Pillar 3 Disclosures
2021

SKIPTON
BUILDING SOCIETY
Since 1853

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1 EXECUTIVE SUMMARY

1.1 Introduction

This document presents the consolidated Pillar 3 disclosures of Skipton Building Society and its subsidiaries (the 'Group') as at 31 December 2021. The Pillar 3 disclosures are reported at a prudential consolidation group level. The prudential group is detailed in section 2.6 and comprises the entire Group except Connells and a small number of other entities whose activities are not closely aligned with the core business.

The Pillar 3 disclosure requirements apply to banks and building societies and require firms to publish key details regarding their capital and risk management.

1.2 Summary of key disclosures

Table 1 summarises the key quantitative disclosures reported in this document as at 31 December 2021 for the prudential consolidation group and individual consolidation group applying the transitional rules, unless explicitly stated. The capital disclosures included in this document are prepared under Capital Requirements Directive (CRD V) rules.

Table 1 Key metrics

	Document reference	Prudential consolidation group 2021 £m	Prudential consolidation group 2020 Restated* £m	Individual consolidation group 2021 £m	Individual consolidation group 2020 Restated* £m
Available capital	Section 4				
Total Common Equity Tier 1 capital		**1,775.5**	1,585.6	**1,722.6**	1,523.4
Additional Tier 1 capital		**9.0**	18.0	**9.0**	18.0
Total Tier 2 capital		**31.0**	26.9	**31.0**	26.9
Total regulatory capital		**1,815.5**	1,630.5	**1,762.6**	1,568.3
Total risk weighted assets (RWAs)	Section 5	**3,984.7**	4,123.2	**3,458.4**	3,677.4
Capital ratios (as a percentage of RWAs)	Section 4				
Common Equity Tier 1 ratio		**44.6%**	38.5%	**49.8%**	41.4%
Tier 1 ratio		**44.8%**	38.9%	**50.1%**	41.9%
Total capital ratio		**45.6%**	39.5%	**51.0%**	42.6%
UK leverage ratio (end-point)	Section 4.4				
Total Tier 1 capital		**1,775.5**	1,585.6	**1,722.6**	1,523.4
Total exposure excluding exposures to central banks		**26,314.5**	24,539.6	**24,396.8**	22,935.0
UK leverage ratio		**6.8%**	6.5%	**7.1%**	6.6%
CRR leverage ratio (end-point)	Section 4.4				
Total Tier 1 capital		**1,775.5**	1,585.6	**1,722.6**	1,523.4
Total leverage ratio exposure		**28,745.7**	27,775.1	**26,827.9**	26,170.5
CRR leverage ratio		**6.2%**	5.7%	**6.4%**	5.8%
Liquidity coverage ratio (LCR)	Section 12.1	**173.3%**	194.0%	**171.9%**	189.7%
Asset encumbrance	Appendix 5				
Carrying amount of encumbered assets		**6,508.1**	6,410.6	**6,604.7**	6,556.0
Carrying amount of unencumbered assets		**22,185.7**	20,048.8	**20,317.6**	18,420.5

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

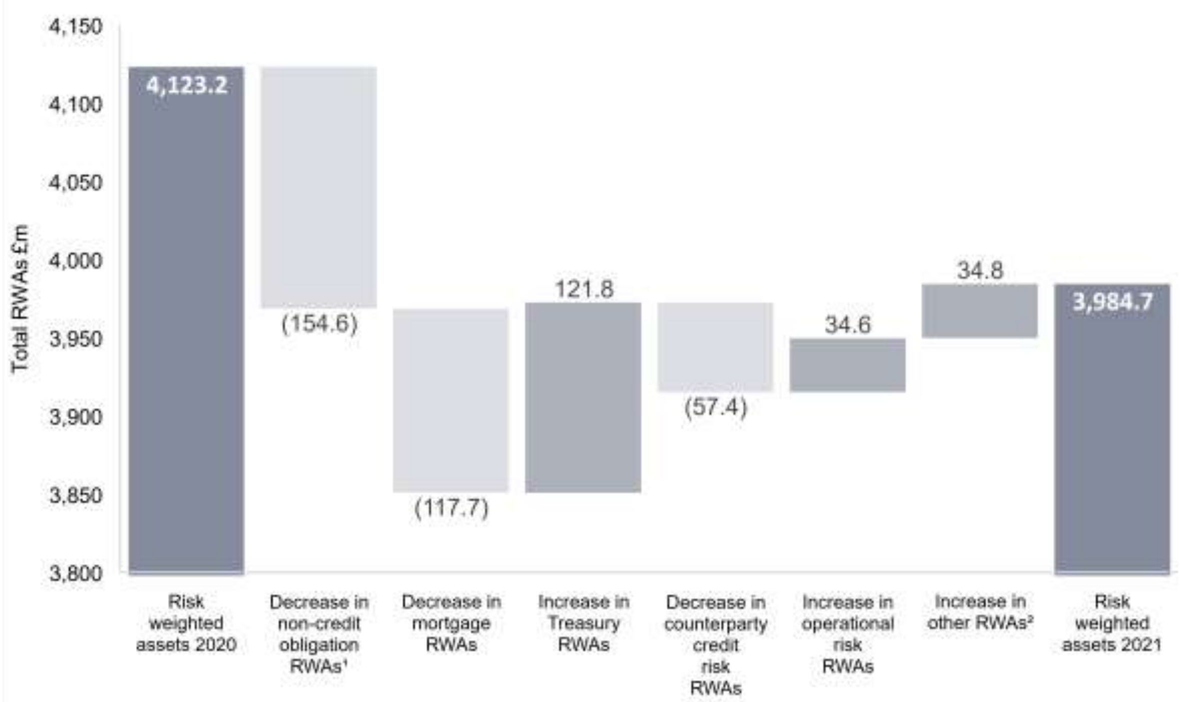
Total regulatory capital

During 2021, the total capital resources in the prudential group increased by £185.0m. This is mainly due to the retained profits accumulated during the period and dividend income received from the Connells group.

Total risk weighted assets

Risk weighted assets (RWAs) decreased by £138.5m during the year. Whilst we have seen strong mortgage book growth, risk weighted mortgage assets have decreased due to risk weights required for new lending being lower than the risk weights for accounts that have redeemed during the year. New lending is subject to our credit decision process and presents a low level of default risk which increases over time. The risk weighted mortgage assets have also decreased due to the improvement in house prices in the year. The RWAs in relation to the fair value of hedge adjustments on fixed rate assets have also decreased as the markets have increased their long-term expectations of interest rates. These decreases have been partly offset by an increase in the RWAs for treasury assets, where we have taken the opportunity to diversify our holdings in a broader range of liquid assets, typically short dated certificates of deposit issued by highly rated financial institutions, which carry a higher risk weighting then holding cash with the Bank of England. See section 5.1.7 for further details.

The graph below illustrates the movements in total RWAs during 2021.



Notes

1. Non-credit obligation assets relate to fair value hedge adjustment for fixed rate IRB mortgage assets, property, plant and equipment and right-of-use assets. There has been a significant decrease in the fair value hedge adjustment for fixed rate IRB mortgage assets in 2021 as the markets have increased their long term expectations for interest rates, resulting in a negative fair value adjustment of our existing fixed rate mortgage book, which is excluded from the total RWAs.
2. Other assets include sundry debtors, exposures to equity investments, exposures in relation to London Clearing House collateral, and advances made by our factored debt and invoice discounting business, Skipton Business Finance Limited.

Capital ratios

As a result of the movement in regulatory capital and risk weighted assets, the CET 1 ratio and the total capital ratio have increased to 44.6% and 45.6% respectively.

Leverage ratio

The UK leverage ratio has increased to 6.8% at 31 December 2021 (2020: 6.5%), due to the profits and dividend income accumulated during the year. The UK leverage ratio calculation excludes deposits with central banks from the leverage exposure measure.

The CRR leverage ratio has increased to 6.2% at 31 December 2021 (2020: 5.7%) driven by profits and dividend income accumulated during the year. See section 4.4 for further details.

Liquidity coverage ratio

The liquidity coverage ratio (LCR) is 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. As at 31 December 2021 the LCR was 173.3% (2020: 194.0%) and was above both the regulatory and internal limits set by the Board throughout the period. The reduction in the LCR is due to the Society holding greater levels of liquidity at the end of 2020 to support its strong pipeline of mortgage completions ahead of the end of the stamp duty window in March 2021, which was ultimately extended. See section 12.1 for further details.

Asset encumbrance

The asset encumbrance measure shows when part or all of an asset's value is pledged to another party to secure, collateralise or credit enhance a financial transaction from which it cannot be freely withdrawn. This may be done to attain funding and/or to collateralise derivative exposures. As at 31 December 2021 the level of asset encumbrance was within our risk appetite. See Appendix 5 for further details.

1.3 Prior period adjustments

On 8 March 2021 Connells Limited (Connells), a subsidiary of the Society, completed the acquisition of Countrywide plc. As disclosed at the time of acquisition, the cash consideration payable by Connells pursuant to the acquisition had been funded from an intra-group credit facility provided by the Society to Connells. At 31 December 2020 the credit facility was in place but not drawn down. The 2020 capital figures have been re-stated to appropriately recognise this facility. As Connells is outside the Society's prudential group the intra-group facility is risk weighted at 100%, a conversion factor of 50% is also applied as the exposure was undrawn. This reduces the Society's CET1 ratio reported as at 31 December 2020 from 39.7% to 38.5%.

2 INTRODUCTION

2.1 Background

These disclosures have been prepared under onshored CRR Part Eight (Articles 431 to 455) of Regulation (EU) No 575/2013. Some of the regulations introduced under the CRR 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 are set out in detail in section 4.2.2. The CRR has also been amended by onshored provisions within regulation (EU) No 2019/876 (CRR II) and (EU) No 2020/873 (CRR Quick Fix).

2.2 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, and the governance framework applied in the preparation of the disclosures. The policy also ensures that the Group's risk profile is comprehensively disclosed and that our disclosures are comparable to other market participants.

2.3 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 2021, unless otherwise stated. As such, these disclosures should be read in conjunction with the Group's Annual Report and Accounts. These disclosures will be issued on an annual basis in conjunction with the publication of the Group's Annual Report and Accounts.

During 2021 the Group's consolidated assets exceed the €30bn threshold as detailed in the EBA's guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013 and therefore the Group is required to assess whether to provide certain Pillar 3 disclosures more frequently than annually. Our assessment concluded that no additional Pillar 3 disclosures were required during 2021 on the basis that the Group is considered to have a relatively simple business model, there have not been any material changes to the prudential group since December 2020 and an appropriate level of the additional Pillar 3 disclosures recommended by the EBA are already reported in the Group's half-yearly financial report.

2.4 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).

2.5 Verification of disclosure

The design of specific controls surrounding the preparation of these disclosures and compliance with regulatory reporting requirements has been reviewed by the Society's second line function. These disclosures have also been reviewed and approved by the Board Risk Committee (BRC) on behalf of the Board at a meeting also attended by members of the Board Audit Committee (BAC).

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 Annual Report and Accounts which are externally audited.

The Group has a policy in place to ensure that a consistent level of internal review and control is applied to all financial and regulatory disclosures. These processes have been applied in the preparation of the Pillar 3 disclosures.

2.6 Scope of application

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

Prudential consolidation group	Individual consolidation group
Skipton Building Society (Society) Amber Homeloans Limited (Amber)[1] North Yorkshire Mortgages Limited (NYM)[1] Darrowby No. 4 plc Darrowby No. 5 plc Skipton Covered Bonds Limited Liability Partnership Skipton Financial Services Limited (SFS) Skipton Business Finance Limited (SBF) Skipton International Limited (SIL) Skipton Group Holdings Limited (SGHL) Skipton Investments Limited	Skipton Building Society (Society) Amber Homeloans Limited (Amber)[1] North Yorkshire Mortgages Limited (NYM)[1]

1. From 1 June 2021, the Amber Homeloans and North Yorkshire Mortgages portfolios were successfully integrated into the Society portfolio.

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 subsidiary undertakings
- Skipton Trustees Limited
- Jade Software Corporation Limited and subsidiary undertakings
- Northwest Investments NZ Limited

The above entities are neither consolidated nor deducted from own funds, instead capital is held for the associated cost of investment in accordance with Article 48 of the CRR.

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 V. This results in some differences between the two documents. Table 2 provides a reconciliation of the full group consolidated balance sheet to the prudential group balance sheet as at 31 December 2021. It also sets out the regulatory adjustments applied to derive the exposure amount for which capital is required to be held, the 'regulatory exposure'. The key difference between the accounting and regulatory exposure amounts is the inclusion of off-balance sheet exposures in the regulatory exposure, principally pipeline mortgage exposures.

Table 2 Reconciliation of accounting balance sheet assets to regulatory exposure

Assets	**Accounting balance sheet assets as published in financial statements £m**	Deconsolidation of entities outside the regulatory group £m	**Prudential group balance sheet assets £m**	Assets deducted from own funds [1] £m	Capital adjustments [2] £m	Regulatory exposure of off-balance sheet items post CCF [3] £m	Accounting loan impairment [4] £m	Exposure to counterparty credit risk for derivatives £m	**Prudential group regulatory exposure £m**
Cash in hand and balances with the Bank of England	**2,433.6**	-	**2,433.6**		(0.4)				**2,433.2**
Loans and advances to credit institutions	**468.7**	(60.5)	**408.2**		(1.5)				**406.7**
Debt securities	**2,193.2**	-	**2,193.2**		(0.4)				**2,192.8**
Derivative financial instruments	**227.9**	-	**227.9**					(118.0)	**109.9**
Loans and advances to customers held at amortised cost	**23,024.8**	17.2	**23,042.0**		190.5	1,338.0	10.8		**24,581.3**
Loans and advances to customers held at FVTPL*	**1.2**	-	**1.2**						**1.2**
Equity release portfolio held at FVTPL	**406.6**	-	**406.6**		(0.4)				**406.2**
Current tax asset	**1.0**	0.4	**1.4**						**1.4**
Deferred tax asset	**33.1**	(20.2)	**12.9**						**12.9**
Investments in Group undertakings	**-**	215.8	**215.8**						**215.8**
Investments in joint ventures	**9.5**	(9.5)	**-**						**-**
Equity share investments	**10.2**	(1.7)	**8.5**						**8.5**
Property, plant and equipment	**73.2**	(33.5)	**39.7**						**39.7**
Right-of-use assets	**95.8**	(81.6)	**14.2**						**14.2**
Investment property	**6.6**	-	**6.6**						**6.6**
Intangible assets	**345.6**	(337.9)	**7.7**	(7.1)					**0.6**
Retirement benefit surplus	**1.2**	(1.2)	**-**						**-**
Other assets	**135.8**	(114.6)	**21.2**						**21.2**
Total assets	**29,468.0**	(427.3)	**29,040.7**	(7.1)	187.8	1,338.0	10.8	(118.0)	**30,452.2**

* FVTPL – Loans and advances to customers that are measured at Fair Value Through Profit and Loss.

The regulatory exposure includes exposures to credit risk, wholesale credit risk and securitisation which are explained in detail in the respective named sections of the document. As set out above the balance sheet exposure is adjusted for the following items to derive the regulatory exposure:

1. Under PRA rules intangible assets (including goodwill) must be deducted from regulatory capital with the exception of software assets. On 23 December 2020, EU Regulation 2020/2176 came into force providing an amendment to the deduction of some intangible assets from CET1. This applies a regulatory amortisation of software assets over a three year period. For these assets a deduction is taken for the extent to which the regulatory amortisation exceeds the accounting amortisation, instead of deducting the asset value. For those assets not deducted a 100% risk weight is applied.
2. Specific regulatory capital adjustments relate to the alignment of balance sheet exposures to the prudential regulatory exposure. This includes an adjustment to exclude the negative fair value adjustment for hedged risk for capital purposes.
3. Regulatory exposure of off-balance sheet items post credit conversion factor (CCF) relates to credit commitments for mortgages not yet drawn down.
4. Exposures for retail mortgages measured under the IRB Approach are not adjusted for accounting loan impairment in accordance with Article 166 of the CRR. The accounting loan impairment is therefore added back in the calculation of the regulatory exposure.

2.7 Scope of permission of Internal Ratings Based (IRB) Approach

The Society has PRA permission to apply the IRB Approach to certain credit risk exposures. The IRB Approach is applied to the retail mortgages of the Society, equity and non-credit obligation exposures. The Standardised Approach continues to apply to all other exposures and operational risk.

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. See section 6.9 to 6.10 for further details on the IRB models and the associated governance framework.

2.8 Disclosure levels

In accordance with Article 432 of the CRR an institution may omit one or more of the disclosures required if the information provided is not regarded as material or if it is regarded as proprietary or confidential. Such information, that we have chosen not to disclose, is set out below.

2.8.1 Non material information

All disclosures in this document are on a transitional basis unless explicitly stated. The difference between the transitional and end-point position is that under the end-point rules all existing Additional Tier 1 (AT 1) capital that becomes ineligible as AT 1 under CRD V is transitioned into Tier 2 capital in full, namely £9m of Permanent Interest Bearing Shares (PIBS). As this difference is not significant, we have not presented any information relating to capital adequacy on an end-point basis.

Table 1 in section 1.2 shows that the capital requirements under the prudential consolidation group are higher than under the individual consolidation group. On the basis that the prudential consolidation group represents the lowest capital adequacy and leverage positions and the same risk management framework is applied to both consolidation groups, the granular analysis throughout these disclosures has been disclosed at a prudential consolidation group level only.

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 above £0.1m are listed. Exposures in countries where this criteria are not met have been presented as ‘other countries’.

The Group continues to apply the IFRS 9 transitional arrangements to capital calculations from 1 January 2018, as permitted by EU Regulation (2017/2395), on scaling bases, over the period to 31 December 2024. Based on materiality, no breakdown for the static and dynamic components of IFRS 9 loan impairments from the date of initial adoption to 31 December 2021 has been disclosed by the Group.

Equity investments represent 0.3% of total credit risk exposures and therefore are not material. Based on materiality, the Society have omitted the disclosures required under Article 447 of the CRR.

2.8.2 Proprietary information

An overview of our approach to interest rate risk is set out in section 11.1, 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. An omission is made in accordance of the Article 432 (2) of the CRR.

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

2.8.3 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 are no current or foreseeable material, practical or legal impediments to the prompt repayment of liabilities between the individual consolidation group and its subsidiary undertakings within the prudential consolidation group. 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.

3 RISK MANAGEMENT OBJECTIVES AND POLICIES

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 of the Society for the benefit of members. The key risks to which the Group are exposed include credit risk, liquidity risk, interest rate risk, capital risk, pension obligation risk, model risk, business risk, climate change risk, conduct risk, operational risk and reputational risk. These risks are explained in detail in sections 6 to 12 of these disclosures and in the Risk Management Report of the Group's Annual Report and Accounts, pages 72 to 81.

3.1 Risk culture

The Group's approach to risk management is founded on robust corporate governance practices and a risk management culture designed to guide the activity and decision making of all management and employees. The Board promotes the risk management culture by overseeing the development of Risk Strategy, Risk Appetite, and supporting Frameworks. The Risk Management Strategy relates to both the Society and its subsidiary companies.

To support management in delivery of its strategic goals, the Board oversees a business culture which:

- implements an effective Risk Management Framework ensuring the business understands the risks to which it is exposed and operates effective control systems to mitigate their occurrence;
- appropriately balances risk and reward ensuring that a proper understanding of the risks is provided to support informed decision making at all levels of the organisation;
- ensures that we have colleagues who are appropriately skilled and highly engaged, who perform well and work together to create a great customer experience with the right outcomes, whilst recognising and rewarding behaviours which deliver business performance in a risk controlled manner; and
- ensures that incentive plans are designed to promote good customer outcomes.

The Risk Cycle adopted by the Group is based on an end to end process for managing risks. It is forward-looking and comprises elements for identification, assessment, management and reporting risk.

Employees at all levels are responsible for the management and escalation of risks and must be appropriately skilled to fulfil their responsibilities within the Group contributing to the risk awareness, values and behaviours that underpin a strong risk culture.

The risk culture aligns with risk appetite, awareness, proactive reporting and willingness to challenge and to learn.

3.1.1 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 appetites, inter alia, specifically addresses the maintenance of stakeholders' confidence, credit risk appetite, capital and liquidity adequacy, the leverage ratio, the minimum requirement for owns funds and eligible liabilities (MREL), the 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.

The Board reviews and approves risk appetites and its capacity on an annual basis or more frequently in the event of changes to the risk environment, with the aim of ensuring that the approach is consistent with the Group's strategy, business environment and regulatory environment.

Central to operating within this appetite is a management culture which promotes awareness of actual and potential risks and an understanding of their impact on the portfolio should they crystallise.

A key objective of the Group is to maintain strong capital and liquidity levels. These measures are monitored on an ongoing basis to ensure that the Board risk appetite is maintained, and as a result minimum regulatory requirements are 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 BRC and various sub-committees as set out in section 3.3.

3.2 Risk management framework

The Group has a formal structure 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 who, through the implementation of the organisation's risk framework, identifies, assesses and manages risk.

- **Second line of defence**, comprising independent risk functions (Operational, Credit, Prudential Oversight and 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 three sub-committees of the BRC, namely, the Asset and Liability Committee (ALCO), the Retail Credit Committee (RCC) and the Model Governance Committee (MGC). 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 BRC Chair 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 Board 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 in the Risk Management Report of the Group's Annual Report and Accounts on pages 58 to 81.

3.3 Governance structure

3.3.1 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 so as 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 performance, the integrity of reporting 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 management and the Board of material changes to the risk profile of the Society or any of its subsidiaries 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 known 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 considers 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 of the Group's Annual Report and Accounts, see pages 58 to 81, 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.

Information about the Society's Board, including the recruitment policy for Board members and the diversity policy with respect to all employees including directors and senior managers can be found in the Group's Annual Report and Accounts on pages 58 to 62 and 25. Details of the Board members' other directorships can be found in the Group's Annual Report and Accounts on pages 257 to 259.

3.3.2 Board Risk Committee

To enable appropriate focus on risk matters, the Board has delegated oversight of risk management to the BRC although ultimate responsibility for risk management continues to reside with the Board which receives regular reporting to support its oversight of risk.

The 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 CRD regulations, the Committee's membership comprises only Non-Executive Directors.

The BRC held six scheduled meetings during 2021.

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 BRC is supported by three executive committees, namely, ALCO, RCC and MGC, which have day-to-day responsibility for risk management oversight. Further information regarding the sub-committees can be found in the Risk Management Report of the Group's Annual Report and Accounts on page 73.

3.3.3 Executive Committee

The Executive Committee (ExCo) is responsible for ensuring that the Group meets its strategic and operational objectives as defined in the corporate plan. The Executive Committee, comprising the Executive Directors and other senior Society executives, is chaired by the Group Chief Executive.

3.3.4 Audit Committee

The Audit Committee is responsible for the monitoring and review of the financial reporting process, internal controls and risk management systems and the effectiveness of the Internal Audit and Compliance functions. It is also responsible for ensuring an independent and effective external audit process, which includes making recommendations to the Board on the appointment and removal of the external auditors.

Further information regarding the Audit Committee can be found in the Audit Committee Report of the Group's Annual Report and Accounts on pages 66 to 71.

The responsibilities of the Audit 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.

3.3.5 Remuneration Committee

The purpose of the Remuneration Committee is:

- To determine, on behalf of the Board, the Remuneration Policy;
- Ensure that remuneration arrangements support and encourage desired behaviours and culture;
- Maintain policies that are compliant with governing laws and regulations;
- Ensure appropriate governance of remuneration practices across the Society and its subsidiary companies and exercise effective oversight of these; and
- 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.

The Committee ensures that clear remuneration principles for the Society and its subsidiaries are set and agreed annually. For the PRA and Financial Conduct Authority (FCA) regulated businesses, the principles set out appropriate standards for remuneration design, governance, risk management, and, where applicable, remuneration for Material Risk Takers (MRTs). The Committee receives reports from the Group Remuneration Oversight Committee on the implications of the remuneration policies within the Group and compliance with the principles. The Chief Risk Officers update the Committee on risk related matters and provide information and insight as part of the risk adjustment process.

The terms of reference are also available online at https://www.skipton.co.uk/about-us/governance/board-committees.

The Remuneration Committee held eight scheduled meetings during 2021.

Further information on the Committee's responsibilities can be found in the Group's Annual Report and Accounts on pages 102 to 103.

3.3.6 Nominations Committee

The Nominations Committee, which comprises all the Society's Non-Executive Directors and is chaired by the Society Chair, leads the process for Board appointments and succession planning. The Nominations Committee aims to ensure that the Board's committees are optimally resourced and are refreshed at appropriate intervals to avoid reliance on any one individual.

The terms of reference are also available online at https://www.skipton.co.uk/about-us/governance/board-committees.

3.3.7 Non-Executive Directors' Remuneration Committee

The Non-Executive Directors' Remuneration Committee makes recommendations concerning Non-Executive Directors' remuneration to the Board.

The terms of reference are also available online at https://www.skipton.co.uk/about-us/governance/board-committees.

4 CAPITAL RESOURCES

4.1 Total capital resources

Capital is ultimately held for the protection of depositors and other creditors by providing a buffer against unexpected losses. During 2021 the Group satisfied all of the current capital requirements under CRD V.

Table 3 shows the composition of regulatory capital as at 31 December 2021.

Table 3 Capital composition

	Notes	**2021** £m	2020 Restated* £m
Common Equity Tier 1 capital			
General reserve		**1,781.2**	1,589.7
Fair value reserve		**7.5**	4.1
Cash flow hedging reserve		**4.0**	(15.1)
Cost of hedging reserve		**(3.5)**	(3.5)
Common Equity Tier 1 capital prior to regulatory adjustments		**1,789.2**	1,575.2
Regulatory adjustments:			
Prudential adjustments	1	**(2.7)**	(2.1)
IFRS 9 transitional relief		**6.1**	7.3
Intangible assets	2	**(5.7)**	(5.9)
Software assets quick fix adjustment	2	**(0.9)**	(2.0)
Cash flow hedging reserve	3	**(4.0)**	15.1
Negative amounts resulting from the calculation of expected loss amounts	4	**(6.5)**	(2.0)
Total Common Equity Tier 1 capital		**1,775.5**	1,585.6
Additional Tier 1 capital			
Permanent Interest Bearing Shares (PIBS)	5	**9.0**	18.0
Total Tier 1 capital		**1,784.5**	1,603.6
Tier 2 capital			
Permanent Interest Bearing Shares (PIBS)	5	**31.0**	22.0
Surplus of Impairment Provisions Over Expected Loss	6	**-**	4.9
Total Tier 2 capital		**31.0**	26.9
Total regulatory capital		**1,815.5**	1,630.5
Risk weighted assets (RWAs)			
Credit risk			
IRB Approach			
Secured mortgages on immovable property		**1,584.5**	1,712.6
Non-credit obligation assets	7	**53.8**	208.4
Equity	8	**325.8**	304.7
Standardised Approach			
Secured mortgages on immovable property	9	**965.5**	955.1
Corporates and retail	10	**230.5**	209.7
Treasury	11	**292.2**	169.1
Other		**28.6**	35.7
Counterparty credit risk (including CVA)	12	**44.6**	102.0
Securitisation		**18.7**	20.0
Operational risk		**440.5**	405.9
Market risk		**-**	-
Total risk weighted assets		**3,984.7**	4,123.2
Capital ratios (as a percentage of RWAs)			
Common Equity Tier 1 ratio		**44.6%**	38.5%
Tier 1 ratio		**44.8%**	38.9%
Total capital ratio		**45.6%**	39.5%

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

Notes

1. Prudential adjustments relate to a deduction to capital for an AVA on fair value assets. AVA has been applied to provide for the downside of fair value exposures that are intrinsically subjective in nature.
2. Under PRA rules intangible assets (including goodwill) must be deducted for regulatory purposes, net of deferred tax liability, with the exception of software assets. On 23 December 2020, EU Regulation 2020/2176 came into force providing an amendment to the deduction of some intangible assets from CET 1. This applies a regulatory amortisation of software assets over a three year period. For these assets a deduction is taken for the extent to which the regulatory amortisation exceeds the accounting amortisation, instead of deducting the asset value. For those assets not deducted a 100% risk weight is applied.
3. Under PRA rules the cash flow hedging reserve must be deducted for regulatory purposes.
4. Under PRA rules the amount by which the regulatory expected loss calculated for capital purposes exceeds the impairment provision calculated under IFRS, is deducted from CET 1 capital, gross of tax. This balance includes the regulatory expected loss amounts for equity exposures, gross of tax.
5. Under CRD V end-point rules all existing Additional Tier 1 capital and Tier 2 capital instruments that become ineligible as capital under CRD V are excluded in full. On a transitional basis £40m of PIBS are being phased into Tier 2 capital over the period to 2022. As at 31 December 2021 £31m has been transitioned.
6. Under PRA rules the amount by which the impairment provision calculated under IFRS for accounting purposes exceeds regulatory expected loss, is included in Tier 2 capital.
7. Non-credit obligation assets relate to property, plant and equipment, right-of-use assets and a fair value adjustment for hedged risk under the IRB Approach.
8. Equity exposures primarily relate to the cost of investment in subsidiary companies outside the regulatory group as well as other equity investments.
9. Risk weighted assets on immovable property under the Standardised Approach include £178.7m in relation to commercial mortgages as at 31 December 2021 (31 December 2020: £201.2m).
10. Corporate and retail exposures include debt factoring and invoice discounting in SBF and a loan between the Society and Connells.
11. Treasury risk weighted assets include exposures to central government, institutions and covered bonds balances.
12. Counterparty credit risk exposures relate to derivatives and repurchase transactions, including Credit Valuation Adjustment (CVA). The CVA is held in order to protect the Group from exposure to potential mark to market losses that could arise if the creditworthiness of counterparties to the Society's derivative contracts were to deteriorate.

The total capital ratio has increased to 45.6% during the year. This increase is mainly due to the retained profits accumulated during the period and dividend income received from the Connells group. Risk weighted assets (RWAs) decreased by £138.5m during the year. Whilst we have seen strong mortgage book growth, risk weighted mortgage assets have decreased due to risk weights required for new lending being lower than the risk weights for accounts that have redeemed during the year. New lending is subject to our credit decision process and presents a low level of default risk which increases over time. The risk weighted mortgage assets have also decreased due to the improvement in house prices in the year. The RWAs in relation to the fair value of hedge adjustments on fixed rate assets have also decreased as the markets have increased their long-term expectations of interest rates. These decreases have been partly offset by an increase in the RWAs for treasury assets, where we have taken the opportunity to diversify our holdings in a broader range of liquid assets, typically short dated certificates of deposit issued by highly rated financial institutions, which carry a higher risk weighting than cash held with the Bank of England.

4.1.1 Regulatory capital flow statement

Table 4 below shows the flow of regulatory capital and associated movements that have occurred from 1 January 2021 to 31 December 2021 and shows how the Group's strong financial performance has strengthened our capital position.

Table 4 Capital flow statement

	Common Equity Tier 1 capital £m	Additional Tier 1 capital £m	Tier 2 capital £m
At 1 January 2021	**1,585.6**	**18.0**	**26.9**
Profit after tax for the year	181.4	-	-
Actuarial gain on retirement benefit obligation	12.3	-	-
Movement in fair value reserve	3.4	-	-
Tax on items taken directly to general reserve	6.6	-	-
Deferred tax	(8.8)	-	-
Regulatory adjustments:			
Increase in prudential adjustments	(0.6)	-	-
Decrease in IFRS 9 transitional relief	(1.2)	-	-
Increase in goodwill on deferred tax adjustments	0.2		
Decrease in deduction for software assets	1.1	-	-
Excess regulatory expected loss over impairment provisions	(4.5)	-	(4.9)
Transitioning of PIBS from AT 1 to Tier 2	-	(9.0)	9.0
At 31 December 2021	**1,775.5**	**9.0**	**31.0**

4.2 Tier 1 capital

4.2.1 Common Equity Tier 1 capital

Common Equity Tier 1 (CET 1) capital comprises principally the general reserve (accumulated profit). In line with CRD V, the cash flow hedging reserve is excluded from CET 1.

The following adjustments are also applied to the calculation of CET 1:

- An adjustment is made for an Additional Valuation Adjustment (AVA) on fair value assets and liabilities in accordance with CRD V. The AVA has been applied to provide for the downside of fair value exposures that are intrinsically subjective in nature;

- Goodwill and intangible assets are deducted from regulatory capital in accordance with CRD V with the exception of software assets. On 23 December 2020, EU Regulation 2020/2176 came into force providing an amendment to the deduction of some intangible assets from CET 1. This applies a regulatory amortisation to software assets over a three year period. A deduction is taken for the extent to which the regulatory amortisation exceeds the accounting amortisation for these assets, instead of deducting the asset value. For those assets not deducted, a 100% risk weight is applied;

- A deduction is made for excess expected losses. Regulatory expected loss is the amount expected to be lost on an exposure in the event that it defaults, calculated in line with regulatory requirements for capital and applied to mortgage exposures subject to the IRB Approach. Excess expected loss is the amount by which the regulatory expected loss calculated for capital purposes exceeds the impairment provision calculated under IFRS for accounting purposes. This is deducted from CET 1 in accordance with Article 36 of the CRR. An expected loss amount equal to 2.4% of equity balances, calculated in accordance with Article 158 of the CRR, is also deducted from CET 1;

- Under Article 48 of the CRR, 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; and

- From 27 June 2020, amendments to Article 473a of the CRR included additional IFRS 9 transitional relief measures in response to the COVID-19 pandemic. An add back to capital resources is applied due to increases in expected credit loss provisions for non-credit impaired assets during 2020 - 2024.

4.2.2 Additional Tier 1 capital

Additional Tier 1 (AT 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.

PIBS are perpetual and eligible for regulatory capital but are being phased out of AT 1 capital into Tier 2 capital over a transitional period to 1 January 2022 in accordance with CRD V.

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

4.3 Tier 2 capital

Tier 2 capital comprises of PIBS that have been transitioned out of AT 1 capital under CRD V.

4.4 Leverage ratio

The leverage ratio metric is a non-risk based measure used to manage the risk of excessive leverage[1]. The CRR leverage ratio is defined as the ratio of Tier 1 capital to total exposure which includes both on and off-balance sheet items. The UK leverage ratio is calculated in the same way as the CRR leverage ratio with the exception of the exclusion of exposures to central banks from the leverage exposure measure.

In October 2021, the Statement of Policy on the UK leverage ratio framework (PS21/21) was published and confirmed that under the UK regulatory regime the leverage ratio requirement only applies to financial institutions with deposits equal to or greater than £50bn or non-UK assets equal to or greater than £10bn. The Group is not currently captured by either threshold.

Table 5 below sets out the CRR and UK leverage ratios for the prudential consolidation group reported on a CRD V end-point basis with IFRS 9 transitional arrangements applied together with the UK leverage ratio as at 31 December 2021.

Table 5 Leverage ratio

	Notes	End-point **2021** **£m**	2020 Restated* £m
Total Tier 1 capital		**1,775.5**	1,585.6
Total balance sheet assets after regulatory adjustments	1	**29,193.1**	28,297.9
Derivatives	2	**(447.4)**	(522.8)
Total leverage exposure		**28,745.7**	27,775.1
Central bank exposures		**(2,431.2)**	(3,235.5)
Total UK leverage exposure		**26,314.5**	24,539.6
CRR leverage ratio		**6.2%**	5.7%
UK leverage ratio	3	**6.8%**	6.5%

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

Notes

1. Regulatory adjustments relate to undrawn credit commitments, cash flow hedging reserve, goodwill, intangible assets, AVA, current tax and excess expected loss. These adjustments are made to ensure the denominator balance meets regulatory requirements.
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. Leverage ratio under the UK regulatory regime excludes exposures to central banks from the leverage exposure balance.

During the year the UK leverage ratio has increased to 6.8% on an end-point basis (December 2020: 6.5%). This is mainly due to the retained profits accumulated during the period and dividend income received from the Connells group.

The leverage ratio is monitored on an ongoing basis to ensure that the Group has sufficient levels of capital for current and projected activities. The Group's leverage ratio is a key financial indicator monitored closely by the Board each month. The forecast ratio is incorporated into the Group's strategy and risk appetite framework.

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

[1] The excessive leverage is the extent to which a firm funds its assets excessively with borrowings rather than own funds.

5 CAPITAL REQUIREMENTS

This section sets out the details for each of the components of the Group's capital requirements.

5.1 Pillar 1 capital

Under PRA rules a minimum level of capital (Pillar 1) must be held for credit risk, counterparty credit risk, securitisation positions, operational risk and market risk for the individual and prudential consolidation groups.

5.1.1 Credit risk

The Group has adopted the following approaches to calculate the minimum regulatory capital requirement for credit risk:

IRB Approach for:

- Retail mortgage[2] exposures within the Society;
- Equity exposures[3];
- Non-credit obligation assets[4]; and
- Cash in hand.

Standardised Approach for:

- Retail mortgage exposures within SIL;
- Commercial mortgage exposures within the Society;
- Equity release exposures within the Society;
- Wholesale credit exposures within the regulatory group; and
- Other assets[5].

Section 6 sets out further information on credit risk.

5.1.2 Counterparty credit risk

Counterparty credit risk (CCR) resulting from derivatives and repurchase transactions is calculated under the Standardised Approach and further information can be found in section 7.2 and 7.3.

The Group holds 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. This assessment places a valuation on the risk that the counterparty will default on its obligations before the maturity of the contract. In addition to this CRD V requires additional regulatory capital to be held 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 (CVA).

5.1.3 Securitisation positions

Securitisation positions are calculated under the Standardised Approach and further information can be found in section 9.

[2] Retail mortgage exposures include owner-occupied mortgages and residential buy-to-let mortgages.
[3] Equity exposures primarily relate to the cost of investment in subsidiary companies outside the regulatory group as well as other equity investments.
[4] Non-credit obligation assets relate to property, plant and equipment, right-of-use assets and fair value adjustments for hedged risk assets under the IRB Approach.
[5] Other assets include prepayments, investments properties and intangible assets.

5.1.4 Operational risk

Operational risk is calculated under the Standardised Approach and further information can be found in section 10.

5.1.5 Market risk

Foreign exchange risk is the only Pillar 1 market risk incurred by the individual and prudential consolidation groups. The Group's exposure to foreign currency risk is calculated in accordance with Article 83 of CRD V and is below the 2% de minimis limit. Further information on market risk and currency risk can be found in section 11.

5.1.6 Summary of Pillar 1 capital requirements

Table 6 below provides an overview of RWAs and minimum capital requirements for Pillar 1 capital broken down by exposure class as at 31 December 2021.

Pillar 1 credit risk exposures include balances which are off-balance sheet, such as credit commitments relating to mortgages not yet drawn down. These exposures have a capital requirement but do not appear in the accounting balance sheet of the regulated group. In addition, CCR exposures in relation to derivatives are adjusted in accordance with regulatory requirements and adjustments are made for credit risk mitigation techniques such as netting. Further detail is set out in sections 7.2 and 7.3.

The capital requirement under both the IRB and Standardised Approach is calculated as 8% of the risk weighted exposure amounts for each of the applicable exposure classes.

Table 6 Pillar 1 RWAs and capital requirements

		Risk weighted assets		**Capital requirement**	
		2021	2020 Restated*	**2021**	2020 Restated*
	Notes	**£m**	£m	**£m**	£m
Credit risk (excluding counterparty credit risk and securitisations)		**3,480.9**	3,595.3	**278.6**	287.6
of which IRB Approach		**1,964.1**	2,225.7	**157.1**	178.1
Secured by mortgages on immovable property		**1,465.1**	1,565.5	**117.2**	125.2
Exposures in default	1	**119.4**	147.1	**9.5**	11.8
Non-credit obligation assets	2	**53.8**	208.4	**4.3**	16.7
Equity	3	**325.8**	304.7	**26.1**	24.4
of which Standardised Approach		**1,516.8**	1,369.6	**121.5**	109.5
Secured by mortgages on immovable property		**955.7**	942.6	**76.5**	75.4
Exposures in default	1	**9.8**	12.5	**0.8**	1.0
Corporates	4	**229.6**	208.9	**18.4**	16.7
Retail		**0.9**	0.8	**0.1**	0.1
Central governments or central bank		**12.9**	30.2	**1.0**	2.4
Multilateral development banks	5	**-**	-	**-**	-
Institutions		**243.3**	118.6	**19.5**	9.4
Covered bonds		**26.0**	20.3	**2.1**	1.6
Claims on institutions and corporates with a short-term credit assessment	6	**10.0**	-	**0.8**	-
Other items		**28.6**	35.7	**2.3**	2.9
Counterparty credit risk (CCR)	7	**44.6**	102.0	**3.5**	8.2
Of which mark to market		**15.4**	35.7	**1.2**	2.9
Of which CVA		**29.2**	66.3	**2.3**	5.3
Securitisations	8	**18.7**	20.0	**1.5**	1.6
Operational risk		**440.5**	405.9	**35.2**	32.4
Market risk		**-**	-	**-**	-
Total RWAs		**3,984.7**	4,123.2	**318.8**	329.8

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

Notes

1. Exposures in default refer 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.

2. Non-credit obligation assets relate to property, plant and equipment, right-of-use assets and a fair value adjustment for hedged risk under the IRB Approach.
3. Equity exposures primarily relate to the cost of investments in subsidiary companies outside the regulatory group as well as other equity investments and are calculated under the simple risk weight approach in accordance with Article 155 (2) of the CRR.
4. Corporate exposures relate primarily to debt factoring and invoice discounting in Skipton Business Finance and a loan between the Society Connells.
5. Multilateral development banks are international financial institutions chartered by two or more countries for the purpose of encouraging economic development in poorer nations. In accordance with Article 117 (2) of the CRR these exposures are assigned a 0% risk weight.
6. Claims on institutions and corporates with a short-term credit assessment relate to exposures with a residual maturity of less than three months and a short-term credit rating.
7. Counterparty credit risk exposures relate to derivatives and repurchase transactions, including CVA. Further information on exposures relating to counterparty credit risk is set out sections 7.2 and 7.3.
8. Securitisations relate to purchased Residential Mortgage Backed Securities (RMBSs) excluding retained holdings. Further information on exposures relating to purchased securitisations is set out in section 9.1.

5.1.7 Risk weighted assets flow statement

Table 7 below sets out the movement in Pillar 1 RWAs (excluding operational risk) over the course of the reporting period.

Table 7 Risk weighted assets movements

	IRB credit risk		Standardised credit risk				
	Mortgages	Other assets	Mortgages and loans	Treasury assets [1]	Counterparty credit risk	Other assets	Total
	£m	£m	£m	£m	£m	£m	£m
RWAs at 31 December 2020 restated*	1,712.6	513.1	955.1	189.1	102.0	245.4	3,717.3
Increase / (Reduction) in asset volume	111.2	(133.5)	26.6	17.8	15.1	12.2	49.4
(Improvement) / Reduction in asset quality	(236.6)	-	(16.2)	104.0	(72.5)	1.5	(219.8)
Decrease due to model changes	(2.7)	-	-	-	-	-	(2.7)
RWAs at 31 December 2021	1,584.5	379.6	965.5	310.9	44.6	259.1	3,544.2

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

Note

1. Treasury assets include RWAs to securitisation exposures.

RWAs, excluding operational risk, have decreased by £173.1m during 2021 to £3,544.2m (31 December 2020: £3,717.3m).

Movement in RWAs – Asset volume

RWAs in relation to IRB mortgage exposures have increased during the year as a result of the growth in the mortgage book during the year.

Other IRB assets include the fair value adjustment for hedged risk for fixed rate IRB mortgage assets. This has significantly decreased in value as the markets have increased their long term expectations for interest rates, resulting in a negative fair value adjustment of our existing fixed mortgage book, which is excluded from the total RWAs.

The increase in volume in standardised mortgage RWAs includes new lending growth in SIL, which has been partially offset mortgage redemptions, including redemptions from closed portfolios.

The increase in RWAs attributable to treasury asset volume is driven by an increase in exposure to higher yielding debt instruments in order to maximise the efficiency of the Society’s liquidity portfolio.

The Society enters into derivative transactions to hedge our fixed rate mortgage and savings products. The increase in volume in counterparty credit risk has been caused by the Society pledging initial margin (cash collateral) for clearing of these derivatives transactions.

The increase in volume in other standardised assets relates to advances made by SBF which has partially offset in relation to London Clearing House collateral and sundry debtors.

Movement in RWAs – Asset quality

The improvement in the quality in relation to IRB exposures is due to the risk weights for new lending being significantly lower than the risk weights for accounts that have redeemed during the year. A reduction in the mortgage portfolios loan-to-value (LTV) profile reflecting positive house price growth and a moderate improvement in arrears during the year has also contributed to the improvement.

The improvement in quality in standardised mortgage RWAs is mainly driven by the significant house price growth that has been seen throughout 2021 and arrears remaining low, in part due to the government support schemes.

The reduction in Treasury RWA quality is driven by a change in the mix of liquid assets, as the Society invested excess liquidity in other short dated instruments such as certificates of deposit. Partially offsetting this is less collateral pledged to non-cleared derivative counterparties.

The improvement in counterparty credit risk RWA quality reflects that the Society has less non-cleared derivative transactions outstanding, instead clearing more derivative transactions, which carry a lower risk weighting compared to those which are non-cleared. Changes in the value of cross-currency swaps has also contributed to this improvement in quality.

Movement due to model changes

No material changes have been made to the regulatory approved IRB models in 2021. The minor reduction in RWAs is due to parameter changes following the migration of the Amber and NYM accounts to the Society portfolio and updates made to the Society's application scorecard.

5.2 Pillar 2 capital

Pillar 2 is provided to cover specific risks faced by the Group and the risks that have not been covered by Pillar 1, such as pension and interest rate risks.

5.2.1 Pillar 2A capital

As at 31 December 2021 the Pillar 2A requirement remained a fixed nominal amount of £115.6m (2020: £115.6m). The Group maintains capital levels which exceed this requirement.

5.3 Regulatory capital buffers

Under CRD V, the Society is required to hold a Capital Conservation Buffer (CCoB) and a Countercyclical Buffer (CCyB) to provide capital that can be utilised to absorb losses in stressed conditions. As at 31 December 2021 the CCoB was set at 2.5% of risk weighted assets. During the period the CCyB rate remained at 0% of RWAs for exposures in the UK. Appendix 6 sets out further information regarding the calculation of the CCyB.

5.4 Capital reporting

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.

5.5 Internal Capital Adequacy Assessment Process and stress testing

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 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 12 sets out additional risks considered in the Pillar 2 assessment.

In addition, the Group undertakes other stress testing activities including an annual Reverse Stress Test to identify and model severe stress scenarios that would cause the Group to fail. This analysis is used to understand the viability and sustainability of the business model and strategy and, in doing so, informs our risk appetite, risk reporting and strategic approach.

In line with regulatory requirements the Group maintains recovery plans to minimise the risk of failure of the business and the adverse impact of failure on the financial system. The recovery plan provides a 'menu of options' which could be invoked to deal with a range of stress events and to help minimise the risk of failure. The Group also provides the Bank of England with information to enable the relevant authorities to prepare for orderly resolution if recovery is not possible.

5.6 Minimum Requirement for Own funds and Eligible Liabilities (MREL)

MREL is a regulatory requirement set by the Bank of England to ensure institutions can cover the losses that would need to be absorbed in the event of a resolution scenario. The amount of MREL that institutions need to have is linked to the resolution strategy chosen for each firm and is being phased in over a transitional period to 1 January 2023. The Bank of England's preferred resolution strategy for Skipton Building Society is a single point of entry bail-in under Part 1 of the Banking Act 2009 ("the Banking Act").

At 31 December 2021, our total MREL resources, including MREL eligible senior non-preferred debt, were 54.4% of risk weighted assets. This is in excess of the 2021 requirement of 18% of risk weighted assets plus capital buffers issued by the Bank of England.

From 1 January 2023 we expect the MREL requirement to be equal to 2x (pillar 1 plus pillar 2A capital requirements). Compliance with MREL is reflected in the Society's Corporate Plans.

5.7 Future regulatory developments

The Society submitted updated IRB models to the PRA in 2021 and the process for review and approval is ongoing. Feedback has been received from the PRA and the Society is working with the PRA to implement some remediation changes. The estimated impact of the model changes has been reflected within our regulatory assessment of capital requirements from 1 January 2022. The changes are in accordance with the PRA Supervisory Statement SS11/13.

6 Credit risk

6.1 Credit risk overview

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 historical commercial lending;
- debt factoring and invoice discounting provided by Skipton Business Finance; and
- wholesale counterparties for the purposes of liquidity management.

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 adversely affect the level of impairment losses and increase risk weighted asset percentages for modelled portfolios.

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 RCC 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 BRC. The Board receives monthly updates on the credit risk profile of the Group.

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 supported by manual underwriting. All aspects of the credit decision process are subject to regular independent review and development ensuring they support decisions in line with the Board's credit risk appetite.

The Group includes specialist lending businesses Amber and NYM which were also closed to new lending in 2008. The portfolios of both these businesses were successfully integrated into the Society portfolio with effect from 1 June 2021; the book value of these loans when migrated to the Society on 1 June 2021 was £561.3m.

The performance of the Society's residential mortgage portfolio has been strong throughout 2021. We have seen moderate improvements in arrears (from a low start point at the end of 2020) and a reduction in the LTV profile driven largely by the positive house price growth seen through the year. During 2020 and 2021, the Society supported over 25,000 customers with a COVID-19 payment deferral. These have now all ended and 96.4% of these customers have returned to making full contractual payments.

6.2 Credit risk exposures

Table 8 below sets out the credit risk exposures, excluding counterparty credit risk and securitisations, by class split by those measured under the IRB Approach and those measured under the Standardised Approach. The balances include regulatory adjustments and off-balance sheet items relating to undrawn credit facilities. The average exposure is based on the average of the last two reporting positions.

The Group's overall credit risk exposures have increased by £1.1bn to £30.2bn as at 31 December 2021 driven primarily by an increase in mortgage lending during the year. The majority of exposures (74%) relate to retail mortgages measured under the IRB Approach. See sections 6.9 to 6.10 for further detail on the IRB Approach.

During the year, the Group has increased its exposure to very highly rated multilateral development banks. Central governments and central bank exposures have decreased as there has been less opportunities for investment at yields which are commercially attractive. The Group has seen an increase in collateral pledged to the London Clearing House for cleared derivative transactions, which are reported in corporate exposures.

Table 8 Credit risk exposures by class

	2021 **£m**	2020 Restated* £m	Average 20/21 £m
IRB Approach			
Secured mortgages on immovable property	**22,413.9**	20,868.4	21,641.1
Exposures in default	**49.8**	59.0	54.4
Non-credit obligation assets	**55.7**	210.5	133.1
Equity	**90.8**	82.4	86.6
	22,610.2	21,220.3	21,915.2
Standardised Approach			
Secured mortgages on immovable property	**2,395.6**	2,303.0	2,349.3
Exposures in default	**9.8**	12.5	11.1
Corporates	**451.2**	610.2	530.7
Retail	**1.7**	1.4	1.6
Central governments or central bank	**3,021.5**	3,581.8	3,301.6
Multilateral development banks	**850.8**	640.3	745.6
Institutions	**522.7**	455.8	489.3
Covered bonds	**260.0**	202.6	231.3
Claims on institutions and corporates with a short-term credit assessment	**20.0**	15.2	17.6
Other items	**28.8**	36.0	32.4
	7,562.1	7,858.8	7,710.5
Total credit risk exposures	**30,172.3**	29,079.1	29,625.7

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

Table 9 below sets out exposure classes by geographic distribution based on the location of the underlying asset, split by exposures measured under the IRB Approach and the Standardised Approach. This shows that the majority of the Group's exposures are in the UK.

Table 9 Credit risk exposures by geographical area

As at 31 December 2021	UK £m	Channel Islands £m	Rest of Europe £m	Rest of world £m	Total exposure value £m
IRB Approach					
Secured by mortgages on immovable property	22,413.9	-	-	-	22,413.9
Exposures in default	49.8	-	-	-	49.8
Non-credit obligation assets	52.7	3.0	-	-	55.7
Equity	90.8	-	-	-	90.8
	22,607.2	3.0	-	-	22,610.2
Standardised Approach					
Secured by mortgages on immovable property	1,412.4	983.2	-	-	2,395.6
Exposures in default	9.8	-	-	-	9.8
Corporates	451.2	-	-	-	451.2
Retail	1.7	-	-	-	1.7
Central governments or central bank	2,831.8	-	169.6	20.1	3,021.5
Multilateral development banks	-	-	289.3	561.5	850.8
Institutions	401.2	-	-	121.5	522.7
Covered bonds	260.0	-	-	-	260.0
Claims on institutions and corporates with a short-term credit assessment	-	-	20.0	-	20.0
Other items	27.5	1.3	-	-	28.8
	5,395.6	984.5	478.9	703.1	7,562.1
Total exposures	28,002.8	987.5	478.9	703.1	30,172.3

As at 31 December 2020 Restated*	UK £m	Channel Islands £m	Rest of Europe £m	Rest of world £m	Total exposure value £m
IRB Approach					
Secured by mortgages on immovable property	20,868.4	-	-	-	20,868.4
Exposures in default	59.0	-	-	-	59.0
Non-credit obligation assets	206.8	3.7	-	-	210.5
Equity	82.4	-	-	-	82.4
	21,216.6	3.7	-	-	21,220.3
Standardised Approach					
Secured by mortgages on immovable property	1,290.4	1,012.6	-	-	2,303.0
Exposures in default	12.5	-	-	-	12.5
Corporates	610.2	-	-	-	610.2
Retail	1.4	-	-	-	1.4
Central governments or central bank	3,581.8	-	-	-	3,581.8
Multilateral development banks	-	-	187.0	453.3	640.3
Institutions	236.1	-	152.5	67.2	455.8
Covered bonds	202.6	-	-	-	202.6
Claims on institutions and corporates with a short-term credit assessment	-	-	15.2	-	15.2
Other items	34.2	1.8	-	-	36.0
	5,969.2	1,014.4	354.7	520.5	7,858.8
Total exposures	27,185.8	1,018.1	354.7	520.5	29,079.1

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

Table 10 below sets out exposure classes by maturity, split by exposures measured under the IRB Approach and the Standardised Approach. The maturity profile reflects the inherent nature of long term mortgage lending and shorter term wholesale lending and bonds.

Table 10 Credit risk exposures by maturity

As at 31 December 2021	On demand £m	Up to 1 year £m	1 to 5 years £m	In more than 5 years £m	No stated maturity £m	Total exposure value £m
IRB Approach						
Secured mortgages on immovable property	2.1	73.3	610.5	21,728.0	-	22,413.9
Exposures in default	-	0.2	1.4	48.2	-	49.8
Non-credit obligation assets	1.9	-	-	53.8	-	55.7
Equity	-	-	-	82.3	8.5	90.8
	4.0	73.5	611.9	21,912.3	8.5	22,610.2
Standardised Approach						
Secured by mortgages on immovable property	1.1	11.7	49.4	2,333.4	-	2,395.6
Exposures in default	-	-	0.3	9.5	-	9.8
Corporates	110.7	12.6	26.6	101.5	199.8	451.2
Retail	1.5	-	-	0.2	-	1.7
Central governments or central bank	2,343.5	136.2	232.6	221.4	87.8	3,021.5
Multilateral development banks	-	103.2	629.2	118.4	-	850.8
Institutions	78.6	314.4	-	-	129.7	522.7
Covered bonds	-	12.3	202.6	45.1	-	260.0
Claims on institutions and corporates with a short-term credit assessment	-	20.0	-	-	-	20.0
Other items	0.5	21.7	-	6.6	-	28.8
	2,535.9	632.1	1,140.7	2,836.1	417.3	7,562.1
Total exposures	2,539.9	705.6	1,752.6	24,748.4	425.8	30,172.3

As at 31 December 2020 Restated*	On demand £m	Up to 1 year £m	1 to 5 years £m	In more than 5 years £m	No stated maturity £m	Total exposure value £m
IRB Approach						
Secured mortgages on immovable property	1.1	61.0	551.1	20,255.2	-	20,868.4
Exposures in default	-	0.2	1.6	57.2	-	59.0
Non-credit obligation assets	2.1	-	-	208.4	-	210.5
Equity	-	-	-	82.4	-	82.4
	3.2	61.2	552.7	20,603.2	-	21,220.3
Standardised Approach						
Secured by mortgages on immovable property	1.0	10.4	49.3	2,242.3	-	2,303.0
Exposures in default	-	-	0.3	12.2	-	12.5
Corporates	77.0	11.7	21.9	104.7	394.9	610.2
Retail	1.2	-	-	0.2	-	1.4
Central governments or central bank	3,161.6	113.1	66.7	168.5	71.9	3,581.8
Multilateral development banks	-	49.4	515.5	75.4	-	640.3
Institutions	103.5	19.3	153.2	-	179.8	455.8
Covered bonds	-	-	202.6	-	-	202.6
Claims on institutions and corporates with a short-term credit assessment	-	15.2	-	-	-	15.2
Other items	0.3	21.8	5.8	8.1	-	36.0
	3,344.6	240.9	1,015.3	2,611.4	646.6	7,858.8
Total exposures	3,347.8	302.1	1,568.0	23,214.6	646.6	29,079.1

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details. The corporate and central governments or central bank exposure maturity splits have also been represented.

6.3 Retail lending 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 residential mortgage market in the Channel Islands and in the UK buy-to-let market.

Table 11 below shows the mix of the loans and advances to customers at the reporting date net of impairment. The full group position reported in the Group's Annual Report and Accounts eliminates intra group trading and is therefore lower than the prudential consolidation group position.

Table 11 Loans and advances to customers

	2021 £m	2020 £m
Loans and advances to customers held at amortised cost	**22,678.3**	21,524.2
Loans and advances to customers held at FVTPL	**1.2**	1.3
Equity release portfolio held at FVTPL	**406.6**	433.8
Commercial loans	**178.8**	201.2
Debt factoring advances	**119.5**	85.0
Other loans	**65.4**	70.9
Total	**23,449.8**	22,316.4

The Group has increased its overall lending throughout the year with both the Society and SIL growing their mortgage books, with the exception of commercial loans which continue to run-off since lending ceased in 2008 and the equity release portfolio.

Table 12 below sets out the retail lending profile and is reported gross of impairment and excludes a negative fair value adjustment for hedged risk of £183.2m (2020: the adjustment was positive £152.2m).

Table 12 Retail lending analysis

	2021		2020	
Lending analysis	**£m**	**%**	£m	%
Prime:				
Residential	**17,165.2**	**75.0**	16,144.0	75.4
Buy-to-let	**5,335.0**	**23.3**	4,811.0	22.5
Self build	**13.0**	**0.1**	35.4	0.2
Fast track	**19.9**	**0.1**	25.3	0.1
Self certified	**261.3**	**1.1**	276.6	1.3
Sub-Prime:				
Residential	**14.4**	**0.1**	19.4	0.1
Buy-to-let	**14.5**	**0.1**	19.4	0.1
Self build	**-**	**-**	0.5	-
Self certified	**49.0**	**0.2**	63.5	0.3
Total	**22,872.3**	**100.0**	21,395.1	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 judgments 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 sub-prime lending relates to portfolios that are all in run-off.

Further information on the geographical breakdown of the mortgage book based on the location of the property and related loan-to-value (LTV) analysis is available in note 40 of the Group's Annual Report and Accounts.

6.4 Retail lending credit risk mitigation

The Group has available 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 described in section 6.9.

In certain circumstances, the Group renegotiates loans to customers in financial difficulties (referred to as forbearance activities) to maximise collection opportunities and minimise the risk of default whilst ensuring 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 loan 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 typically include extending the maturity of the loan, changing the timing of interest payments or amending the terms of loan covenants.

The RCC regularly reviews reports on forbearance activities.

During 2020 and 2021, a number of payment deferrals were granted in response to COVID-19, offering an initial three-month mortgage payment deferral, subsequently extended upon request for up to six months, with interest continuing to accrue on these loans. In accordance with regulatory guidance, these mortgage payment deferrals are not automatically recorded as forbearance cases and do not automatically have an impact on the reported staging of balances except where credit risk is judged to have significantly increased since the loan was initially recognised.

Possession is generally considered only as a last resort, once all other options for the customer have been exhausted. Possession balances represent loans against which the Group has taken ownership of properties pending their sale. For the Group, at 31 December 2021 the balance of residential loans where the property has been taken into possession was £2.1m and represents approximately 0.1% of total outstanding loans (2020: £1.1m; less than 0.1%).

Typically, retail 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 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.

6.5 Commercial credit risk

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

An analysis of loans secured on commercial property by industry type is provided in Table 13 below and is reported gross of impairment.

Table 13 Commercial lending analysis

	2021		2020	
Industry analysis	**£m**	**%**	£m	%
Leisure and hotels	**18.4**	**9.4**	19.5	8.9
Retail	**4.7**	**2.4**	5.4	2.5
Nursing / residential homes	**10.1**	**5.2**	11.6	5.3
Offices	**2.1**	**1.1**	2.5	1.1
Commercial and industrial units	**156.8**	**80.4**	176.6	80.6
Miscellaneous	**2.9**	**1.5**	3.4	1.6
Total	**195.0**	**100.0**	219.0	100.0

A geographical breakdown of the commercial mortgage book based on the location of the property and related LTV analysis is available in note 40 of the Group's Annual Report and Accounts.

6.6 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 a 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 CRR 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, 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.

The Group's policy on forbearance for commercial mortgages is the same as the policy for residential mortgages as set out in section 6.4.

6.7 Debt factoring / invoice discounting

Debt factoring advances relate to amounts advanced to clients by SBF, the Group's debt factoring and invoice discounting business. In 2021, SBF successfully gained accreditation to partake in the Government's Recovery Loan Scheme (RLS). This enables SBF to offer RLS loans and RLS Invoice Finance facilities with the Government guaranteeing 80% of all future losses.

The credit and operational risk associated with SBF activities is managed through participation in the Group's operational risk framework and related policies, 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, telephone verification of debtors and individual invoices on a sample basis, close client relationships, regular client account monitoring and ongoing operational risk monitoring. Credit risk in relation to debtors is mitigated by individual exposure monitoring (concentration limits) as well as on an aggregated portfolio basis 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, further assurance is provided by regular internal audits on a scheduled risk basis as agreed with the Society. Summary reports are also submitted to the Group Board and the Society's RCC on a monthly basis.

SBF's debt factoring advances to SMEs were £115.9m as at 31 December 2021 (2020: £81.7m).

6.8 Concentration risk

Concentration risk is the risk that the Group suffers disproportionate losses due to a lack of portfolio diversity including being over-exposed to counterparty, sectoral, geographic, product type or other portfolio concentrations.

Both retail and commercial mortgage 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 on a monthly basis. Concentration risk is also reported to the Board each month. 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.

The Group's exposures are predominantly concentrated in the UK with some exposure to the Channel Islands through SIL. Credit exposures are however well diversified at a regional level and are controlled via risk appetite limits which 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 (a sub-committee of ALCO) and ALCO monthly.

6.9 IRB rating system

A rating system has been developed for the Society's retail 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 on a monthly basis. All mortgages measured using the IRB Approach are or were originated in the UK and relate to UK properties.

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

6.9.1 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 the next twelve months. It also takes into account potential indications that the borrower is unlikely to pay, for example the borrower being made bankrupt.

The PD model uses data about the property and the borrower combined with credit bureau information to derive a credit score for each borrower. This score is then calibrated to give an account level PD.

For accounts less than three months old the application score is mapped to a behavioural score and then a PD is calculated through the PD model.

6.9.2 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 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.

6.9.3 Loss given default (LGD) model

The LGD model, for capital purposes, 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 in the event of a downturn in property valuations.

6.9.4 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 CRR and is used to calculate the unexpected loss capital requirement.

6.9.5 IRB retail lending

Table 14 below provides a breakdown of the capital requirement for the retail mortgage exposures to which the IRB Approach applies.

Table 14 IRB mortgage portfolio comparison

Mortgage portfolio 2021	**Original on-balance sheet gross exposure [2]**	**Off-balance sheet exposures post CCF [3]**	**% of total IRB mortgage exposures**	**Portfolio average risk weight percent**	**Risk weighted assets**
	£m	**£m**	**%**	**%**	**£m**
Society [1]	**21,125.7**	**1,338.0**	**100.0**	**7.1**	**1,584.5**

Mortgage portfolio 2020	Original on-balance sheet gross exposure [2]	Off-balance sheet exposures post CCF [3]	% of total IRB mortgage exposures	Portfolio average risk weight percent	Risk weighted assets
	£m	£m	%	%	£m
Society	19,197.7	1,132.0	97.1	6.9	1,396.8
Amber Homeloans	397.3	-	1.9	58.5	232.3
North Yorkshire Mortgages	200.4	-	1.0	41.7	83.5
Total	19,795.4	1,132.0	100.0	8.2	1,712.6

Notes
1. From 1 June 2021, the Amber Homeloans and North Yorkshire Mortgages portfolios were successfully integrated into the Society portfolio.
2. The original on-balance sheet exposure is not adjusted for impairment in accordance with Article 166.
3. CCF is the credit conversion factor applied to credit commitments for mortgages not yet drawn down.

The above table shows that the portfolio average risk weight percent has reduced from 8.2% to 7.1%. The key driver for this reduction is that the risk weights required for Society new lending are significantly lower than the risk weights for accounts that have redeemed during the year, which includes redemptions from our specialist mortgage portfolios which have generally higher RWAs. We also note improved portfolio quality driven by strong house price growth seen in 2021 and improvements in arrears.

Further details are set out in Appendix 7 for the main parameters used for the calculation of capital requirements for IRB models.

6.9.6 IRB model performance

This section provides an analysis of the performance of the IRB models over the year to 31 December 2021. The performance of models for both IRB retail mortgages and credit commitments for mortgages not yet drawn down is considered. The PD and LGD predictions against actual results are shown below.

Table 15 IRB model performance

IRB retail mortgages 2021	**Predicted Probability of Default %**	**Observed Probability of Default %**	**Predicted Loss Given Default %**	**Observed Loss Given Default %**
Society [1]	**0.40**	**0.24**	**18.70**	**2.18**
IRB retail mortgages 2020	Predicted Probability of Default %	Observed Probability of Default %	Predicted Loss Given Default %	Observed Loss Given Default %
Society	0.38	0.19	19.12	4.36
Amber Homeloans	4.36	3.70	30.49	2.97
North Yorkshire Mortgages	3.45	2.58	23.78	2.44
Combined portfolio total	0.52	0.30	19.43	3.34

Note

1. From 1 June 2021, the Amber Homeloans and North Yorkshire Mortgages portfolios were successfully integrated into the Society portfolio.

The PD for December 2021 shows the prediction for accounts that were up-to-date or less than 3 months in arrears as at December 2020. The observed default rate is calculated for these accounts over the next 12 months to December 2021. For up-to-date and in-arrears accounts, the combined portfolio PD is 0.40% against an observed default rate of 0.24%.

The predicted PD across the combined portfolio continues to be higher than the observed default rate, demonstrating that the estimates remain appropriately prudent. The predicted PD and observed default rate for the combined portfolio have both reduced compared to 2020 due to the Governments response to the COVID-19 pandemic reducing both the default rate and the proportion of customers in arrears. The predicted LGD values are calculated using parameters reflective of an economic downturn. The observed LGD is calculated as the actual loss amount for accounts in default, as a proportion of the balance associated with these cases, using a five-year measurement period. The measurement period is reflective of the typical time experienced by the Society for losses to be realised. The observed losses have been discounted consistently with the predicted losses to aid in comparability.

The predicted LGD across each portfolio continues to be higher than observed due to the use of appropriately prudent economic downturn parameters in the predicted value calculation, which is a regulatory requirement. There has been a reduction in the observed LGD compared to 2020, due to a decrease in the proportion of defaults resulting in a possession sale in the 5 year window (8.9% vs 13.4%).

6.9.7 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:

- 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;
- Calculating a risk adjusted return on capital for mortgage products; and
- To inform and monitor exposures against the Society’s Credit Risk Appetite.

We continue to enhance our IRB credit risk models to ensure effective risk management 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.

6.9.8 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.

The following table sets out a comparison of expected loss to impairment provisions.

Table 16 IRB expected loss and impairment provisions

	IRB Expected loss 2021 £m	**IFRS 9 Expected loss 2021 £m**	IRB Expected loss 2020 £m	IFRS 9 Expected loss 2020 £m
IRB Retail mortgages				
Society [1]	**15.3**	**10.8**	10.6	12.4
Amber Homeloans	**-**	**-**	5.9	8.5
North Yorkshire Mortgages	**-**	**-**	1.7	2.2
	15.3	**10.8**	18.2	23.1
Equity exposures				
Society	**2.0**	**-**	2.0	-
Total	**17.3**	**10.8**	20.2	23.1

Note
1. From 1 June 2021, the Amber Homeloans and North Yorkshire Mortgages portfolios were successfully integrated into the Society portfolio.

IRB expected loss is calculated in line with the regulatory requirements for capital. The IFRS 9 expected loss for impairment is calculated in line with the International Financial Reporting Standard. A key area of difference is that the IRB expected loss includes estimates that reflect a severe economic downturn, whilst IFRS 9 calculations reflect a weighted probability of a range of economic scenarios. This has led to differences in the impact that COVID-19 has had on IRB and IFRS 9 expected losses. The expected loss figures also include an amount equal to 2.4% of equity exposures, calculated in accordance with Article 158 of the CRR.

The Society's IFRS 9 expected losses have reduced significantly over the last 12 months primarily driven by changes to the Society's forward-looking economic scenarios. The Society's forward-looking economic assumptions are significantly more favourable at the end of 2021 than they had been at the end of 2020. The Society has seen a minor reduction in IRB expected losses compared to 2020. The drivers for this reduction are consistent with the drivers for the reduction in portfolio average risk weight percent detailed in section 6.9.5.

6.10 Controls and governance

6.10.1 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.

All amendments, updates and any new models are also subject to independent validation and approved by the MGC.

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 and Risk Modelling team who assess the performance of the models using various statistical techniques.

Oversight of all model monitoring activity is provided by the MGC, which is chaired by the Chief Financial Risk and Data Officer, and comprises the Chief Operating Officer, and a number of senior managers from across the Society. MGC reports into BRC and provides BRC with a quarterly update report.

Monitoring reports include an assessment of performance against trigger limits. If appropriate, the Credit Risk and Risk Modelling team will make recommendations for amendments or updates to the models based on the information reported. Any changes to the models and implementation of any new models require approval from MGC.

Regular independent reviews are performed by the Internal Audit function with outcomes reported to the MGC and the Board Audit Committee.

Overall accountability for the credit risk and IRB models and the governance framework applied sits with the Chief Financial Risk and Data Officer.

6.10.2 Independent validation

The Society's IRB Models are subject to regular independent validation and MGC approval. The independent validator:

- Reviews the frequency, quality and appropriateness of the model monitoring reports;
- Reviews the appropriateness of the Credit Risk and Risk 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 and Risk Modelling team;
- Provides independent assessment of compliance with prevailing regulation; and
- Reviews model documentation prepared by the Credit Risk and Risk Modelling team.

7 Wholesale 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 credit risk also incorporates counterparty credit risk exposures resulting from derivative and repurchase transactions.

7.1 Management of wholesale credit risk

We regularly review and closely monitor the number of counterparties to whom we will lend and, for those counterparties to whom we have lent; we review both the amount and duration of any limits. We also review the exposures to counterparties resulting from derivative and repurchase transactions as part of this assessment. Netting and collateralisation agreements are used to reduce counterparty credit exposure; these are discussed further in section 7.2 and 7.3.

The allocation of counterparty 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. 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 stress scenarios. The adequacy of collateral securing covered bonds held by the Society is also reviewed on a quarterly basis.

The Group's treasury investments are held to provide liquidity and 99.9% (2020: 99.9%) of the Group's treasury investments, excluding exposures to a central clearing house used to clear derivatives to manage interest rate risk in line with regulation, are rated A3 or better. The Group's policy is that initial investments in treasury assets are typically A3 or better (with the exception of some unrated building societies where separate credit analysis is undertaken).

If the credit rating for an exposure is downgraded such that it no longer meets this rating criteria 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.

Table below sets out the ECAIs ratings mapped to risk weights for the Group's exposures.

Table 17 Mapping for External Credit Assessment Institutions ratings

Credit quality step	Fitch	Moody's	Central governments and central banks	Multilateral development banks	Institutions (< 3 months maturity)	Institutions (> 3 months maturity)	Covered Bonds	Corporates
1	**AAA to AA-**	**Aaa to Aa3**	0%	0%	20%	20%	10%	20%
2	**A+ to A-**	**A1 to A3**	20%	50%	50%	20%	20%	50%
3	**BBB+ to BBB-**	**Baa1 to Baa3**	50%	50%	100%	50%	20%	100%
4	**BB+ to BB-**	**Ba1 to Ba3**	100%	100%	150%	100%	50%	100%
5	**B+ to B-**	**B1 to B3**	100%	100%	150%	100%	50%	150%
6	**Inferior to B-**	**Inferior to B3**	150%	150%	150%	150%	100%	150%

Table 18 below sets out exposure values, including additional valuation adjustments, resulting from wholesale asset lending for the applicable exposure class associated credit quality step under the Standardised Approach for the prudential consolidation group. Exposures have no applicable credit risk mitigation.

Table 18 Treasury exposures by class

	Credit quality step	2021 £m	2020 Restated* £m
Central governments or central banks	1	3,006.9	3,550.9
Multilateral development banks	1	850.8	640.2
Institutions (< 3 months maturity)	Unrated	0.1	-
Institutions (< 3 months maturity)	1	65.3	15.2
Institutions (> 3 months maturity)	1	-	172.5
Institutions (no stated maturity)	1	3.0	0.1
Institutions (< 3 months maturity)	2	33.5	115.2
Institutions (> 3 months maturity)	2	314.4	-
Institutions (no stated maturity)	2	126.5	178.5
Covered bonds	1	260.0	202.6
Corporates [1]	Unrated	199.8	394.8
Total exposures		**4,860.3**	5,270.0

* The 2020 figures have been restated for the institution's exposure maturity split.

Note

1. These items are exposures in relation to London Clearing House collateral.

The Group has increased investments in short dated certificates of deposit and seen a reduction in collateral pledged to institutions for both cleared and non-cleared derivative transactions. The Group has also increased investments in highly rated multilateral development banks and reduced in the amount held with central banks.

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.

The Group does not currently use credit derivatives for risk mitigation in respect of wholesale credit exposures.

7.2 Counterparty credit risk in relation to derivative transactions

Counterparty credit risk in relation to derivatives is the risk that a counterparty defaults and the Society is then required to replace swaps which had a positive market value at current prices.

The Group uses derivative instruments (interest rate and foreign currency) 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, including cross currency swaps.

The Group measures derivative counterparty credit exposure values using the counterparty credit risk mark to market method. Under this method, exposure is derived by adding the replacement cost of the derivatives (the market value of derivative relationships in a net asset position, from the Society's perspective) to the cumulative potential future credit exposure of all derivative relationships. The potential future credit exposure of an individual derivative contract is calculated by multiplying the notional amount of the derivative by a percentage, which is determined by the residual maturity and type of contract.

The Group addresses the counterparty credit risk associated with derivatives by using legal documentation for 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 collateral to set against derivative credit exposures in the event of counterparty default. Derivative positions and collateral are valued daily and compared with counterparty valuations. 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 'minimum transfer amounts' which set criteria to avoid the movement of small amounts of collateral. Any disputes in value are monitored and escalated by the dispute resolution procedures.

The Society is only permitted to receive and post cash as collateral or margin in respect of derivative exposure. The only exception relates to cross currency swaps, used to hedge the interest rate and foreign exchange risks associated with non-sterling denominated covered bonds, where high quality sovereign securities could be received by Skipton Covered Bond Limited Liability Partnership (LLP).

The Society has an indirect relationship with a central counterparty to clear standardised derivatives which are subject to mandatory clearing under EU regulatory requirements. Under central clearing, margin is exchanged on a daily basis.

Table 19 below provides exposure values, including additional valuation adjustments, on derivative counterparty credit risk exposures for the prudential consolidation group.

Table 19 Counterparty credit risk exposures

	2021	2020
	£m	£m
Gross positive fair value of contracts	**227.9**	64.1
Netting benefits	**(80.4)**	(47.8)
Replacement cost of derivatives	**147.5**	16.3
Potential future credit exposure	**107.2**	99.6
Total derivative credit exposure	**254.7**	115.9
of which: Institutions	**33.3**	83.3
of which: Corporates	**221.4**	32.6
Collateral held	**(144.6)**	-
Asset valuation adjustment	**(0.2)**	(0.2)
Total	**109.9**	115.7

There has been an increase in the positive fair value of derivative contracts due to higher market interest rates during the year. Cleared derivative contracts, shown under Corporates, form most of the Group's exposure. If the Society's credit ratings were downgraded, there would be no impact on the collateral required to be posted in relation to existing swap agreements, other than the asset swap being provided by the Society to Skipton Covered Bond LLP.

The credit valuation adjustment (CVA) capital charge is calculated from counterparty credit risk exposures reported in Table 20.

Table 20 **Credit valuation adjustment (CVA) capital charge**

	Exposure value		**Risk weighted assets**	
	2021	2020	**2021**	2020
	£m	£m	**£m**	£m
Credit valuation adjustment (CVA) capital charge	**254.7**	115.9	**29.2**	66.3

The CVA exposure value has increased in 2021 because of the increase in the positive fair value of derivative contracts in the period. The risk weighted asset position has however decreased, as a greater proportion of the exposure is in the form of cleared derivative contracts which carry a lower risk weighting.

7.3 Counterparty credit risk in relation to repurchase transactions

As part of liquidity management, repurchase transactions are occasionally entered into by the Society with another counterparty. Under these transactions, highly rated securities are sold to another counterparty in return for cash with an agreement to repurchase these assets at an agreed price at a later date. Counterparty credit exposure can therefore result if the cash received by the Society is less than the market value of the assets.

For repurchase agreements, the Global Master Repurchase Agreement 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.

If the Society's credit ratings were downgraded, there would be no impact on the collateral required to be posted in relation to existing repurchase agreements.

At the reporting date, the Group's exposure to counterparty credit risk from this type of transaction was £nil (2020: £18k).

7.4 Wrong-way risk

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 has little exposure to this type of risk as it currently only accepts cash or high quality sovereign debt securities as collateral.

8 Impairment provisions

8.1 Impairment provisions definitions

The Group carries out an assessment of impairment of loans and advances to customers at each reporting date. For accounting purposes, all impairment provisions are calculated in line with IFRS 9 which provides for expected credit losses (ECL[6]) based on the credit risk categorisation of the exposure. All assets are categorised into three stages as follows:

Stage 1 A financial asset which has not experienced a significant increase in credit risk since origination. 12 month ECLs are recognised and interest revenue is determined by the effective interest rate (EIR) on the gross carrying amount.

Stage 2 A financial asset which has experienced a significant increase in credit risk since initial recognition. Lifetime ECLs are recognised and interest revenue is determined by the EIR on the gross carrying amount.

Stage 3 A financial asset which is identified as in default and considered credit impaired. Lifetime ECLs are recognised and interest revenue is determined by the EIR on the net carrying amount.

8.2 Retail lending impairment provisions

Table 21 sets out the gross retail loans and advances to customers by impairment stage status and past due balances. Past due loans are classified as three or more months in arrears.

Table 21 Impairment stages - Retail lending

As at 31 December 2021	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Retail lending	**22,343.3**	**458.9**	**70.1**	**22,872.3**
of which past due	**-**	**77.9**	**59.6**	**137.5**

As at 31 December 2020	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Retail lending	19,135.9	2,184.4	74.8	21,395.1
of which past due	-	109.9	66.3	176.2

Despite the challenges caused by COVID-19 the performance of residential mortgages has been stable throughout 2021. At the reporting date, 0.60% of retail loans were classed as past due compared to 0.82% in 2020. Arrears have remained low, in part due to the government support schemes and the COVID-19 payment deferrals. The last of these COVID-19 payment deferrals ended in October 2021.

As shown in the table above, during 2021 there was a net decrease in stage 2 loans of £1,725.5m for the Group. The Group has revised its view on forward-looking economic indicators to a more positive outlook than the view applied by the Group as at 31 December 2020; as a result, a number of accounts which were previously held in stage 2 were assessed to no longer meet the ‘significant increase in credit risk’ criteria and were thus transferred back to stage 1. See note 1w) of the Group’s Annual Report and Accounts for further details.

[6] ECL represents the present value of all cash shortfalls over the expected life of the financial instrument to determine impairment allowances under IFRS 9.

Table 22 below provides information on movements in the impairment loss allowance for retail loans during the year.

Table 22 Impairment charges – Retail lending

	2021 £m
Loss allowance at 1 January 2021	**23.1**
Amounts written off during the year, net of recoveries	**(0.8)**
Income statement credit for the year	**(11.4)**
Loss allowance at 31 December 2021	**10.9**

The impairment on residential loans and advances to customers was a £11.4m credit (2020: £13.7m charge). The key driver for this credit to profit for the year is the changes made to the Society's forward-looking economic assumptions, which have been updated to reflect the improved economic outlook as the UK emerges from the height of the COVID-19 pandemic; full details can be found in note 1w) of the Group's Annual Reports and Accounts.

Further information on retail loan stages broken down by types of lending and significant geographical areas is available in the note 40 of the Group's Annual Report and Accounts.

8.3 Commercial lending impairment provisions

Table 23 sets out the gross commercial loans by impairment stage status and past due balances. The Society continues to remain appropriately prudent in assessing risk in sectors heavily impacted by the COVID-19 pandemic (Retail, Leisure and Offices) to stage 2.

Table 23 Impairment stages – Commercial lending

As at 31 December 2021	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Commercial lending	**33.6**	**147.4**	**14.0**	**195.0**
of which past due	**0.1**	**11.3**	**12.2**	**23.6**

As at 31 December 2020	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Commercial lending	36.0	161.9	21.1	219.0
of which past due	0.1	20.6	15.3	36.0

Table 24 below shows the impairment loss allowance for the year for commercial loans.

Table 24 Impairment charges – Commercial lending

	2021 £m
Loss allowance at 1 January 2021	**17.8**
Amounts written off during the year, net of recoveries	**-**
Income statement credit for the year	**(1.6)**
Loss allowance at 31 December 2021	**16.2**

Arrears levels within the commercial portfolio have stabilised during 2021 and remain low.

There was a credit to the Income Statement in the year of £1.6m credit (2020: £11.5m charge) for the impairment allowance on this portfolio; this benefit to the Income Statement reflects the more stable arrears position, together with the impact of recent property valuations being better than previously expected. In 2021 we continued to provide support, through concessionary arrangements, to commercial customers who had been financially affected by COVID-19; the majority of these customers have since returned to regular payment terms as the financial difficulties caused by COVID-19 have eased.

Further information on commercial loan stages broken down by industry and significant geographical areas is available in note 40 of the Group's Annual Report and Accounts.

8.4 Impairments of treasury assets

The Group holds treasury investments in order to meet liquidity requirements and for general business purposes. The credit risk arising from these investments is closely monitored and managed by the Group.

At 31 December 2021 none of the Group or the Society's treasury assets were past due (2020: none past due). At 31 December 2021 the ECLs on the Group and the Society's treasury assets were all held as stage 1 (2020: all stage 1).

The impairment loss allowance in respect of treasury assets as at 31 December 2021 was £0.6m (2020: £0.3m).

8.5 Further information on non-performing loans

In 2018, the EBA published the guidelines on disclosure of non-performing exposures (NPEs). The guidelines refer not only to NPEs, but also to performing exposures with a high risk of becoming non-performing, such as stage 2 exposures and forborne exposures. The Group has adopted these guidelines and the relevant templates based on the proportionality are set out in Appendix 9.

9 Securitisation and Issued Covered Bonds

Access to wholesale funding allows the Group to diversify its funding sources and increase the term of funding to assist in managing its basis and refinance risk. The Group carries out securitisation transactions using its own mortgage assets as well as acquiring Residential Mortgage Backed Securities (RMBS) from other third parties.

9.1 Purchased securitisations

The Society has a portfolio of purchased RMBS. All purchased RMBS are held at fair value through other comprehensive income on the Society's Balance Sheet.

The Group's Treasury policy states that all RMBS purchased must pass strict due diligence, and adhere to a clearly defined credit risk policy, including being AAA rated at the time of purchase and the underlying collateral pools being comprised solely of UK assets. The Society also performs regular on-going performance monitoring and stress testing of its RMBS holdings to ensure that the assets remain high quality. RMBS are reviewed in accordance with the CRR and are also reviewed in accordance with the EU Securitisation Regulation.

Since the beginning of 2019, regulation has been in place which gives issuers the option to add a Simple, Transparent and Standardised (STS) label to their RMBS. The label is designed to make it clearer for investors to understand and assess the risks of investment. These bonds also come with capital and liquidity benefits for investors. The Society purchased £59m of RMBS in 2021, £42m of which were STS.

Capital requirements for purchased RMBS are calculated based on the external ratings-based approach (ERBA). This approach uses the credit quality of the instrument, as with all other liquid assets, and the final legal maturity of the tranche to arrive at a risk weight percentage. In 2021, the Group's average risk weight percentage on its non-STS RMBS was 15.5% (2020: 16.6%), and for its STS RMBS was 10% (2020: 10%).

Table 25 Purchased securitisation exposures

	2021 £m	2020 £m
Securitisation positions	**169.9**	157.5
of which STS:	**139.0**	100.9

9.2 Originated securitisations

This section sets out securitisation activity in line with Article 449 of the CRR for funding purposes using mortgage assets owned by the Group and the issuance of securitisation notes.

The Group has securitised certain residential mortgage loans by the transfer of the beneficial interest in such loans to one (as at 31 December 2021) special purpose vehicle (SPV). The legal title to the mortgages remains with the Group and would only transfer to the SPV in limited circumstances, including the insolvency of the Society. The securitisation issuance of notes enables a subsequent raising of debt to investors who gain the security of the underlying assets as collateral. The SPV is fully consolidated into the Group's Accounts in accordance with the Society's accounting policies for securitisation activities under IFRS 10. The SPV is funded through loans from the Society and its activities are carried out under the direction of the Society, in line with the transaction documentation. The Society is exposed to variable returns from this entity and has the ability to affect these returns in line with the transaction documentation; this SPV therefore passes the test of control under IFRS 10 and is fully consolidated into the Group Accounts.

For securitisations, the transfers of the mortgage loans to the SPVs are not treated as sales and the loans are not derecognised but remain on the Society's own balance sheet, as it retains the risks and rewards of the mortgage loans through the receipt of substantially all of the profits of the SPVs. In the Society's accounts, the proceeds received from the transfer of mortgage loans to structured entities are accounted for as a deemed loan from the SPV and are disclosed within amounts owed to other customers on the balance sheet. The mortgage loans acquired by the SPV remain on the Statement of Financial Position of the Society as they do not satisfy the IFRS9 derecognition criteria.

During 2021, the SPV named Darrowby No. 4 plc (Darrowby 4) repaid its outstanding funding and is in the process of being liquidated. The SPV named Darrowby No. 5 plc (Darrowby 5), constituted wholesale funding of £305.3m (2020: £407.1m) (net of unamortised issue costs).

The roles that the Society takes in relation to the securitisation transactions is set out below. The Society retains the first loss element:

Table 26 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 5	✓	Repaid	✓	✓

The securitisation 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, and these continue to be calculated in line with capital requirements consistent with other mortgage assets.

Nature of the risks including liquidity risk inherent in securitised assets

The Directors of the SPV's have responsibility for the overall system of internal control and for reviewing its effectiveness. When the transactions were entered into, derivative instruments were taken out, with a third party, to manage the associated risk of fixed rate income versus floating rate expense. The effectiveness of the risk management is monitored on an ongoing basis. More detail regarding the management of these risks is given in note 13 of the Group's Annual Report and Accounts.

The SPV's operations are financed primarily by means of the Notes. The SPV's issued such financial instruments to finance the acquisition of its portfolio of mortgage loans. The SPV uses derivative financial instruments (a swap) to economically hedge against the possible variance between the fixed rates of interest receivable on the mortgage loans in the portfolio and the floating rates of interest payable on the Notes.

The principal risks arising from the SPV's financial instruments are credit risk, liquidity risk, interest rate risk and operational risk.

The key risks and uncertainties faced by the SPV are managed within the framework established for the Group.

Credit risk

The SPV is exposed through the deemed loan to the risk of default in payment by the borrowers and the failure by the Society acting as administrator on behalf of the SPV, to realise or recover sufficient funds under the arrears and default procedures in respect of the loan and related security in order to discharge all amounts due and owing by the relevant borrowers under the loans, which may adversely affect payments on the Notes. The risk to the noteholders is mitigated to some extent by certain credit enhancement features.

Liquidity risk

The SPV's are subject to the risk of insufficiency of funds on any interest payment date as a result of payments being made late by borrowers after the end of the relevant collection period. This risk is addressed in respect of the Notes by the provision of liquidity from the General Reserve Fund. To the extent that an income deficit remains following the application of Available Revenue Receipts, the risk is further addressed by the provision of liquidity from Principal Receipts.

Interest rate risk

The SPV's minimise exposure to interest rate risk by ensuring that the interest rate characteristics of its assets and liabilities are similar. Where this is not possible, the SPV uses derivative financial instruments to mitigate any residual interest rate risk.

At the year end Darrowby 5 was party to an interest rate swap, used to economically hedge against interest rate risk arising from the resetting of interest rates of assets and liabilities on different bases.

Operational risk

In order to meet its obligations to the Noteholders, the SPV has entered into contracts with a number of third parties who have agreed to provide operational support to the Company in accordance with the Transaction Documents.

CSC Capital Markets has been appointed to provide corporate services in accordance with a corporate service agreement for the Darrowby 5 securitisation. Other third parties who have agreed to provide services with respect to the Notes include the paying agents, transaction account provider and swap provider. The Society acts as administrator and cash manager and is sufficiently rated to fulfil this role without the need for a back-up. The SPV activities are subject to periodic review by the Seller's internal audit department.

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, both recognised ECAI's under the European Banking Authority. The notes were called and repaid in full in February 2021.

Darrowby 5 was incorporated in November 2018. In February 2020, Darrowby 5 issued £600m of AAA rated debt securities. The notes are rated by both Fitch and Moody's, both recognised ECAI's under the European Banking Authority. As at 31 December 2021, rated debt securities totalled £393.2m (2020: £524.4m) of which £86.8m (2020: £115.8m) was held by the Group.

The performance of the securitisation funding transaction is monitored on a monthly basis by the Society's Secured Funding Group. Further details on the SPV is shown in Table 27 below:

Table 27 Special purpose vehicles

31 December 2021

Securitisation company [1]	Gross Assets Securitised £m	Notes held by third parties [2] £m	Notes held by the Group [2,3] £m	Underlying assets in arrears [4] £m
Darrowby 5	**453.4**	**306.4**	**153.5**	**0.5**

31 December 2020

Securitisation company [1]	Gross Assets Securitised £m	Notes held by third parties [2] £m	Notes held by the Group [2,3] £m	Underlying assets in arrears [4] £m
Darrowby 4	117.8	57.8	63.9	0.2
Darrowby 5	578.3	408.6	182.5	0.3

Notes

1. All securitisation companies are classed as the residential mortgage backed securities.
2. Excludes accrued interest and adjustment for unamortised issue cost.
3. Class B notes and retained rated Class A notes (and those partially pledged in a repurchase agreement).
4. A mortgage account where one or more monthly payments have become due and remain unpaid.

9.3 Issued covered bonds

Skipton Covered Bonds Limited Liability Partnership (LLP) provides a guarantee for issues of covered bonds by the Society. As at 31 December 2021, the Society had £1bn (2020: £1bn) and €1bn (2020: €1bn) of covered bonds in issue. At the reporting date, the Society has over-collateralised the LLP with £818m (2020: £819m) of mortgages to secure the ratings of the covered bonds and to provide operational flexibility. From time to time, the obligation of the Society to provide collateral may increase due to the formal requirements of the covered bonds programme and the value of the collateral would depend upon conditions at that time. The Society may also voluntarily contribute collateral to support the covered bond ratings.

During the period, the Society voluntarily repurchased £36.0m (2020: £26.6m) of mortgages from the LLP to maintain the quality of the pool and the over-collateralisation requirement.

For covered bonds, the Society issues the covered bonds (and not the LLP) and then lends the proceeds to the LLP on back to back terms. In the accounts of the Society, neither the loan to the LLP nor the consideration for the transfer of mortgage loans are recognised separately as an additional asset and liability. This avoids the 'grossing up' of the financial statements that would otherwise arise.

The LLP undertakes interest rate and cross currency swaps under separate ISDA agreements. Each agreement includes a Credit Support Annex (CSA) which provides for collateralisation of the swap exposure above a certain threshold.

10 Operational risk

10.1 Operational risk definition

The Group's definition of operational risk includes conduct risk and is defined as the risk of poor customer outcome or loss, resulting from inadequate or failed internal processes, systems, people, culture or behaviours and/or from external factors.

10.2 Operational risk management framework

The Group places high importance on the strength of the control environment and the operational risk management processes and oversight arrangements.

The Operational Risk Framework is in place to assist achievement of the Group Corporate Plan and strategic objectives, by ensuring the Group optimises the balance between risk and reward within risk appetite, conforms with applicable rules, regulations, mandatory obligations and protects the Group's reputation through:

- Ensuring all colleagues have a responsibility to identify, assess, manage, and report risks, supporting a risk aware culture across the 'three lines of defence' model as outlined in section 3.2;
- Understanding and maintaining fair customer outcomes and experience throughout the customer journey;
- Ensuring that an appropriate level of capital is held in support of the Group's operational risks through the analysis of extreme but plausible stressed scenarios; and
- Ensuring that appropriate information is available to support effective decision making and to identify and mitigate any potential systemic weaknesses in operating processes or controls.

10.3 Operational risk management

The Board has overall accountability for the risk management within the Group. The Board has delegated the oversight of the management of operational risk to the BRC. The role of the BRC is to ensure that there is appropriate consideration and assessment of future risks and stresses, ensuring that management continue to develop robust strategies to protect the business and its customers.

Throughout the year, the Executive reported to BRC and ensured that an appropriate Operational Risk Framework was in place to identify, assess, manage and report on the operational risks that could impact the ability of the Group to meet its business objectives and serve our customers.

The financial services sector faces an ever changing and complex cyber security, fraud and financial crime landscape, particularly in relation to online channels, which require increasingly sophisticated controls. We continually review and enhance the key controls in place to mitigate these risks.

Operational resilience remains a key focus, to ensure that the Society and subsidiary firms are able to provide a reliable service to customers and to prevent, respond and recover in a timely and organised manner in the event of an operational disruption. This is supported by our Operational Resilience Policy, Framework and governance structure. The continued response of the Society and its subsidiaries to the ongoing pandemic through periods of lockdown, remote working and remobilisation, tested and demonstrated that the Risk Management Framework operated effectively in ensuring that the business continued to operate within risk appetite and maintain operational resilience. This allowed the Society to continue to offer high levels of customer service during a period of significant uncertainty with work ongoing to develop our new ways of working in a post pandemic world and changing customer and colleague expectations.

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. Regulated businesses actively monitor these regulations and ensure that appropriate controls are implemented to meet new and existing requirements.

The ability to attract and retain talent in an increasingly competitive market is an industry wide challenge that is expected to continue. Minimising the potential for any detrimental impact to customer outcomes or colleague wellbeing remains a key area of management focus and attention.

The Group has adopted the Standardised Approach to calculate the Pillar 1 capital requirement for operational risk, compliant with the requirements of CRD V. We apply published regulatory risk factors, known as 'beta factors' to the sum of the average of three years' net income, segmented by business line.

The Pillar 1 capital requirement for operational risk at a prudential group level was as follows:

Table 28 Operational risk capital requirement

	2021	2020
	£m	£m
Operational risk weighted asset (RWA)	**440.5**	405.9
Operational risk capital requirement (RWA x 8%)	**35.2**	32.5

To calculate the Group's Pillar 2 requirement for operational risk, we created and assessed a series of single-factor and multi-factor scenarios over different levels of stress.

11 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 and foreign currency 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 section 11.1 below. The Society is not impacted by commodity price risk. 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 12.2.

11.1 Interest rate risk

The main market risk faced by the Group is interest rate risk. Interest rate risk is the risk of loss arising from adverse movements in market interest rates.

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

11.1.1 Repricing gap analysis

To assess the Pillar 2 capital requirement for interest rate risk, the Group monitors interest rate risk exposure against limits by determining the effect on the Group's current net notional value of assets and liabilities for a parallel shift in interest rates equivalent to 2% for all maturities, in line with regulatory requirements. These results are compared to the Board limit and operational trigger at least weekly and are 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.

11.1.2 Earnings-at-risk and market value sensitivity

Other interest rate risk metrics employed by the Group incorporate earnings-at-risk and market value methodologies. The market value exposure position is calculated using at least 250 monthly yield curve movements from, approximately, the last seven years. The earnings-at-risk methodology is calculated using at least 100 stochastically (randomly) generated rate paths. Both of these approaches employ 95% confidence intervals. The outputs of these interest rate risk measurement methodologies are compared to their respective Board limits and operational triggers at least weekly and are reported to ALCO and the Board monthly. All these measures are used to guide interest rate risk management decisions.

The interest rate exposures during 2021 were as follows:

Table 29 Interest rate exposures

	2021				2020
	Exposure £m	**Average £m**	**High £m**	**Low £m**	Exposure £m
Static earnings-at-risk	**3.8**	**4.0**	**15.0**	**0.4**	0.4
Historical value-at-risk	**1.2**	**3.5**	**5.1**	**1.2**	1.1
-2% parallel interest rate shift	**(9.2)**	**(19.6)**	**(5.1)**	**(35.9)**	1.2
+2% parallel interest rate shift	**7.0**	**13.8**	**28.6**	**0.6**	(3.2)

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

Throughout 2021, given the current economic uncertainty the Group has prudently managed its interest rate risk exposure within the Board's risk appetite. The increase in exposure to rising interest rates is a result of a small portfolio of unhedged fixed rate liquid assets.

Further information on market risk is available in note 39 of the Group's Annual Report and Accounts.

11.2 Currency risk

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

Both at 31 December 2021 and during the year, the Society and its subsidiaries had no material direct exposure to foreign currency exchange fluctuations. The currency risk appetite of the Group is low and any funding issues denominated in foreign currency are immediately swapped into sterling.

The Group has issued two regulated covered bonds in Euros totalling €1bn (2020: two bonds, €1bn). The exposure to foreign currency fluctuations on these bonds are fully hedged as derivative contracts were taken out to swap the Euros into Sterling on issuance of the covered bonds.

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

In addition, a number of the Group's businesses undertake transactions denominated in foreign currency as part of their normal business. Any amounts outstanding at 31 December 2021 are not material.

The Group's exposure to foreign exchange risk is calculated in accordance with CRD V, representing 8% of the net sterling equivalent of the foreign currency assets and liabilities. The own funds requirement for foreign-exchange risk, calculated using guidance in Article 352 of the CRR, is below 2% de minimis limits of total own funds. Since this is below the threshold set out in Article 351 of the CRR, the Group's foreign exchange exposures are not reported.

11.3 Market risk mitigation

The Group's Treasury function is responsible for managing the Group's exposure to all aspects of market risk within the operational limits set out in the Group's Treasury policy, which is reviewed and recommended by ALCO and approved by the Board on an annual basis.

The Group's Market & Liquidity Risk function measures and monitors adherence to the Treasury policy and reports regularly on all aspects of market risk exposure, including interest rate risk and foreign currency 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.

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.

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 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.

The Group holds capital to absorb potential losses for any risks that are unable to be mitigated through the use of derivatives.

12 Other risks faced by the business

12.1 Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its current and future financial obligations as they fall due, or is only able to do so at excessive cost.

The Group'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 maturity mismatches within the balance sheet 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 Group continues to hold strong levels of liquid assets to ensure it can meet its liabilities as they fall due and to help mitigate the current economic uncertainty arising from the COVID-19 pandemic. The LCR, a measure designed to ensure that financial institutions have sufficient high quality assets available to meet their liquidity needs for a 30 day liquidity stress scenario, has remained well above both the regulatory limit of 100% and the internal limit set by the Board throughout the period.

The following table shows the breakdown of components of the LCR on a prudential group basis. The values shown have been calculated as a simple average of the twelve month end observations preceding each quarter end.

Table 30 Liquidity Coverage Ratio

	31/03/2021	30/06/2021	30/09/2021	31/12/2021
Liquidity buffer £m	**3,753.7**	**4,027.6**	**4,346.0**	**4,348.9**
Total net cash outflows £m	**2,057.0**	**2,190.4**	**2,255.0**	**2,337.9**
Liquidity Coverage Ratio %	**181.9%**	**183.3%**	**193.1%**	**186.3%**

The LCR is monitored weekly by the Society whilst the Net Stable Funding Ratio [7] (NSFR) is currently measured on a monthly basis using the latest available guidance. The Group's NSFR of 146.7% at 31 December 2021 (2020: 139.2%) is well in excess of the regulatory requirement of 100%, confirming that the Group holds sufficient stable funding to meet the new requirement, which is effective from 1 January 2022.

The Group's main source of funding is retail deposits which, at 31 December 2021, accounted for 80.2% (2020: 79.0%) of our total funding.

The Group conducts at least annually 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.

Further information on liquidity risk is available in note 38 of the Group's Annual Report and Accounts.

[7] The Net Stable Funding Ratio (NSFR) is a long term stable funding metric, which measures the stability of our funding sources relative to the assets (mortgage balances) we are required to fund.

12.2 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 pension legislation.

The Group has funding obligations for three defined benefit schemes, the two primary schemes of which carry funding deficits. The two primary schemes were closed to new entrants on 5 April 1995 and closed to future accrual of benefit by 31 December 2009.

Whilst the pensions Trustee oversees the investment strategy for the pension funds, it is for the boards of the Society and Connells to ensure that the schemes are adequately funded to meet all liabilities.

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

- The Board, at least annually, regularly reviews the Group's pension risk strategy;
- 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 BRC and Board.

The Group also performs stress testing on the pension scheme liabilities and assets as part of the pension risk metrics for BRC and also in its capital planning methodologies articulated in the ICAAP. Note 31 in the Group's Annual Report and Accounts outlines the steps management have undertaken to manage the Group's pension risk exposure.

12.3 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 MGC provides a formal forum for monitoring and managing model risk in the Society, ensuring that all material models:

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

The MGC manages model risk with reference to a defined model risk appetite and governance policy which have both been approved by BRC, and also provide regular updates on model governance compliance to BRC.

12.4 Climate change risk

Climate change risk refers to the commercial impact that climate and environmental changes present to our business model.

The ExCo is responsible for management of the financial and operational risks arising from climate change and the management strategy to mitigate these risks.

Climate change, considered as the combination of extreme weather events and longer-term climate modifications, presents both risks and opportunities to the Society, our members and the wider Group. Climate risks arise from both the potential impacts of climate change as well as societal responses to climate change. Climate risk can therefore manifest in various ways including the impact on traditional risk categories such as credit risk, operational risk and market risk. In addition, climate change presents risks and opportunities with respect to our business model, driven by changing customer and investor sentiments, regulatory expectations and government policy intervention.

Progress has been made during 2021 with respect to embedding our approach to managing the risks from climate change. We have also published a Group Responsible Business Report which includes significantly more detail on our impact on the climate and the actions we are taking which is available on our website.

Other key risks to which the Group is exposed include conduct risk, reputational risk and business risk. These risks are explained in the Risk Management Report of the Group's Annual Report and Accounts, pages 72 to 81.

13 Remuneration

Remuneration in the Society is subject to the PRA and FCA Remuneration Codes. The Remuneration Codes include the principle of proportionality and since 2016, the Society (and SIL, a subsidiary business in scope of the regulations) have been at proportionality 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 considerations on malus and clawback arrangements have applied to remuneration awarded from 2016 onwards. SBF was subject to these additional requirements from 2019.

In accordance with the PRA criteria, MRTs were identified in the core Society, SBF and 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 V requirements for remuneration. Under CRD V changes were made to the criteria for identifying MRTs, which were applied across the Group for 2021. These changes resulted in changes to our MRT numbers with an increase in SBS and a decrease in SBF.

13.1 Decision making

As outlined in section 3.3.5 the Group Remuneration Committee is responsible for ensuring that clear Group Remuneration Principles and standards for the governance of remuneration are set and agreed annually and are adopted by the subsidiary businesses.

13.1.1 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, salary levels of similar positions in comparable organisations and internal benchmarks. Salaries are reviewed annually and individual increases are awarded based on the position to internal benchmark and any cost of living adjustment.

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 Chair of the Board Audit, Board Risk and Remuneration Committees. The Society Chair's fees are reviewed and approved by the Remuneration Committee.

13.1.2 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 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, in practice scheme maximums do not exceed 50% of basic salary. The Remuneration Committee can exercise discretion and award above the 50% cap and have done so this year for the Group Chief Executive, as described in the Annual Report and Accounts. A review is conducted, one-year post award, to ensure that performance has been sustained at the level expected by the Board. If it hasn't, subsequent awards may be reduced by up to 25% subject to the discretion of the Group Remuneration Committee.

Executive Committee members have 50% of their annual variable awards automatically deferred for between one and five years, unless their remuneration exceeds de minimis limits (i.e. total remuneration awarded for the current performance year is greater than £44,000 and the variable amount awarded for the current year does not represent more than 33% of total remuneration), in which case, deferral is in line with regulatory requirements which can increase the deferral amount to 60% and the deferral period to between four and seven years depending on the nature of the role held by the senior manager.

For MRTs below executive level, a proportion of variable pay is deferred in line with regulatory requirements, if remuneration for the current year exceeds the de minimis threshold. In this event, payments are made via an instrument which means that 50% of the award payable in each year will be retained for a further year and will only be paid subject to meeting the agreed capital 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 the Society and SIL; an overview of the key features of the schemes is set out below:

13.1.3 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 50% of basic salary.

The SVPA is based 48% on financial measures which include Group and Mortgages and Savings division profit and the Mortgages and Savings division cost income ratio, 22% on team key performance indicators (KPIs) (which include customer, risk and people metrics) and 30% on personal and strategic objectives. For participants in second- and third-line functions (Risk, Compliance and Audit), a weighting of 20% for financial measures, 15% team KPIs and a 65% weighting for personal and strategic objectives has been allocated. As already indicated, 50% of the award from the scheme is automatically deferred for between one and five years unless a greater proportion or longer period is required by regulation.

The Senior Leaders' Scheme, which typically includes Heads of Department, is based on 50% on the achievement of business measures and 50% on the personal performance. 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 Scheme which is a similar design to the Senior Leader Scheme. The maximum opportunity from this scheme is 14% of basic salary.

13.1.4 SIL

SIL has its own Remuneration Committee which oversees its remuneration practices and ensures compliance with the Group 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 2021, firstly to approve the 2020 bonus payments and 2021 salary increases and secondly to agree the 2022 bonus scheme and approve the 2021 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 Group Remuneration Committee.

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 2021, bonus payments to SIL MRTs were capped, at 60% of basic salary for the Managing Director and 40% for his direct reports. The Managing Director's bonus will be deferred for five years, vesting no faster than on a pro-rata basis, in line with regulation.

13.1.5 Skipton Business Finance

In 2020 SBF formed a Committee which comprises of the Chair, Managing Director and Finance Director of SBF and attendees from the Reward Team where necessary. The SBF Committee met five times in 2021 to review bonus schemes and salary increases. All bonus schemes, payments and MRTs are reported to and approved by the Group Remuneration Committee.

The SBF Executive Team all participate in the SBF Executive Scheme. The maximum awards payable for participants is 30% of base salary for the Managing Director and 25% for his direct reports. The Executive Scheme is based 70% on performance against the Corporate Plan and 30% individual performance.

SBF operate a Medium Term Incentive (MTI) scheme. Payments are based on performance over a rolling three-year cycle, with 50% paid two years following the signing of the statutory accounts and 50% deferred for a further year. The MTI is designed to reward performance against two independent measures of, SBF profit (70% weighting) and the delivery of the client and employee strategy (30% weighting). Employee strategy is determined against achievement of targets for a combination of client satisfaction score (15%) and the employee satisfaction score (15%).

Payment of all remuneration including MTI will be capped at 50% of the basic salary as at 31 December of the performance year.

13.1.6 Risk / performance adjustment

The potential risk implications of MRTs 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.

To ensure that rewards are based on sustainable performance over a multi-year period, the Remuneration Committee conducts a 'sustainable performance assessment' one year after the original performance year. The Committee reviews performance against the original scheme measures and considers whether the performance which generated the award has been materially sustained in line with Board expectations.

If the Committee considers that performance has not been adequately maintained, an adjustment of up to 25% of the original award can be made to either current year awards or to deferred payments, subject to specific criteria.

On an annual basis, the Remuneration Committee also seeks confirmation from BRC 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.

SBF produce a Risk Adjustment Assessment which is presented to the Society Remuneration Committee on an annual basis to facilitate discussion on any specific risk issues or changes in the risk profile of the business that may need to be taken into account when considering whether risk adjustment should be applied to payments to participants of the SBF bonus schemes.

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

13.2 Aggregate quantitative information on remuneration

As outlined above, MRTs have been identified in the core Society, SBF and SIL.

Table 31 Group's quantitative remuneration

2021 Group [1]	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released [3] £000
Senior management (including Executive and Non-Executive Directors)	17	3,630	1,358	4,988	292
Other Material Risk Takers [2]	57	5,723	970	6,693	62
Total	**74**	**9,353**	**2,328**	**11,681**	**354**

Notes

1. The Group table includes aggregate remuneration for MRTs in the Society, SBF and SIL.
2. The members of the SIL and SBF Management Committees are included in the category 'Other Material Risk Takers'.
3. Prior year performance pay now released includes Short Term Incentive (STI) and MTI payments from prior years now due to be paid.

2021 Society (Mortgages and Savings division)	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released [1] £000
Senior management (including Executive and Non-Executive Directors)	**17**	**3,630**	**1,358**	**4,988**	**292**
Other Material Risk Takers	**48**	**4,751**	**731**	**5,482**	**-**
Total	**65**	**8,381**	**2,089**	**10,470**	**292**

Notes

1. The prior year performance now released includes STI and MTI payments from prior years now due to be paid.

2021 SBF (Debt factoring division)	Number of beneficiaries [2]	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released [1] £000
Material Risk Takers	**1**	**201**	**86**	**287**	**40**

Notes

1. The prior year performance now released includes STI and MTI payments from prior years now due to be paid.
2. The number of SBF MRTs has reduced from 2020.The updated MRT criteria now means we only recognise the Head of SBF as an MRT.

2021 SIL (Mortgages and Savings division)	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released [2] £000
Material Risk Takers [1]	**8**	**771**	**153**	**924**	**22**

Notes

1. The Material Risk Takers are all members of the SIL Management Committee and/or the SIL Board.
2. The prior year performance pay includes deferred payments from the 2020 annual bonus award.

The 2020 Other Material Risk Takers figures for Society and SBF have been restated due to corrections made after the date of publication.

2020 Group [1]	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released [3] £000
Senior management (including Executive and Non-Executive Directors)	16	3,362	-	3,362	324
Other Material Risk Takers [2]	57	6,210	970	7,180	102
Total	73	9,572	970	10,542	426

Notes

1. The Group table includes aggregate remuneration for MRTs in the Society, SBF and SIL.
2. The members of the SIL and SBF Management Committees are included in the category 'Other Material Risk Takers'.
3. Prior year performance pay now released includes STI and MTI payments from prior years now due to be paid.

2020 Society (Mortgages and Savings division)	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released [1] £000
Senior management (including Executive and Non-Executive Directors)	16	3,362	-	3,362	324
Other Material Risk Takers	44	4,684	785	5,469	-
Total	60	8,046	785	8,831	324

Notes

1. Prior year performance pay now released includes STI payments from prior years now due to be paid.

2020 SBF (Debt Factoring division)

	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released [1] £000
Material Risk Takers	5	755	32	787	102

Notes

1. The prior year performance now released includes STI and MTI payments from prior years now due to be paid.

2020 SIL (Mortgages and Savings division)

	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released [2] £000
Material Risk Takers [1]	8	771	153	924	-

Notes

1. The Material Risk Takers are all members of the SIL Management Committee and/or the SIL Board.
2. The prior year performance pay includes deferred payments from the 2019 annual bonus award.

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 2021. The regulatory capital figures are shown on a transitional basis in accordance with onshored Annex I of the European Commission Implementing Technical Standard 1423/2013 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) of the CRR. Rows without numbers have been added to set out a transparent flow of adjustments made to the CET 1 capital. Any blank cells in the template have been removed.

		Accounting Balance Sheet Value 2021 £m	Adjustments and adjusted accounting value 2021 £m	Own Funds Value 2021 £m
Members' interests				
	General Reserve	1,951.5	-	-
	Fair value reserve	7.5	-	-
	Cash flow hedging reserve	4.0		
	Cost of hedging reserve	(3.5)	-	-
	Translation reserve	4.5	-	-
	Attributable to members of Skipton Building Society	1,964.0	-	-
	Non-Controlling interests	0.4	-	-
	Total members' interests	1,964.4	-	-
Less:	Reserves attributable to non regulatory subsidiaries	-	(175.2)	-
	Accounting Balance Sheet value after adjustments	-	1,789.2	-
Common Equity Tier 1 (CET1) capital: instruments and reserves				
2	Retained Earnings	-	-	1,781.2
3	Accumulated other comprehensive income (and other reserves), to include unrealised gains and losses under the applicable accounting standards	-	-	8.0
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments			1,789.2
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
7	Additional value adjustments (negative amount)	-	-	(2.7)
	Intangible Assets (per the Accounting Balance Sheet)	(345.6)	-	-
Less:	Intangible Assets attributable to non regulatory subsidiaries	-	345.6	-
	Accounting Balance Sheet value after adjustments	-	-	-
8	Intangible assets (net of related tax liability) (negative amount)	-	-	(6.6)
	Cash flow hedging reserve (per the Accounting Balance Sheet)	4.0	-	-
Less:	Cash flow hedging reserve attributable to non regulatory subsidiaries	-	-	-
	Accounting Balance Sheet value after adjustments	-	4.0	-
11	Fair value reserves related to gains or losses on cash flow hedges	-	-	(4.0)
12	Negative amounts resulting from the calculation of expected loss amounts	-	-	(6.5)
12a	IFRS9 transitional adjustment to CET1	-	-	6.1
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	-	-	(13.7)
29	**Common Equity Tier 1 (CET1) capital**			1,775.5
Additional Tier 1 (AT1) capital: instruments				
	Subscribed capital	41.6	-	-
Less:	Removal of accrued interest	-	(1.6)	-
	Accounting Balance Sheet value after adjustments		40.0	-
44	Additional Tier 1 (AT1) capital	-	-	9.0
45	Tier 1 capital (T1 = CET1 + AT1)			1,784.5
Tier 2 (T2) capital: instruments and provisions				
46	Capital instruments and the related share premium accounts	-	-	31.0
58	Tier 2 (T2) capital	-	-	31.0
59	Total capital (TC = T1 **+ T2)**	-	-	1,815.5

Appendix 2 Capital instruments key features

The table below shows the capital instruments currently in issue by the Group with the key details of these capital instruments as at 31 December 2021. These have been disclosed in line with onshored Annex III of the European Commission Implementing Technical Standards 1423/2013 on disclosure for own funds by institutions under Article 437(1) of the CRR.

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[1])**
2	ISIN	**GB0008194119**	**GB0004440623**
3	Gov. law(s)	**English**	**English**
4	Trans. CRR rules	**Additional Tier 1 up to headroom**	**Additional Tier 1 up to headroom**
5	Post-transitional CRR rules	**Tier 2**	**Tier 2**
6	Eligible at Solo/Sub-consolidated/Solo & Sub-consolidated	**Solo**	**Solo**
7	Instrument type (types to be specified by each jurisdiction)	**PIBS**	**PIBS**
8	Regulatory capital value	**25,000,000[1]**	**15,000,000[1]**
9	Nominal amount of instrument	**25,000,000**	**15,000,000**
9a	Issue px	**100.476**	**100.000**
9b	Redemption px	**100.000**	**100.000**
10	Accounting classification	**Liability - amortised cost**	**Liability - amortised cost**
11	Date of issue	**05/03/1992**	**26/04/2000**
12	Perpetual or dated	**Perpetual**	**Perpetual**
13	Original maturity	**No maturity**	**No maturity**
14	Issuer call	**No**	**No**
15	Optional call date, contingent call dates and redemption amount	**No Issuer call**	**No Issuer call**
16	Subsequent call dates, if applicable	**n/a**	**n/a**
17	Fixed or floating dividend/coupon	**Fixed**	**Fixed**
18	Coupon rate and any related index	**12.875%**	**8.500%**
19	Existence of a dividend stopper	**Yes[2]**	**Yes[2]**
20a/b	Fully discretionary, partially or mandatory (in terms of timing)	**Partially Discretionary**	**Partially Discretionary**
21	Existence of step up or other incentive to redeem	**No**	**No**
22	Noncumulative or cumulative	**Noncumulative**	**Noncumulative**
23	Convertible or non-convertible	**Nonconvertible**	**Nonconvertible**
24	If convertible, conversion trigger(s)	**n/a**	**n/a**
25	If convertible, fully or partially	**n/a**	**n/a**
26	If convertible, conversion rate	**n/a**	**n/a**
27	If convertible, mandatory or optional conversion	**n/a**	**n/a**
28	Specify output instrument	**n/a**	**n/a**
29	Specify issuer of output instrument	**n/a**	**n/a**
30	Write-down features	**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**
35	Instrument type immediately senior	**Subordinated debt**	**Subordinated debt**
36	Non-compliant transitioned features	**Yes**	**Yes**
37	If yes, specify non-compliant features	**No conversion to CET 1**	**No conversion to CET 1**

Note

1. In March 1992, the Society issued £25.0m of PIBS, comprising 25,000 individual shares and each one had a nominal value of £1,000. In April 2000, the Scarborough Building Society issued £15.0m of PIBS, comprising 6,000 individual shares and each one had a nominal value of £2,500. These were assumed by the Society in 2009 following the merger with Scarborough Building Society.
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.

Appendix 3 Own funds disclosure template

The table below shows the own funds position of the prudential consolidation group in line with onshored Annex IV to Annex V of the European Commission Implementing Technical Standard 1423/2013 on disclosure of own funds by institutions under Article 437(1) (d) and (e) of the CRR, where CRR refers to Regulation (EU) 575/2013. Any blank cells in the template have been removed.

		Transitional 2021 £m	2020 Restated* £m
Common Equity Tier 1 (CET1) Capital: instruments and reserves			
2	Retained Earnings	**1,781.2**	1,589.7
3	Accumulated other comprehensive income (and other reserves), to include unrealised gains and losses under the applicable accounting standards	**8.0**	(14.5)
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	**1,789.2**	1,575.2
Common Equity Tier 1 (CET1) capital: regulatory adjustments			
7	Additional value adjustments (negative amount)	**(2.7)**	(2.1)
8	Intangible assets (net of related tax liability) (negative amount)	**(6.6)**	(7.9)
11	Fair value reserves related to gains or losses on cash flow hedges	**(4.0)**	15.1
12	Negative amounts resulting from the calculation of expected loss amounts	**(6.5)**	(2.0)
12a	IFRS9 transitional adjustment to CET1	**6.1**	7.3
28	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**(13.7)**	10.4
29	**Common Equity Tier 1 (CET1) capital**	**1,775.5**	1,585.6
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	**9.0**	18.0
36	Additional Tier 1 (AT1) capital before regulatory adjustments	**9.0**	18.0
44	**Additional Tier 1 (AT1) capital**	**9.0**	18.0
45	**Tier 1 capital (T1 = CET1 + AT1)**	**1,784.5**	1,603.6
Tier 2 (T2) capital: instruments and provisions			
46	Capital instruments and the related share premium accounts	**31.0**	22.0
50	Credit risk adjustments	**-**	4.9
51	Tier 2 (T2) capital before regulatory adjustments	**31.0**	26.9
Tier 2 (T2) capital: regulatory adjustments			
58	**Tier 2 (T2) capital**	**31.0**	26.9
59	**Total capital (TC = T1 + T2)**	**1,815.5**	1,630.5
60	**Total risk weighted assets**	**3,984.7**	4,123.2
Capital ratios and buffers			
61	Common Equity Tier 1 (as a percentage of risk exposure amount)	**44.56%**	38.46%
62	Tier 1 (as a percentage of risk exposure amount)	**44.78%**	38.89%
63	Total capital (as a percentage of risk exposure amount)	**45.56%**	39.54%
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)	**7.017%**	7.009%
65	of which: capital conservation buffer requirement	**2.500%**	2.500%
66	of which: countercyclical buffer requirement	**0.017%**	0.009%
67	of which: systemic buffer requirement	**0.000%**	0.000%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**37.56%**	31.55%
Applicable caps on the inclusion of provisions in Tier 2			
77	Cap on inclusion of credit risk adjustments in T2 under standardised Approach	**19.3**	17.7
79	Cap for inclusion of credit risk adjustments in T2 under internal- ratings based Approach	**11.8**	13.4
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)			
82	Current cap on AT1 instruments subject to phase out arrangements	**9.0**	18.0
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	**31.0**	22.0
84	Current cap on T2 instruments subject to phase out arrangements	**18.9**	37.8

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

Appendix 4 Leverage ratio disclosures templates

The tables below set out the leverage ratio for the prudential group under the CRR end-point basis with IFRS 9 transitional arrangements applied 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 published financial statements are adjusted to provide an exposure measure used to calculate the leverage ratio.

Template LRSum:		**Applicable amount**	
		2021	2020 Restated*
Summary reconciliation of accounting assets and leverage ratio exposures		**£m**	£m
1	Total assets as per published financial statements	**29,468.0**	28,263.4
2	Adjustments for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	**(427.3)**	(230.9)
4	Adjustments for derivative financial instruments	**(447.4)**	(522.8)
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off balance sheet exposures)	**166.2**	255.7
7	Other adjustments	**(13.8)**	9.7
8	**Total leverage ratio exposure**	**28,745.7**	27,775.1

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

Row 4 above includes the derivative asset from the Group's Annual Report and Accounts of £227.9m (2020: £64.1m) as well as the total derivative exposure from row 11 in Template LRCom 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:		**CRR leverage ratio exposures**	
		2021	2020 Restated*
Leverage ratio common disclosure		**£m**	£m
On-balance sheet exposures (excluding derivatives and SFTs)			
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**28,812.7**	27,968.4
2	(Asset amounts deducted in determining Tier 1 capital)	**(13.8)**	9.7
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**28,798.9**	27,978.1
Derivative exposures			
4	Replacement cost associated with *all* derivatives transactions (ie net of eligible cash variation margin)	**2.9**	16.3
5	Add-on amounts for PFE associated with *all* derivatives transactions (mark-to-market method)	**107.2**	99.6
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(329.5)**	(574.6)
11	**Total derivative exposures (sum of lines 4 to 10)**	**(219.4)**	(458.7)
Securities financing transaction exposures			
16	Total securities financing transaction exposures (sum of lines 12 to 15a)	**-**	-
Other off-balance sheet exposures			
17	Off-balance sheet exposures at gross notional amount	**1,662.8**	2,647.2
18	(Adjustments for conversion to credit equivalent amounts)	**(1,496.6)**	(2,391.5)
19	Other off-balance sheet exposures (sum of lines 17 to 18)	**166.2**	255.7
Capital and total exposures			
20	Tier 1 capital	**1,775.5**	1,585.6
21	Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)	**28,745.7**	27,775.1
Leverage ratio			
22	Leverage ratio	**6.2%**	5.7%
Choice on transitional arrangements and amount of derecognised fiduciary items			
EU-23	Choice on transitional arrangements for the definition of the capital measure	**End-point**	End-point

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

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 2021 £m	2020 Restated* £m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**28,812.7**	27,968.4
EU-2	Trading book exposures	**-**	-
EU-3	Banking book exposures, of which:	**28,812.7**	27,968.4
EU-4	Covered bonds	**260.3**	202.8
EU-5	Exposures treated as sovereigns	**3,024.4**	3,586.4
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	**851.6**	640.9
EU-7	Institutions	**523.3**	466.0
EU-8	Secured by mortgages of immovable properties	**23,453.8**	22,008.2
EU-9	Retail exposures	**1.7**	1.4
EU-10	Corporate	**451.2**	483.7
EU-11	Exposures in default	**59.5**	71.5
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	**186.9**	507.5

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

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:

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

The prudential consolidation group has a leverage ratio of 6.2%. 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.

Description of the factors that had an impact on the leverage ratio during the year to 31 December 2021

During the year the CRR leverage ratio increased to 6.2% on an end-point basis (December 2020: 5.7%).

Tier 1 capital has increased in the year primarily driven by an increase in retained profits accumulated during the period and dividend income received from the Connells group. Exposures continue to be mainly in retail mortgages, and liquidity exposures to support the group's activities.

Appendix 5 Asset encumbrance

Asset encumbrance occurs through the pledging of assets to secured creditors. 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 covered bond issuances; and 3) to collateralise derivative exposures through CSAs with counterparts and through centralised derivative clearing.

The asset encumbrance disclosure templates below are prepared in accordance with the EBA regulatory reporting technical standards set out in EBA/RTS/2017/03.

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 2021.

Template A - Encumbered and unencumbered assets		Carrying amount of encumbered assets	of which notionally eligible EHQLA [1] and HQLA [2]	Fair value of encumbered assets	of which notionally eligible EHQLA and HQLA	Carrying amount of unencumbered assets	of which EHQLA and HQLA	Fair value of unencumbered assets	of which EHQLA and HQLA
		£m	£m	£m	£m	£m	£m	£m	£m
		010	030	040	050	060	080	090	100
010	Assets of the reporting institution	6,508.1	54.8	-	-	22,185.7	4,078.7	-	-
030	Equity instruments	-	-	-	-	3.0	-	-	-
040	Debt securities	54.8	54.8	54.8	54.8	1,934.0	1,666.8	1,934.0	1,666.8
050	of which: covered bonds	-	-	-	-	265.8	235.5	265.8	235.5
060	of which: asset-backed securities	-	-	-	-	163.0	122.6	163.0	122.6
070	of which: issued by general governments	54.4	54.4	54.4	54.4	365.4	365.4	365.4	365.4
080	of which: issued by financial corporations	0.4	0.4	0.4	0.4	1,154.7	935.4	1,154.7	935.4
090	of which: issued by non-financial corporations	-	-	-	-	-	-	-	-
120	Other assets [3]	6,440.1	-	-	-	20,248.7	2,411.9	-	-
121	of which: Mortgage Loans	6,063.1	-	-	-	17,052.4	-	-	-

Notes

1. EHQLA related to assets of extremely high liquidity and credit quality.
2. HQLA relates to assets of high liquidity and credit quality.
3. "Other assets" include loans and advances (including 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. With the exception of mortgage loans, these assets would not be available for encumbrance in the normal course of business.

The table below details, as a median calculation rather than point in time, for different classes of assets, the level of collateral received on a prudential consolidation group basis in the year ended 2021.

Template B - Collateral received		**Fair value of encumbered collateral received or own debt securities issued**	**of which notionally eligible EHQLA and HQLA**	**Unencumbered**	
				Fair value of collateral received or own debt securities issued available for encumbrance	**of which EHQLA and HQLA**
		£m	**£m**	**£m**	**£m**
		010	030	040	060
130	**Collateral received by the reporting institution**	-	-	**10.9**	-
140	Loans on demand	-	-	**10.9**	-
150	Equity instruments	-	-	-	-
160	Debt securities	-	-	-	-
170	of which: covered bonds	-	-	-	-
180	of which: asset-backed securities	-	-	-	-
190	of which: issued by general governments	-	-	-	-
200	of which: issued by financial corporations	-	-	-	-
210	of which: issued by non-financial corporations	-	-	-	-
220	Loans and advances other than loans on demand	-	-	-	-
230	Other collateral received	-	-	-	-
231	of which:	-	-	-	-
240	Own debt securities issued other than own covered bonds or asset-backed securities	-	-	-	-
241	Own covered bonds and asset-backed securities issued and not yet pledged			**96.3**	-
250	**Total assets and collateral received**	**6,508.1**	**54.8**		

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

Template C - Sources of encumbrance	**Matching liabilities, contingent liabilities or securities lent**	**Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered**
	£m	**£m**
Encumbered assets / collateral received and associated liabilities	010	030
010 Carrying amount of selected financial liabilities	**4,452.20**	**6,508.10**

Template D – Accompanying narrative information
General information on asset encumbrance

The Pillar 3 asset encumbrance disclosure templates have been compiled in accordance with EBA regulatory reporting requirements. These numbers reflect EBA methodology and, as such, may differ from the disclosures contained in the Group's Annual Report and Accounts due to differences in the definitions of encumbrance for certain assets.

Asset encumbrance generally occurs through the pledging of assets: to secured creditors, as collateral, or to credit enhance financial transactions. Such assets become unavailable for other purposes. The Group uses 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. Assets are solely encumbered at the Society level.

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

Information relating to the impact of the institution's business model on its level of encumbrance and the importance of encumbrance on the institution's funding model

Mortgage assets are used in long term secured funding transactions such as securitisations, covered bonds and Bank of England schemes. The Society has issued Residential Mortgage Backed Securities through its Darrowby programme and it has issued Covered Bonds from its regulated Covered Bond programme. Further asset encumbrance occurs through the Society's participation in the Bank of England's Term Funding Scheme. The level of over-collateralisation associated with the Society's secured funding programmes is regularly monitored and they are maintained at levels that are both efficient and prudent. The Group has no sources of encumbrance by any currency other than the reporting currency. Unencumbered other assets include goodwill, deferred tax assets, property, plant and other fixed assets, and derivative assets. The underlying assets and cover pool assets related to any retained securities issued from the Society's secured funding programmes are treated as unencumbered from a regulatory reporting perspective.

Appendix 6 Countercyclical capital buffer

The tables below set out the geographical distribution of the Group credit exposures relevant for the calculation of countercyclical buffer (CCyB) using templates prescribed in Annex I and II of the European Commission Delegated Regulation 2015/1555 in accordance with Article 440. The CCyB disclosure is presented in the following two tables.

The table below shows the country of residence of the obligor (borrower) for the Group general credit exposures, trading book exposures (of which there are none) and securitisation exposures. The Group does not offer mortgages on properties outside of the United Kingdom or Channel Islands.

Breakdown by Country	General credit exposures		Trading book exposure		Securitisation exposure		Own funds requirements				Own funds requirement weights	Countercyclical capital buffer rate
	Exposure value for SA £m 010	Exposure value IRB £m 020	Sum of long and short position of trading book £m 030	Value of trading book exposure for internal models £m 040	Exposure value for SA £m 050	Exposure value for IRB £m 060	Of which: General credit exposures £m 070	Of which: Trading book exposures £m 080	Of which: Securitisation exposures £m 090	**Total £m 100**	% 110	% 120
United Kingdom	1,534.6	22,800.5	-	-	169.9	-	209.0	-	1.5	**210.5**	**81.05**	
Jersey	615.4	0.1	-	-	-	-	17.3	-	-	**17.3**	**6.65**	
Guernsey	362.8	3.1	-	-	-	-	10.5	-	-	**10.5**	**4.04**	
Hong Kong	151.4	0.6	-	-	-	-	4.3	-	-	**4.3**	**1.64**	**1.000%**
United Arab Emirates	100.8	2.2	-	-	-	-	2.9	-	-	**2.9**	**1.11**	
United States	85.0	7.6	-	-	-	-	2.5	-	-	**2.5**	**0.97**	
Singapore	88.3	0.8	-	-	-	-	2.5	-	-	**2.5**	**0.96**	
Netherlands	33.4	1.2	-	-	-	-	1.2	-	-	**1.2**	**0.46**	
Switzerland	26.7	2.0	-	-	-	-	0.8	-	-	**0.8**	**0.29**	
China	20.2	0.3	-	-	-	-	0.6	-	-	**0.6**	**0.22**	
Canada	16.8	1.2	-	-	-	-	0.5	-	-	**0.5**	**0.18**	
Qatar	16.9	-	-	-	-	-	0.5	-	-	**0.5**	**0.18**	
Saudi Arabia	14.8	-	-	-	-	-	0.4	-	-	**0.4**	**0.16**	
Germany	13.2	1.2	-	-	-	-	0.4	-	-	**0.4**	**0.15**	
Malaysia	13.0	0.2	-	-	-	-	0.4	-	-	**0.4**	**0.14**	
New Zealand	11.3	2.7	-	-	-	-	0.3	-	-	**0.3**	**0.13**	
France	10.2	3.2	-	-	-	-	0.3	-	-	**0.3**	**0.13**	
Spain	9.8	2.1	-	-	-	-	0.3	-	-	**0.3**	**0.12**	
Australia	3.6	7.2	-	-	-	-	0.2	-	-	**0.2**	**0.08**	
Bahrain	7.3	0.2	-	-	-	-	0.2	-	-	**0.2**	**0.08**	
Japan	7.2	0.3	-	-	-	-	0.2	-	-	**0.2**	**0.08**	
Thailand	6.7	0.0	-	-	-	-	0.2	-	-	**0.2**	**0.08**	
Ireland	6.3	1.0	-	-	-	-	0.2	-	-	**0.2**	**0.07**	
India	6.1	0.7	-	-	-	-	0.2	-	-	**0.2**	**0.07**	
Cayman Islands	6.1	-	-	-	-	-	0.2	-	-	**0.2**	**0.07**	
Sweden	4.7	0.6	-	-	-	-	0.1	-	-	**0.1**	**0.05**	
Italy	4.3	0.8	-	-	-	-	0.1	-	-	**0.1**	**0.05**	
South Africa	4.2	0.3	-	-	-	-	0.1	-	-	**0.1**	**0.05**	
Cyprus	4.0	0.2	-	-	-	-	0.1	-	-	**0.1**	**0.04**	
Bermuda	4.0	-	-	-	-	-	0.1	-	-	**0.1**	**0.04**	
Isle of Man	1.5	0.1	-	-	-	-	0.1	-	-	**0.1**	**0.04**	
Israel	3.5	0.3	-	-	-	-	0.1	-	-	**0.1**	**0.04**	
Monaco	3.5	-	-	-	-	-	0.1	-	-	**0.1**	**0.04**	
Denmark	3.1	0.4	-	-	-	-	0.1	-	-	**0.1**	**0.04**	
Taiwan	3.0	-	-	-	-	-	0.1	-	-	**0.1**	**0.03**	
Kuwait	2.9	0.1	-	-	-	-	0.1	-	-	**0.1**	**0.03**	
Belgium	2.8	0.3	-	-	-	-	0.1	-	-	**0.1**	**0.03**	
Philippines	2.5	-	-	-	-	-	0.1	-	-	**0.1**	**0.03**	
British Virgin Islands	2.3	-	-	-	-	-	0.1	-	-	**0.1**	**0.03**	
Other countries	29.4	4.9	-	-	-	-	0.7	-	-	**0.7**	**0.35**	
Total	**3,243.6**	**22,846.4**	**-**	**-**	**169.9**	**-**	**258.2**	**-**	**1.5**	**259.7**	**100.00**	

The diversification of countries in the table above is primarily due to SIL providing mortgages to expatriates and non-UK citizens.

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 institution specific countercyclical buffer rate[8], 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 exposures to central governments, multilateral development banks and institutions with a long-term maturity are exempt from the countercyclical buffer analysis. Those exposures are excluded from above table. As a result, the total own funds requirement does not reconcile to Table 6.

The institution specific CCyB rate is a weighted average, including countries with a zero buffer percentage rate, and is derived from dividing the buffer requirement over the risk exposure amount. During the period the CCyB rate remained at 0% of RWAs for exposures in the UK.

Amount of institution-specific countercyclical capital buffer	**2021**	2020 Restated*
Total risk exposure amount £m	**3,984.7**	4,123.2
Institution specific countercyclical buffer rate %	**0.017%**	0.009%
Institution specific countercyclical buffer requirement £m	**0.7**	0.4

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

[8] 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.

Appendix 7 Retail lending exposures by PD scale

The table below sets out the main parameters used for the calculation of the capital requirement for IRB models for the Society.

PD scale	Original on-balance sheet gross exposure	Off-balance sheet exposures pre CCF[8]	EAD[9] post CRM[10] and post CCF	Average PD	Number of obligors	Average LGD	RWAs	RWA density	EL	Value adjustments and provisions
	£m	£m	£m	%		%	£m	%	£m	£m
Society exposures - Secured by mortgages on immovable properties										
0.00 to <0.15	10,409.9	1,571.1	11,906.8	0.09	79,343	19.19	478.2	4.01	1.9	
0.15 to <0.25	7,551.7	2.0	7,650.9	0.19	57,737	15.72	484.4	6.32	2.2	
0.25 to <0.50	2,338.7	1.0	2,371.5	0.32	20,049	15.75	226.9	9.56	1.2	
0.50 to <0.75	271.3	-	275.2	0.61	2,541	17.16	44.8	16.25	0.3	
0.75 to <2.50	330.0	-	335.0	1.26	2,944	19.05	97.6	29.12	0.8	
2.50 to <10.00	91.9	-	93.1	4.86	813	17.66	54.7	58.64	0.8	
10.00 to <100.00	82.4	-	83.4	32.43	763	17.74	78.5	94.04	4.9	
100.00 (Default)	49.8	-	49.9	100.00	421	24.24	119.4	239.18	3.2	
Subtotal	21,125.7	1,574.1	22,765.8	0.53	164,611	17.64	1,584.5	6.96	15.3	10.8

[8] CCF – Credit conversion factor applied to credit commitments for mortgages not yet drawn down.

[9] EAD – Exposures at default are the amounts that the customer would owe in the event of default. The balance takes 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.

[10] CRM – Credit risk mitigation relates to the techniques used to reduce the credit risk associated with an exposure.

Appendix 8 Impact of IFRS 9 transitional arrangements

The Group has adopted IFRS 9 with effect from 1 January 2018. The implementation of IFRS 9 does not have a significant impact on the Group's capital position. The impact is reduced further due to the IFRS 9 transitional arrangements a per the EBA guidelines EBA/GL/2018/01 which the Group has elected to apply from 1 January 2018 as per Article 473a (a) of the CRR and the introduction of additional IFRS 9 transitional relief measures in response to the COVID-19 pandemic.

		2021 £m	2020 Restated* £m
Available capital			
1	Common Equity Tier 1 (CET1) capital	**1,775.5**	1,585.6
2	Common Equity Tier 1 (CET1) capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,769.4**	1,578.3
2a	Common Equity Tier 1 (CET1) capital as if the temporary treatment of unrealised gains and losses measured at fair value through OCI (other comprehensive income) in accordance with Article 468 of the CRR had not been applied	**1,775.5**	1,585.6
3	Tier 1 capital	**1,784.5**	1,603.6
4	Tier 1 capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,778.4**	1,596.3
4a	Tier 1 capital as if the temporary treatment of unrealised gains and losses measured at fair value through OCI in accordance with Article 468 of the CRR had not been applied	**1,784.5**	1,603.6
5	Total capital	**1,815.5**	1,630.5
6	Total capital as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**1,809.4**	1,623.2
6a	Total capital as if the temporary treatment of unrealised gains and losses measured at fair value through OCI in accordance with Article 468 of the CRR had not been applied	**1,815.5**	1,630.5
Risk-weighted assets			
7	Total risk-weighted assets	**3,984.7**	4,123.2
8	Total risk-weighted assets as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**3,977.4**	4,115.3
Capital ratios			
9	Common Equity Tier 1 (as a percentage of risk exposure amount)	**44.56%**	38.46%
10	Common Equity Tier 1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**44.49%**	38.35%
10a	Common Equity Tier 1 (as a percentage of risk exposure amount) as if the temporary treatment of unrealised gains and losses measured at fair value through OCI in accordance with Article 468 of the CRR had not been applied	**44.56%**	38.46%
11	Tier 1 (as a percentage of risk exposure amount)	**44.78%**	38.89%
12	Tier 1 (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**44.71%**	38.79%
12a	Tier 1 (as a percentage of risk exposure amount) as if the temporary treatment of unrealised gains and losses measured at fair value through OCI in accordance with Article 468 of the CRR had not been applied	**44.78%**	38.89%
13	Total capital (as a percentage of risk exposure amount)	**45.56%**	39.54%
14	Total capital (as a percentage of risk exposure amount) as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**45.49%**	39.44%
14a	Total capital (as a percentage of risk exposure amount) as if the temporary treatment of unrealised gains and losses measured at fair value through OCI in accordance with Article 468 of the CRR had not been applied	**45.56%**	39.54%
Leverage ratio			
15	Leverage ratio total exposure measure	**28,745.7**	27,775.1
16	Leverage ratio	**6.2%**	5.7%
17	Leverage ratio as if IFRS 9 or analogous ECLs transitional arrangements had not been applied	**6.2%**	5.7%
17a	Leverage ratio as if the temporary treatment of unrealised gains and losses measured at fair value through OCI in accordance with Article 468 of the CRR had not been applied	**6.2%**	5.7%

* The 2020 figures have been restated to appropriately recognise a credit facility provided by the Society to Connells. See section 1.3 for further details.

Transitional arrangements reduce the impact on the capital, risk weighted assets, capital ratios and leverage ratio of expected credit loss provisions over the period to 31 December 2024.

From 27 June 2020, amendments to the Capital Requirements Regulation, included additional IFRS 9 transitional relief measures in response to the COVID-19 pandemic and extended the transitional arrangements period by two years (up until 31 December 2024). The impact of the IFRS 9 transitional relief increases the Society's capital resources by £6.1m as at 31 December 2021. These adjustments are applied by adding back the impact of the expected credit loss provision to CET 1 resources, risk weighted assets and leverage ratio exposure. The key element included within the transitional arrangements relates to £5.9m of additional commercial loan impairment in the period, which is allowed 100% relief under the revised transitional relief measures.

Appendix 9 Non-performing and forborne exposures

The non-performing and forborne exposure templates below are prepared in accordance with the EBA guidelines set out in EBA/GL/2018/10. The Society is only required to disclose four templates as per the threshold requirement.

The following tables show an overview of the credit quality of forborne exposures.

2021

Template 1	Gross carrying amount / nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forborne exposures	
	Performing forborne	Non-performing forborne			On performing forborne exposures	On non-performing forborne exposures		Of which collateral and financial guarantees received on non-performing exposures with forbearance measures
			Of which defaulted	Of which impaired				
Loans and advances	**126.9**	**39.4**	**32.5**	**39.4**	**(4.5)**	**(3.7)**	**157.8**	**35.8**
Non-financial corporations	**39.4**	**10.5**	**10.5**	**10.5**	**(4.1)**	**(2.1)**	**43.5**	**8.5**
Households	**87.5**	**28.9**	**22.0**	**28.9**	**(0.4)**	**(1.6)**	**114.3**	**27.3**
Total	**126.9**	**39.4**	**32.5**	**39.4**	**(4.5)**	**(3.7)**	**157.8**	**35.8**

2020

Template 1	Gross carrying amount / nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forborne exposures	
	Performing forborne	Non-performing forborne			On performing forborne exposures	On non-performing forborne exposures		Of which collateral and financial guarantees received on non-performing exposures with forbearance measures
			Of which defaulted	Of which impaired				
Loans and advances	117.1	43.8	39.0	43.8	(5.2)	(4.6)	151.0	39.2
Non-financial corporations	37.1	16.4	16.4	16.4	(4.5)	(2.3)	46.6	14.1
Households	80.0	27.4	22.6	27.4	(0.7)	(2.3)	104.4	25.1
Total	117.1	43.8	39.0	43.8	(5.2)	(4.6)	151.0	39.2

The following table sets out the collateral obtained by taking possession and execution processes.

Template 9	**2021**		2020	
	Collateral obtained by taking possession			
	Value at initial recognition	Accumulated negative changes	Value at initial recognition	Accumulated negative changes
Other than PPE	**1.9**	**-**	1.1	-
Residential immovable property	**1.9**	**-**	1.1	-
Total	**1.9**	**-**	1.1	-

The following tables show an overview of the quality of performing and non-performing exposures by past due days.

Template 3	2021											
	Gross carrying amount / nominal amount											
	Performing exposures			Non-performing exposures								
		Not past due or past due ≤ 30 days	Past due > 30 days ≤ 90 days		Unlikely to pay that are not past due or are past due ≤ 90 days	Past due > 90 days ≤ 180 days	Past due > 180 days ≤ 1 year	Past due > 1 year ≤ 2 years	Past due > 2 years ≤ 5 years	Past due > 5 years ≤ 7 years	Past due > 7 years	Of which defaulted
Loans and advances	26,131.7	26,095.6	36.1	89.3	25.9	31.1	19.2	9.1	3.5	0.4	0.1	64.8
Central banks	2,500.2	2,500.2	-	-	-	-	-	-	-	-	-	-
Credit institutions	139.6	139.6	-	-	-	-	-	-	-	-	-	-
Other financial corporations	328.1	328.1	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	294.5	289.6	4.9	19.3	1.8	7.6	8.4	1.5	-	-	-	14.0
Of which SMEs	112.6	112.6	-	5.3	-	5.3	-	-	-	-	-	-
Households	22,869.3	22,838.1	31.2	70.0	24.1	23.5	10.8	7.6	3.5	0.4	0.1	50.8
Debt securities	2,193.2	2,193.2	-	-	-	-	-	-	-	-	-	-
General governments	466.8	466.8	-	-	-	-	-	-	-	-	-	-
Credit institutions	1,726.4	1,726.4	-	-	-	-	-	-	-	-	-	-
Off-balance sheet exposures	1,781.4			-								-
Non-financial corporations	133.5			-								-
Households	1,647.9			-								-
Total	30,106.3	28,288.8	36.1	89.3	25.9	31.1	19.2	9.1	3.5	0.4	0.1	64.8

The Group holds an equity release mortgage book, which is closed to new business and is held at fair value through profit or loss (FVTPL), together with a small portfolio of other mortgages also held at FVTPL. These mortgages are not included in the table above for the reasons outlined under template 4 on page 74; the total fair value of these portfolios was £407.8m at 31 December 2021 (31 December 2020: £435.1m).

Template 3	2020											
	Gross carrying amount / nominal amount											
	Performing exposures			Non-performing exposures								
		Not past due or past due ≤ 30 days	Past due > 30 days ≤ 90 days		Unlikely to pay that are not past due or are past due ≤ 90 days	Past due > 90 days ≤ 180 days	Past due > 180 days ≤ 1 year	Past due > 1 year ≤ 2 years	Past due > 2 years ≤ 5 years	Past due > 5 years ≤ 7 years	Past due > 7 years	Of which defaulted
Loans and advances	25,595.3	25,538.1	57.2	100.1	26.0	36.3	27.4	8.2	2.2	-	-	81.5
Central banks	3,349.7	3,349.7	-	-	-	-	-	-	-	-	-	-
Credit institutions	179.9	179.9	-	-	-	-	-	-	-	-	-	-
Other financial corporations	394.9	394.9	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	278.2	261.7	16.5	25.4	6.9	9.9	8.1	0.5	-	-	-	21.1
Of which SMEs	80.3	80.3	-	4.3	-	4.3	-	-	-	-	-	-
Households	21,392.6	21,351.9	40.7	74.7	19.1	26.4	19.3	7.7	2.2	-	-	60.4
Debt securities	1,505.0	1,505.0	-	-	-	-	-	-	-	-	-	-
General governments	315.7	315.7	-	-	-	-	-	-	-	-	-	-
Credit institutions	1,189.3	1,189.3	-	-	-	-	-	-	-	-	-	-
Off-balance sheet exposures	1,645.2			-								-
Non-financial corporations	262.9			-								-
Households	1,382.3			-								-
Total	28,745.5	27,043.1	57.2	100.1	26.0	36.3	27.4	8.2	2.2	-	-	81.5

The following tables show an overview of the performing and non-performing exposures and related provisions.

2021

Template 4	Gross carrying amount / nominal amount						Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
	Performing exposures			Non-performing exposures			Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions				On performing exposures	On non-performing exposures
		Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3		Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3			
Loans and advances	26,131.7	25,525.5	606.2	89.3	5.3	84.0	(18.5)	(4.0)	(14.5)	(9.7)	(0.9)	(8.8)	-	23,025.5	75.3
Central banks	2,500.2	2,500.2	-	-	-	-	(0.2)	(0.2)	-	-	-	-	-	-	-
Credit institutions	139.6	139.6	-	-	-	-	(0.1)	(0.1)	-	-	-	-	-	-	-
Other financial corporations	328.1	328.1	-	-	-	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	294.5	147.2	147.3	19.3	5.3	14.0	(12.1)	(0.1)	(12.0)	(5.0)	(0.9)	(4.1)	-	167.2	10.0
Of which SMEs	112.6	112.6	-	5.3	5.3	-	(0.1)	(0.1)	-	(0.9)	(0.9)	-	-	-	-
Households	22,869.3	22,410.4	458.9	70.0	-	70.0	(6.1)	(3.6)	(2.5)	(4.7)	-	(4.7)	-	22,858.3	65.3
Debt securities	2,193.2	2,193.2	-	-	-	-	-	-	-	-	-	-	-	-	-
General governments	466.8	466.8	-	-	-	-	-	-	-	-	-	-	-	-	-
Credit institutions	1,726.4	1,726.4	-	-	-	-	-	-	-	-	-	-	-	-	-
Off-balance sheet exposures	1,781.4	1,781.4	-	-	-	-	(0.1)	(0.1)	-	-	-	-		1,647.8	-
Non-financial corporations	133.5	133.5	-	-	-	-	-	-	-	-	-	-		-	-
Households	1,647.9	1,647.9	-	-	-	-	(0.1)	(0.1)	-	-	-	-		1,647.8	-
Total	30,106.3	29,500.1	606.2	89.3	5.3	84.0	(18.6)	(4.1)	(14.5)	(9.7)	(0.9)	(8.8)	-	24,673.3	75.3

The Group holds an equity release mortgage book, which is closed to new business and is held at fair value through profit or loss (FVTPL), together with a small portfolio of other mortgages also held at FVTPL. The total fair value of these portfolios was £407.8m at 31 December 2021 (31 December 2020: £435.1m). As these mortgages are held at FVTPL, they cannot be split by stage which only applies to financial assets on which expected credit losses (ECLs) are assessed, and therefore these balances are not included in the table above.

2020

Template 4	Gross carrying amount / nominal amount						Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
	Performing exposures			Non-performing exposures			Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions				On performing exposures	On non-performing exposures
		Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3		Of which stage 1	Of which stage 2		Of which stage 2	Of which stage 3			
Loans and advances	25,595.3	23,248.9	2,346.4	100.2	4.3	95.9	(31.0)	(5.4)	(25.6)	(11.1)	(0.9)	(10.2)	-	21,553.6	85.6
Central banks	3,349.7	3,349.7	-	-	-	-	(0.3)	(0.3)	-	-	-	-	-	-	-
Credit institutions	179.9	179.9	-	-	-	-	(0.2)	(0.2)	-	-	-	-	-	-	-
Other financial corporations	394.9	394.9	-	-	-	-	-	-	-	-	-	-	-	-	-
Non-financial corporations	278.2	116.4	161.8	25.4	4.3	21.1	(13.6)	(0.1)	(13.5)	(5.1)	(0.9)	(4.2)	-	183.4	16.9
Of which SMEs	80.3	80.3	-	4.3	4.3	-	(0.1)	(0.1)	-	(0.9)	(0.9)	-	-	-	-
Households	21,392.6	19,208.0	2,184.6	74.8	-	74.8	(16.9)	(4.8)	(12.1)	(6.0)	-	(6.0)	-	21,370.2	68.7
Debt securities	1,505.0	1,505.0	-	-	-	-	-	-	-	-	-	-	-	-	-
General governments	315.7	315.7	-	-	-	-	-	-	-	-	-	-	-	-	-
Credit institutions	1,189.3	1,189.3	-	-	-	-	-	-	-	-	-	-	-	-	-
Off-balance sheet exposures	1,645.2	1,645.2	-	-	-	-	(0.1)	(0.1)	-	-	-	-		1,382.2	-
Non-financial corporations	262.9	262.9	-	-	-	-	-	-	-	-	-	-		-	-
Households	1,382.3	1,382.3	-	-	-	-	(0.1)	(0.1)	-	-	-	-		1,382.2	-
Total	28,745.5	26,399.1	2,346.4	100.2	4.3	95.9	(31.1)	(5.5)	(25.6)	(11.1)	(0.9)	(10.2)	-	22,935.8	85.6

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.
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, less regulatory adjustments. CET 1 capital is fully loss absorbing.
Covered bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets to be solely for the benefit of the holders of the covered bonds. The Group has established covered bonds as part of its funding activities. Covered bonds use retail / residential mortgages as the asset pool.
Credit Valuation Adjustment (CVA)	The adjustment applied to the fair values of derivatives to reflect the creditworthiness of the counterparty.
CRD V	CRD V became effective on 31 December 2020 and is made up of the Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR), as amended by the onshored provisions within CRR II regulation (EU) 2019/876 and the CRR 'Quick Fix' package.
CRR	UK Capital Requirements Regulation.
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 and currency risk.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or a liability measured at amortised cost and to allocate associated interest income or expense over the relevant period.
Expected Credit Loss (ECL)	The present value of all cash shortfalls over the expected life of the financial instrument to determine impairment allowances under IFRS 9.
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 separately identifiable net assets at the date of acquisition.
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.
Internal 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 requirements.
Internal ratings-based approach (IRB)	An advanced approach to measuring capital requirements in respect of credit risk. 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.
CRR Leverage ratio	The ratio of Tier 1 capital divided by total exposure, which includes on and off balance sheet assets, after netting derivatives.
UK leverage ratio	The UK leverage ratio represents the UK regulatory regime which excludes deposits with central banks from the leverage exposure measure.
Liquid assets	The total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.
Liquidity Coverage Ratio (LCR)	A measure designed to ensure that financial institutions have sufficient high quality assets available to meet their liquidity needs for a 30 day liquidity stress scenario.

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.
Loss given default (LGD)	An estimate of the loss that would be incurred should a borrower default on their credit obligations.
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, or is the holder of a Permanent Interest Bearing Share in the Society.
Net Stable Funding Ratio	The Net Stable Funding Ratio (NSFR) is a long term stable funding metric, which measures the stability of our funding sources relative to the assets (mortgage balances) we are required to fund.
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.
Probability of Default (PD)	An estimate of the probability that a borrower will default on their credit obligations.
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 bond 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 V 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.
Significant increase in credit risk	A significant increase in credit risk on a financial asset is judged to have occurred when an assessment using quantitative and qualitative factors identifies that the credit risk has increased significantly since the asset was originally recognised.
Stage 1 financial assets	Stage 1 financial assets are assets which have not experienced a significant increase in credit risk since origination. 12 month ECLs are recognised and interest revenue is determined by the EIR on the gross carrying amount.
Stage 2 financial assets	Stage 2 financial assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECLs are recognised and interest revenue is determined by the EIR on the gross carrying amount.
Stage 3 financial assets	Stage 3 financial assets are identified as in default and considered credit impaired. Lifetime ECLs are recognised and interest revenue is determined by the EIR on the net carrying amount.
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 judgments 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, less regulatory deductions. 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 PIBS that have been transitioned out of additional Tier 1 capital – under CRD V all of the Society's PIBS will be phased out of Tier 1 capital as they fail to satisfy the CRD V requirements. However the Society's 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

For media enquiries please contact the Skipton press office.

Tel: **0345 601 7247**

Email: **newsline@skipton.co.uk**