
30	Capital instruments and the related share premium accounts	-	-	-	-
31	of which: classified as equity under the applicable accouning 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	54.0	63.0	(54.0)	(63.0)
	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**	54.0	63.0	(54.0)	(63.0)
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 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)	-	-	-	-
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	-	-	-	-
	Of which items to be detailed 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 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	-	-	-	-
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	54.0	63.0	(54.0)	(63.0)
45	Tier 1 capital (T1 = CET1 + AT1)	1,190.6	1,117.3	(54.0)	(63.0)
Tier 2 (T2) capital: instruments and provisions					
46	Capital instruments and the related share premium accounts	36.4	29.4	4.0	13.0
47	Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	30.0	30.0	(30.0)	(30.0)
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**	66.4	59.4	(26.0)	(17.0)
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 has 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 synthetic holdings by the institution of the T2 instruments of subordinated loans of financial sector entities where the institution has a significant invesmtent in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	-	-
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 by line, e.g. Material net interim 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 by line, e.g. Reciprocal cross holdings in AT1 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	-	-	-	-
57	**Total regulatory adjustments to Tier 2 (T2) capital**	-	-	-	-
58	**Tier 2 (T2) capital**	66.4	59.4	(26.0)	(17.0)
59	**Total capital (TC = T1 + T2)**	1,257.0	1,176.7	(80.0)	(80.0)
59a	Risk weighted assets in respect of amount subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2014 (i.e. CRR residual amounts)	-	-	-	-
60	**Total risk weighted assets**	4,763.2	6,276.4	-	-
Capital ratios and buffers					
61	Common Equity Tier 1 (as a percentage of risk exposure amount)	23.86%	16.80%	0.00%	0.00%
62	Tier 1 (as a percentage of risk exposure amount)	25.00%	17.80%	-1.13%	-1.00%
63	Total capital (as a percentage of risk exposure amount)	26.39%	18.75%	-1.68%	-1.27%
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)	5.13%	4.50%	0.00%	0.00%
65	of which: capital conservation buffer requirement	0.00%	0.00%	0.00%	0.00%
66	of which: countercyclical buffer requirement	0.08%	0.07%	0.00%	0.00%
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)	18.39%	10.75%	-1.68%	-1.28%
Amounts below the thresholds for deduction (before risk weighting)					
72	Direct and indirect holdings by the institution of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	1.7	1.7	-	-
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)	-	-	-	-

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)			-	-
77	Cap on inclusion of credit risk adjustments in T2 under standardised Approach	54.7	73.5	-	-
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 2014 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	54.0	63.0	-	-
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	36.0	27.0	-	-
84	Current cap on T2 instruments subject to phase out arrangements	113.3	132.2	-	-
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	-	-	-	-

* - where ‘CRR’ refers to Regulation (EU) No 575/2013

Appendix 4 Leverage Templates

The tables below set out the leverage ratio for the prudential group under the CRR fully loaded definition using templates prescribed in Annex I and II of the European Commission Implementing Technical Standards on disclosure for the leverage ratio under Article 451(1), using an end-of-year leverage ratio calculation as permitted by the CRR.

The following table shows how the assets per the financial statements are adjusted to provide an exposure measure used to calculate the Leverage ratio

Template LRSum:

	Summary reconciliation of accounting assets and leverage ratio exposures	2016 £m	2015 £m
1	Total assets as per published financial statements	19,019.7	17,511.4
2	Adjustments for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	(242.1)	(179.1)
3	(Adjustments for fiduciary assets recognised on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio exposure measure in accordance with Article 429(13) of Regulation (EU) No 575/2013 "CRR")	-	-
4	Adjustments for derivative financial instruments	(374.9)	(258.6)
5	Adjustments for securities financing transactions "SFTs"	2.0	-
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off balance sheet exposures)	966.9	112.9
EU-6a	(Adjustment for intragroup exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (7) of Regulation (EU) No 575/2013)	-	-
EU 6b	(Adjustment for exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (14) of Regulation (EU) No 575/2013)	-	-
7	Other adjustments	(66.8)	(35.9)
8	**Total leverage ratio exposure**	19,304.8	17,150.7

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Notes

1. Row 4 above includes the Derivative asset from the Group Annual Report and Accounts of £116.1m (£95.1m in 2015) as well as the total derivative exposure from row 11 in Template LR Com below.

The following table shows how the on-balance sheet exposures are modified to determine a total exposure figure that is then used to determine the leverage ratio.

Template LRCom: Leverage ratio common disclosure		CRR leverage ratio exposures 2016 £m	2015 £m
On-balance sheet exposures (excluding derivatives and SFTs)			
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	18,661.5	17,237.2
2	(Asset amounts deducted in determining Tier 1 capital)	(66.8)	(35.9)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	18,594.7	17,201.3
Derivative exposures			
4	Replacement cost associated with *all* derivatives transactions (ie net of eligible cash variation margin)	3.4	2.5
5	Add-on amounts for PFE associated with *all* derivatives transactions (mark-to-market method)	46.8	52.6
EU-5a	Exposure determined under Original Exposure Method	-	-
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	-	-
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	(309.0)	(218.6)
8	(Exempted CCP leg of client-cleared trade exposures)	-	-
9	Adjusted effective notional amount of written credit derivatives	-	-
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-	-
11	**Total derivative exposures (sum of lines 4 to 10)**	(258.8)	(163.5)
Securities financing transaction exposures			
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	-	-
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	-	-
14	Counterparty credit risk exposure for SFT assets	-	-
EU-14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Article 429b (4) and 222 of Regulation (EU) No 575/2013	2.0	-
15	Agent transaction exposures	-	-

EU-15a	(Exempted CCP leg of client-cleared SFT exposure)	-	-
16	Total securities financing transaction exposures (sum of lines 12 to 15a)	2.0	-
Other off-balance sheet exposures			
17	Off-balance sheet exposures at gross notional amount	1,255.3	1,128.9
18	(Adjustments for conversion to credit equivalent amounts)	(288.4)	(1,016.0)
19	Other off-balance sheet exposures (sum of lines 17 to 18)	966.9	112.9
Exempted exposures in accordance with CRR Article 429 (7) and (14) (on and off balance sheet)			
EU-19a	(Exemption of intragroup exposures (solo basis) in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
EU-19b	(Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
Capital and total exposures			
20	Tier 1 capital	1,136.6	1,054.3
21	Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)	19,304.8	17,150.7
Leverage ratio			
22	Leverage ratio	5.9%	6.1%
Choice on transitional arrangements and amount of derecognised fiduciary items			
EU-23	Choice on transitional arrangements for the definition of the capital measure	Fully loaded	Fully loaded
EU-24	Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation (EU) NO 575/2013	-	-

The following table shows more detail behind the on-balance sheet exposure figure quoted above

Template LRSpl: **Split-up of on balance sheet exposures (excluding derivatives and SFTs)**		CRR leverage ratio exposures 2016 £m	2015 £m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	18,661.5	17,237.2
EU-2	Trading book exposures	-	-
EU-3	Banking book exposures, of which:	18,661.5	17,237.2
EU-4	Covered bonds	39.2	19.3
EU-5	Exposures treated as sovereigns	1,611.4	1,530.9
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	155.0	149.3
EU-7	Institutions	443.4	454.4
EU-8	Secured by mortgages of immovable properties	15,493.6	14,171.5
EU-9	Retail exposures	1.6	1.0
EU-10	Corporate	103.8	72.0
EU-11	Exposures in default	132.8	134.1
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	680.7	704.7

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The following table details how the Group manages the risk of excessive leverage and what factors have had an impact on the leverage ratio.

Template LRQua:

1. Description of the processes used to manage the risk of excessive leverage

The prudential consolidation group has a leverage ratio of 5.9%. Although there is currently no statutory minimum leverage ratio for the Society it is expected each financial institution regardless of size within the EU will shortly be required to have a leverage ratio of no less than 3.0%. The Group's leverage ratio is a key financial indicator monitored closely by the Board each month. The leverage ratio is projected for the next five years as part of the Corporate Plan. The Corporate Plan is subject to stress tests to ensure the Group is able to operate safely and with sufficient capital and leverage during a severe downturn in the general economy and idiosyncratic Society only stress events. It is recognised that such forward planning is essential to the successful management of the Group's leverage and capital ratios. The Board are satisfied that the risk appetite, controls and planning framework will prevent the group from taking excessive leverage within its balance sheet.

2. Description of the factors that had an impact on the leverage ratio during the year to 31 December 2016

The Group's fully loaded leverage ratio has decreased by 0.2% to 5.9% during the year to 31 December 2016. The main cause of this movement is the use of the IRB Approach. Tier 1 capital has increased in the year largely due to profits added to general reserves but this growth is reduced slightly by the deduction of Excess Expected Losses under the IRB Approach. The exposure balance under the IRB Approach is also higher than under the Standardised Approach as it includes undrawn credit facilities. Exposures continue to be mainly in residential mortgages, liquidity exposures are also created to support the group's activities. Under a Standardised Approach our fully loaded Leverage ratio would have increased to 6.3%.

Appendix 5 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; 2) attain long term funding through secured funding transactions, such as securitisations; and 3) to collateralise derivative exposures through credit support annexes (CSAs) with counterparts and in future through centralised derivative clearing.

The 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 four securitisation transactions, whereby the beneficial interest in certain mortgages is 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 table below details, as a median calculation rather than point in time, for different classes of assets, the level of encumbrance and both the carrying and fair value of those assets on a prudential consolidation group basis in the year ended 2016.

Prudential consolidated group 2016	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
	010	040	060	090
Assets	£m	£m	£m	£m
010 Assets of the reporting institution	2,974.2	-[1]	15,764.1	-[1]
030 Equity instruments	-	-	1.7	1.7
040 Debt securities	194.0	194.0	859.4	859.4
120 Other assets	-	-[1]	399.3[2]	-[1]

Notes

1. The EBA has released guidance on the reporting of Fair Values per Article 443 of the CRR stating that the fair value of these assets should not be reported.
2. “Other assets” include loans and advances (excluding mortgages) and other balance sheet items not listed above including derivative financial assets, property, plant and other fixed assets, intangible assets including goodwill, and deferred tax assets. These assets would not be available for encumbrance in the normal course of business.

The following table shows the carrying amount of selected encumbered assets, collateral received and associated liabilities.

Prudential consolidated group 2016	**Matching liabilities, contingent liabilities or securities lent**	**Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered**
	010	**030**
Encumbered assets/collateral received and associated liabilities	**£m**	**£m**
010 Carrying amount of selected financial liabilities	1,464.2	3,049.6

The table below details, as a median calculation rather than point in time, for different classes of assets, the level of encumbrance and both the carrying and fair value of those assets on a prudential consolidation group basis in the year ended 2015.

Prudential Group 2015	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
	010	040	060	090
Assets	£m	£m	£m	£m
010 Assets of the reporting institution	3,239.3	-[1]	13,679.5	-[1]
030 Equity instruments	-	-	1.7	1.7
040 Debt securities	46.7	46.7	1,093.1	1,094.5
120 Other assets	-	-[1]	413.6[2]	-[1]

Notes

1. The EBA has released guidance on the reporting of Fair Values per Article 443 of the CRR stating that the fair value of these assets should not be reported.
2. "Other assets" include loans and advances (excluding mortgages) and other balance sheet items not listed above including derivative financial assets, property, plant and other fixed assets, intangible assets including goodwill, and deferred tax assets. These assets would not be available for encumbrance in the normal course of business.

The following table shows the carrying amount of selected encumbered assets, collateral received and associated liabilities.

Prudential consolidation group 2015	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
	010	030
Encumbered assets/collateral received and associated liabilities	£m	£m
010 Carrying amount of selected financial liabilities	1,451.7	3,314.2

Appendix 6 Countercyclical Capital buffer

The countercyclical capital buffer disclosure is presented in the following two tables. The table below shows the country of residence of the obligor (borrower) for the Society's general credit exposures, trading book exposures (of which there are none) and securitisation exposures. The Other countries line shows summarised figures from countries for which the individual own funds requirement is immaterial. This summarisation makes no difference to calculation of the countercyclical buffer rate, or requirement.

Note that the residence of the obligor does not necessarily align with the location of the property against which the lending has been secured, the Society only lends to UK residents at the time of purchase. The Skipton Group does not offer mortgages on properties outside of the United Kingdom or Channel Islands.

Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

Breakdown by Country	General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements				Own funds requirement weights	Countercyclical capital buffer rate
	Exposure value for SA	Exposure value IRB	Sum of long and short position of trading book	Value of trading book exposure for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	**Total**		
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**%**	**%**
United Kingdom	1,127.4	14,907.9	-	-	191.6	-	300.1	-	3.1	**303.2**	90.0	-
Jersey	761.0	-	-	-	-	-	22.2	-	-	**22.2**	6.6	-
Guernsey	263.2	0.7	-	-	-	-	7.8	-	-	**7.8**	2.3	-
Netherlands	35.0	1.6	-	-	-	-	0.6	-	-	**0.6**	0.2	-
Switzerland	50.8	2.3	-	-	-	-	1.4	-	-	**1.4**	0.4	-
USA	26.4	10.7	-	-	-	-	0.6	-	-	**0.6**	0.2	-
Australia	0.8	8.7	-	-	-	-	0.3	-	-	**0.3**	0.1	-
United Arab Emirates	1.5	3.1	-	-	-	-	0.1	-	-	**0.1**	-	-
Spain	-	2.2	-	-	-	-	0.2	-	-	**0.2**	0.1	-
Hong Kong	-	0.6	-	-	-	-	-	-	-	**-**	-	0.625
Sweden	-	0.5	-	-	-	-	-	-	-	**-**	-	1.500
Norway	-	0.3	-	-	-	-	-	-	-	**-**	-	1.500
Other Countries	2.1	18.9	-	-	-	-	0.4	-	-	**0.4**	0.1	-
Total	**2,268.2**	**14,957.5**	**-**	**-**	**191.6**	**-**	**333.7**	**-**	**3.1**	**336.8**	**100%**	

Amount of institution-specific countercyclical capital buffer	2016 £m / %
Total risk exposure amount	4,763.2
Institution specific countercyclical buffer rate	0.000%
Institution specific countercyclical buffer requirement	0.004

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.
Asset backed securities (ABS)	An asset backed security is a security whose value and income payments are derived from and collateralised (or 'backed') by a specified pool of underlying assets. Typically these assets are pools of residential or commercial mortgages.
Basel II	
Basel 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.
Common Equity Tier 1 Capital	Common Equity Tier 1 (CET 1) capital primarily comprises internally generated capital from retained profits. An adjustment is made to deduct intangible assets and goodwill. CET 1 capital is fully loss absorbing.
Contractual maturity	The final payment date of a loan or other financial instrument, at which point the entire remaining outstanding principal and interest is due to be repaid.
CRD IV	CRD IV is made up of the Capital Requirements Regulation (CRR), which is directly applicable to firms across the EU, and the Capital Requirements Directive (CRD), which must be implemented through national law. CRD IV became effective in the UK from 1 January 2014.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
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.
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 other 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 Process (ILAAP)	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 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.
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 LTVs on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in a house price index).
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.
Renegotiated loans	Loans are classed as renegotiated, with the customer's consent, when their terms have changed during the year. Loans and advances may be renegotiated whether or not the customer is experiencing financial difficulty in repaying their loan with the Group.
Repo / reverse repo	Short to medium term funding agreements which allow a borrower to sell a financial asset, such as an ABS or government bonds as security for cash. As part of the agreement the borrower agrees to repurchase the security at some later date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo, which can typically be resold or repledged if desired.
Residential loans	Mortgage lending secured against residential property.
Residential mortgage backed securities (RMBS)	A category of ABS that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal).
Risk appetite	The articulation of the level of risk that the Group is willing to take in order to safeguard the interests of the Society's members whilst achieving business objectives.
Risk weighted asset (RWA)	The value of assets, after adjustment, under CRD IV rules to reflect the degree of risk they represent.

Securitisation	A process by which a group of assets, usually loans, are aggregated into a pool which is used to back the issuance of new securities. A firm transfers these assets to a special purpose vehicle which then issues securities backed by the assets. The Group has established securitisation structures as part of its funding activities. These securitisation structures use retail / residential mortgages as the asset pool.
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 – under CRD IV all of the Society's PIBS will be phased out of Tier 1 capital as they fail to satisfy the CRD IV requirements. However £40m of our PIBS will continue to satisfy the criteria for Tier 2 capital and will therefore be phased into Tier 2.
Wholesale funding	Amounts owed to credit institutions, amounts owed to other customers and debt securities in issue excluding balances deposited by offshore customers.

Media Enquiries

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