# Pillar 3 Disclosures 31 December 2015

SKIPTON
BUILDING SOCIETY
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# Contents

# 1 INTRODUCTION

This document presents the consolidated Pillar 3 disclosures of the Skipton Building Society Group (the 'Group') as at 31 December 2015.

## 1.1 Background

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

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

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

## 1.2 Pillar 3 Policy

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

## 1.3 Basis and frequency of disclosure

These Pillar 3 disclosures are based upon the Group's Annual Report and Accounts for the year ended 31 December 2015, unless otherwise stated. The frequency of disclosure has been assessed in accordance with EBA guidelines and disclosures will be issued on an annual basis in conjunction with the publication of the Group's Annual Report and Accounts, unless there is a material change to the Group's risk profile or regulatory change, when disclosures will be made more frequently.

## 1.4 Media and location of publication

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

## 1.5 Verification of disclosure

The design of specific controls surrounding the preparation of these disclosures has been independently reviewed and independent external advice on compliance with regulatory reporting requirements has been applied. These disclosures have also been reviewed by the Board Risk Committee. There is no requirement for the disclosures to be externally audited, although some of the information within the disclosures also appears in the Group's 2015 Annual Report and Accounts which are externally audited.

## 1.6 Scope of application

The balances within the Group's Annual Report and Accounts are prepared in line with International Financial Reporting Standards (IFRS), whilst the balances within the Pillar 3 disclosures are prepared in line with CRD IV. This results in some differences between the two documents. A reconciliation of the accounting values to regulatory capital values has been set out in Appendix 1.

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

- Individual consolidation group
- Prudential consolidation group

At 31 December 2015, the individual consolidation group comprised the following companies:

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

At 31 December 2015 the prudential consolidation group comprised the following companies:

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

In 2015, the Group completed the sale of Pearson Jones plc. As this business was not considered to be a major line of business to the Group it was not classified as a discontinued operation. As such the figures reported here and in the audited accounts for 2014 have not been restated to remove the impact of this disposal.

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

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

- Connells Limited and its subsidiaries
- Skipton Trustees Limited

- Jade Software Corporation Limited
- Northwest Investments Limited

### 1.6.1 Disclosure levels

In accordance with Article 13 of CRR, key information has been disclosed at both a prudential and an individual consolidation group level. However, in accordance with Article 432 of CRR, where the difference between the two consolidation groups is immaterial, the granular analysis has been disclosed at a prudential group level only. In addition, the Group's exposure to foreign currency risk leads to an immaterial capital requirement, see section 6.3.1 for further detail. An overview of our approach to interest rate risk is set out in section 7.8, 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.

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

## 1.7 Transferability of capital

In order to ensure the greatest degree of flexibility in the allocation of capital, the Board aims to retain the optimal level of capital in the prudential consolidation group and individual consolidation group – the regulated entities. This general principle is subject to a number of regulatory, taxation and commercial considerations which are taken into account before decisions regarding dividend payments from Group entities are finalised. The Board considers that there is no current or foreseeable material, practical or legal impediments to the prompt repayment of liabilities between the individual consolidation group and its subsidiary undertakings.

Prior consent is required from the GFSC before any capital can be repatriated or dividends paid by Skipton International Limited to Skipton Building Society as the parent company.

# 2 RISK MANAGEMENT OBJECTIVES AND POLICIES

## 2.1 Introduction

The Society is a mutual organisation run for the benefit of its members. The Board adopts a prudent approach to managing risk in order to increase the long term value for the benefit of members. The key risks to which the Group is exposed include business risk, reputational risk, credit risk, regulatory risk, market risk, currency risk, pension obligation risk, operational risk, model risk, technological risk, interest rate risk, equity risk, liquidity risk and taxation risk. These risks are explained in detail in sections 6 and 7 of these disclosures and in the Risk Management Report of the Annual Report and Accounts, pages 50 to 56.

## 2.2 Risk appetite

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

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

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

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

## 2.3 Group risk management framework

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

- **First line of defence**, being line management within the business which, through the implementation of the organisation's risk framework, identifies, assesses and manages risk.
- **Second line of defence**, comprising independent Risk functions (Operational, Credit, Market and Liquidity) and related independent Compliance functions. These functions challenge, monitor, guide and support the business in managing its risk exposure. The risk framework includes the four Board Risk Committee sub-committees, namely, the Conduct and Operational Risk Committee, the Asset and Liability Committee, the Retail Credit Committee and the Model Governance Committee, details of which are set out in sections 2.5.1 to 2.5.4. These sub-committees are responsible for recommending and monitoring the Group's adherence to policy. The independent Risk functions are represented on each of these sub-committees. The Board Risk Committee is responsible for approving changes to policy, oversight of the risk management framework and monitoring of the business risk profile against the Board approved risk appetite. The Board Risk Committee Chairman is responsible for ensuring the independence of the second line of defence from the first line of defence.

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

Further details on the specific responsibilities of the Board and the Executive Committees are summarised in this section and set out in detail in the Directors' Report on Corporate Governance and the Risk Management Report in the Annual Report and Accounts.

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

## 2.4 Board

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

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

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

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

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

- **Recognise and manage risk** - *The Board has a sound system of risk oversight, risk management and internal control supported by timely and transparent reporting*.

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

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

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

The Board consider that the risk management systems in place are adequate and aligned to the profile and strategy of the Group. The Directors' Report on Corporate Governance and the Risk Management Report in the Annual Report and Accounts, see pages 40 and 50 respectively, include declarations to this effect and provide further detail on the Board's review of the framework of internal control and compliance with the UK Corporate Governance Code.

***Board meetings***

The Board meets at least 10 times per year and the Non-Executive Directors also meet, without Executive Directors present, at least once a year.

***Board members***

Details of the Board members' other directorships can be found in the Annual Report and Accounts on pages 168 to 170. The recruitment policy for Board members and the diversity policy with respect to all employees including directors and senior managers can also be found in the Annual Report and Accounts on pages 42 and 43 respectively.

## 2.5 Board Risk Committee

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

The current members of the Committee are:

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

In accordance with the Capital Requirements Directive (CRD) regulations, the Committee's membership comprises only Non-Executive Directors. To support the Committee in fulfilling its duties, its meetings are also attended by Mr Cutter (Group Chief Executive), Mr Ndawula (Group Finance Director) and other Senior Executives of the Society.

The Board Risk Committee met eight times in the year. The responsibilities of the Committee are delegated by the Board and are set out in its written terms of reference, which are available on our website at www.skipton.co.uk/about-us/governance/board-committees.

The Board Risk Committee also has a number of sub-committees, which have day-to-day responsibility for risk management oversight. These committees are set out in sections 2.5.1 to 2.5.4 below.

### 2.5.1 Conduct and Operational Risk Committee

The Conduct and Operational Risk Committee (CORC) is primarily responsible for developing and maintaining the Group's conduct and operational risk management frameworks and monitoring management of the risks arising in these areas. CORC also recommends changes to the conduct and operational risk appetites and associated policies to the Board Risk Committee. Mr Gibson (Chief

Conduct Risk Officer and Secretary) chairs CORC which comprises Senior Executives from each of the divisions and the Group Operational Risk and Compliance teams.

### 2.5.2 Asset and Liability Committee

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

### 2.5.3 Retail Credit Committee

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

### 2.5.4 Model Governance Committee

The Model Governance Committee (MGC) is primarily responsible for the review and approval of Credit Risk models. It will expand this to all key models over time (for example, financial models). Mr Ndawula (Group Finance Director) chairs MGC and its members include the Chief Operating Officer and Chief Financial Risk Officer, in addition to Senior Executives from across the Operational areas, Finance and Credit Risk.

## 2.6 Executive Committee

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

## 2.7 Audit Committee

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

- Ms M Cassoni, Non-Executive Director (Committee Chairman)
- Mrs C Black, Non-Executive Director
- Mrs D P Cockrem, Non-Executive Director (appointed to the Committee on 1 September 2015)
- Mr G E Picken, Non-Executive Director
- Mr P J S Thompson, Non-Executive Director

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

Audit Committees' which was last updated in September 2012. The Committee's primary responsibilities are:

- To keep under review the effectiveness of the Group's internal controls, including financial controls and risk management systems;
- To monitor the integrity of the Group's financial reporting process specifically by reviewing, challenging and recommending to the Board for approval the Group's annual and interim financial statements, reviewing and recommending to the Board for approval any formal announcements relating to the Group's financial performance, and reviewing significant reporting judgements and reporting how these were addressed;
- To provide advice, where requested by the Board, on whether the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for members to assess the Group's strategy, business model and performance;
- To provide oversight of the external audit process by monitoring the relationship with the external auditor, agreeing their remuneration and terms of engagement, monitoring their performance, objectivity and independence, ensuring that the policy to provide non-audit services is appropriately applied and making recommendations to the Board on their appointment, reappointment or removal;
- To review the effectiveness of the Internal Audit and Compliance Monitoring functions and review their material findings; and
- To report to the Board on how the Committee has discharged its responsibilities.

The Committee met seven times during 2015.

## 2.8 Remuneration Committee

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

- Ensure that remuneration policies, principles and practices are appropriate to enable the business to attract, retain and reward people with the right skills, experience, knowledge and behaviours to support achievement of business goals and objectives;
- Maintain policies which are compliant with governing laws and regulations;
- Ensure that remuneration arrangements support and encourage desired behaviours and culture; and
- Ensure appropriate governance of remuneration practices across the Society and its subsidiary companies and exercise effective oversight of these.

Amongst its other duties, the Committee specifically:

- Sets remuneration for the Chairman and the Executive Directors;
- Approves the remuneration policy for senior managers who have a material impact on the Society's risk profile ('MRTs');
- Reviews recommendations from the Group Chief Executive for approval of the remuneration for key Executives in the Group; and

- Agrees the design and overall targets for any short or longer term variable pay schemes applicable to Senior Executives and MRTs.

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

The full terms of reference of the Remuneration Committee and the remuneration principles are available on request from the Group Secretary. The terms of reference are also available online at http://www.skipton.co.uk/about-us/governance/board-committees.

The Remuneration Committee met nine times during 2015. In discharging its duties, the Committee reviews and takes into account independently produced data in relation to similar Financial Services organisations. Remuneration consultants advising the Committee are independent from the Group.

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

The Remuneration Committee undertook a review of its advisers in early 2015 to support the anticipated changes in the regulatory landscape. Following a selection process, PwC were selected as advisers due to the broad base of their expertise and, specifically, their ability to guide the Society through the anticipated regulatory changes. In 2015, the committee paid £189,750 (net of VAT) in fees to PwC in respect of remuneration services.

The Directors Remuneration Report outlines the arrangements for determining the remuneration policy of Skipton Building Society (SBS), the link between pay and performance and the key incentive schemes for the Society's Material Risk Takers (MRTs). This is set out on pages 57 to 72 of the Group's Annual Report and Accounts which are published on the Society's website www.skipton.co.uk. Similar detail for Skipton Financial Services (SFS) and Skipton International Ltd (SIL) can be found in section 9.

## 2.9 Non-Executive Directors' Remuneration Committee

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

# 3 Summary of Key Disclosures

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

## 3.1 Capital

The table below sets out the capital adequacy as at 31 December 2015 under CRD IV applying both the transitional rules and the CRD IV end-point or 'fully loaded' position for the prudential consolidation group. The key difference between the transitional and fully loaded position is that under the fully loaded rules all existing additional Tier 1 and Tier 2 instruments that became ineligible as capital under CRD IV are excluded in full (namely a £50m tranche of Permanent Interest Bearing Shares (PIBS) and £30m of subordinated debt instruments).

| **Prudential Consolidation Group** | **CRD IV Transitional** | | **CRD IV Fully Loaded** | |
|---|---|---|---|---|
| | **2015** | Restated* 2014 | **2015** | Restated* 2014 |
| | **£m** | £m | **£m** | £m |
| Total common equity tier 1 | **1,054.3** | 934.0 | **1,054.3** | 936.6 |
| Total tier 1 capital | **1,117.3** | 1,006.0 | **1,054.3** | 936.6 |
| Total tier 2 capital | **59.4** | 55.7 | **42.4** | 44.4 |
| **Total own funds** | **1,176.7** | 1,061.7 | **1,096.7** | 981.0 |
| **Risk weighted assets** | | | | |
| **Total risk weighted assets (RWAs)** | **6,276.4** | 5,821.6 | **6,276.4** | 5,821.6 |
| **Pillar 1 capital requirement (RWA x 8%)** | **502.1** | 465.7 | **502.1** | 465.7 |
| **Excess capital over minimum Pillar 1 requirement** | **674.6** | 596.0 | **594.6** | 515.3 |
| **Capital Ratios** | | | | |
| Common equity tier 1 (%) | **16.80** | 16.04 | **16.80** | 16.09 |
| Tier 1 (%) | **17.80** | 17.28 | **16.80** | 16.09 |
| Total Capital (%) | **18.75** | 18.24 | **17.47** | 16.85 |

* The comparative figures have been restated due to a change in accounting policy relating to dividend payments to non-controlling shareholders of subsidiary undertakings (fully loaded and transitional) and a reclassification of fair value adjustments under CRD IV rules (fully loaded only). Further details are provided in note 1b) to the Annual Report and Accounts.

During 2015 the total capital of the Group increased by £115m due primarily to a corresponding increase in retained profits (see section 4.5 and the regulatory capital flow statement for more details). The common equity tier 1 (CET1) ratio has also increased to 16.80% (2014: 16.04%) demonstrating that the increase in lending during the year has been supported by the strong profit and capital generation. Further detail on the Group's capital position is set out in sections 4 to 6 in this document.

## 3.2 Leverage ratio

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

| | **CRD IV Transitional** | | **CRD IV Fully Loaded** | |
|---|---|---|---|---|
| | **2015** | Restated* 2014 | **2015** | Restated* 2014 |
| | **£m** | £m | **£m** | £m |
| Total Tier 1 Capital | **1,117.3** | 1,006.0 | **1,054.3** | 936.6 |
| Total Exposure | **17,369.3** | 15,789.9 | **17,369.3** | 15,789.9 |
| **Leverage Ratio** | **6.4%** | 6.4% | **6.1%** | 5.9% |

* The comparative figure has been restated due to a change in accounting policy relating to dividend payments to non-controlling shareholders of subsidiary undertakings (fully loaded and transitional) and a reclassification of fair value adjustments under CRD IV rules (fully loaded only). Further details are provided in note 1b) to the Annual Report and Accounts.

The figures above show that whilst the Group has increased lending throughout 2015, it has also increased its capital base and has a leverage ratio of 6.4% (6.1% under the fully loaded position). Further detail on the Group's leverage ratio is set out in section 8 and Appendix 4 of this document.

## 3.3 Encumbrance

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

The following table shows the median level of encumbrance within the Group for the year ended 31 December 2015.

| | **Carrying amount of encumbered assets** | **Carrying amount of unencumbered assets** |
|---|---|---|
| | **£m** | **£m** |
| Assets | **3,239.3** | **13,679.5** |

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

# 4 CAPITAL RESOURCES

## 4.1 Total capital resources

The following tables show the capital resources as at 31 December 2015 under CRD IV applying both the transitional rules and the CRD IV fully loaded position for both the prudential and the individual consolidation group.

| **Prudential Consolidation Group** | **CRD IV Transitional** | | **CRD IV Fully Loaded** | |
|---|---|---|---|---|
| | | Restated* | | Restated* |
| | **2015** | 2014 | **2015** | 2014 |
| | **£m** | £m | **£m** | £m |
| **Common Equity Tier 1** | | | | |
| Reserves | **1,059.4** | 943.3 | **1,059.4** | 943.3 |
| Prudential Adjustments (Note 1) | **(0.9)** | (0.9) | **(0.9)** | (0.9) |
| Deductions from common equity tier 1 capital | **(7.4)** | (11.1) | **(7.4)** | (11.1) |
| Deduction of unrealised gains on available-for-sale debt securities | **-** | (2.6) | **-** | - |
| Deduction of cash flow hedging reserve | **3.2** | 5.3 | **3.2** | 5.3 |
| **Total Common Equity Tier 1 capital** | **1,054.3** | 934.0 | **1,054.3** | 936.6 |
| **Additional Tier 1** | | | | |
| Permanent Interest Bearing Shares | **63.0** | 72.0 | **-** | - |
| **Total Tier 1 capital** | **1,117.3** | 1,006.0 | **1,054.3** | 936.6 |
| **Tier 2** | | | | |
| Subordinated liabilities | **32.4** | 37.7 | **2.4** | 4.4 |
| Permanent Interest Bearing Shares | **27.0** | 18.0 | **40.0** | 40.0 |
| **Total Tier 2 capital** | **59.4** | 55.7 | **42.4** | 44.4 |
| **Total Own funds** | **1,176.7** | 1,061.7 | **1,096.7** | 981.0 |

| Individual Consolidation Group | CRD IV Transitional | | CRD IV Fully Loaded | |
|---|---|---|---|---|
| | | | | Restated* |
| | **2015** | 2014 | **2015** | 2014 |
| | **£m** | £m | **£m** | £m |
| **Common Equity Tier 1** | | | | |
| Reserves | **1,037.7** | 924.7 | **1,037.7** | 924.8 |
| Prudential Adjustments (Note 1) | **(0.9)** | (0.9) | **(0.9)** | (0.9) |
| Deductions from common equity tier 1 capital | **(1.1)** | (1.7) | **(1.1)** | (1.7) |
| Deduction of unrealised gains on available-for-sale debt securities | **-** | (2.6) | **-** | - |
| Deduction of cash flow hedging reserve | **3.2** | 5.3 | **3.2** | 5.3 |
| **Total Common Equity Tier 1 capital** | **1,038.9** | 924.8 | **1,038.9** | 927.5 |
| **Additional Tier 1** | | | | |
| Permanent Interest Bearing Shares | **63.0** | 72.0 | **-** | - |
| **Total Tier 1 capital** | **1,101.9** | 996.8 | **1,038.9** | 927.5 |
| **Tier 2** | | | | |
| Subordinated liabilities | **32.4** | 37.7 | **2.4** | 4.4 |
| Permanent Interest Bearing Shares | **27.0** | 18.0 | **40.0** | 40.0 |
| **Total Tier 2 capital** | **59.4** | 55.7 | **42.4** | 44.4 |
| **Total Own funds** | **1,161.3** | 1,052.5 | **1,081.3** | 971.9 |

* The comparative figures have been restated due to a change in accounting policy relating to dividend payments to non-controlling shareholders of subsidiary undertakings (fully loaded and transitional) and a reclassification of fair value adjustments under CRD IV rules (fully loaded only). Further details are provided in note 1b) to the Annual Report and Accounts.

**Notes**

1. Prudential adjustments include deductions to capital for deferred tax and an Additional Valuation Adjustment ('AVA') on fair value assets. AVA has been applied to prudently provide for the downside of fair value exposures that are intrinsically subjective in nature.

## 4.2 Common equity tier 1 capital

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

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

## 4.3 Additional tier 1 capital

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

All PIBS are unsecured and rank pari passu with each other. They are deferred shares of the Society and rank behind the claims against the Society of all subordinated note holders, depositors, payables and investing members of the Society. One tranche of PIBS with a par value of £50m has future quarterly call dates commencing on 13 April 2017 providing the Society with an opportunity to repay the shares at par. On the initial call date, this tranche of PIBS will no longer be eligible for regulatory capital. The remaining PIBS do not have call dates and will remain eligible for regulatory capital but will be phased out of Tier 1 capital into Tier 2 capital over a transitional period to 1 January 2022.

For capital purposes PIBS and subordinated liabilities are disclosed at par value and the associated merger fair value adjustments are included within the general reserve.

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

## 4.4 Tier 2 capital

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

- The instrument is removed from capital immediately, either from 1 January 2014 when CRD IV became effective, or from its first call date after 1 January 2014.

- The instrument may be phased out of capital over the period to 2022 (or less if maturity occurs before this). This treatment is referred to as 'grandfathering'.

As a result, subordinated liabilities with a regulatory capital value of £38.6m (nominal value of £45.3m) became ineligible to continue as regulatory capital in 2014. Of the remaining £32.4m of regulatory capital at 31 December 2015 (nominal value £40m), £2.4m is fully eligible for regulatory capital and £30.0m is subject to 'grandfathering' rules.

Subordinated liability instruments with less than five years to maturity and that continue to be eligible or are grandfathered are amortised down to zero on a straight line basis in accordance with Article 64 of CRR.

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

## 4.5 Regulatory capital flow statement

The table below shows the flow of regulatory capital and associated movements that have occurred from 31 December 2014 to 31 December 2015. This shows an increase in common equity tier 1 due to profits generated during the year with no significant movements experienced in other balances. This table is presented at a prudential group level on a transitional basis as this represents our current regulatory capital position at our highest regulated consolidation group.

**Prudential Consolidation Group**

| | **2015**<br>**£m** |
|---|---|
| **Common Equity Tier 1 capital at 1 January (restated)*** | **934.0** |
| Profit for the year | 109.6 |
| Actuarial gain on retirement benefit obligation | 2.8 |
| Available for sale reserve | 1.5 |
| Tax on items taken directly to reserves | 1.3 |
| Net reduction in goodwill | 3.2 |
| Movement in fair value for PIBS and subordinated liabilities (note 1) | 1.4 |
| Net reduction in intangible assets | 0.5 |
| **Common Equity Tier 1 capital at 31 December** | **1,054.3** |
| | |
| **Additional Tier 1 capital at 1 January** | **72.0** |
| Phasing of PIBS from Tier 1 to Tier 2 capital | (9.0) |
| **Additional Tier 1 capital at 31 December** | **63.0** |
| | |
| **Tier 2 capital at 1 January** | **55.7** |
| Amortisation of Tier 2 subordinated liabilities | (5.3) |
| Phasing of PIBS from Tier 1 to Tier 2 capital | 9.0 |
| **Tier 2 capital at 31 December** | **59.4** |
| | |
| **Total Own funds at 1 January (restated)** | **1,061.7** |
| **Total Own funds at 31 December** | **1,176.7** |

* The comparative figures have been restated due to a change in accounting policy relating to dividend payments to non-controlling shareholders of subsidiary undertakings (fully loaded and transitional) and a reclassification of fair value adjustments under CRD IV rules (fully loaded only). Further details are provided in note 1b) to the Annual Report and Accounts.

**Notes**

1. For capital purposes PIBS and subordinated liabilities are disclosed at par value and the associated merger fair value adjustments are included in the general reserve.

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

# 5 CAPITAL ADEQUACY

## 5.1 Summary of capital adequacy

Under PRA rules a minimum level of capital (Pillar 1) must be held for credit risk, operational risk and market risk for the individual and prudential consolidation groups. The Group has adopted the standardised approach to calculate the minimum regulatory capital resource requirement for credit risk and operational risk. Market risk has been calculated in accordance with Article 83 of CRD IV. Foreign exchange risk is the only Pillar 1 market risk incurred by the individual and prudential groups, and under guidance within CRR Article 351 both the individual and prudential groups' foreign exchange risk can be disregarded on the grounds of materiality. Section 6 sets out further detail on the capital requirements under Pillar 1.

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

| **Prudential Consolidation Group** | **CRD IV Transitional** | | **CRD IV Fully Loaded** | |
|---|---|---|---|---|
| | | Restated | | Restated |
| | **2015** | 2014 | **2015** | 2014 |
| | **£m** | £m | **£m** | £m |
| Total common equity tier 1 | **1,054.3** | 934.0 | **1,054.3** | 936.6 |
| Total tier 1 capital | **1,117.3** | 1,006.0 | **1,054.3** | 936.6 |
| Total tier 2 capital | **59.4** | 55.7 | **42.4** | 44.4 |
| **Total own funds** | **1,176.7** | 1,061.7 | **1,096.7** | 981.0 |
| **Risk weighted assets** | | | | |
| Credit risk | **5,930.1** | 5,524.6 | **5,930.1** | 5,524.6 |
| Operational risk | **346.3** | 297.0 | **346.3** | 297.0 |
| Market risk | **-** | - | **-** | - |
| **Total risk weighted assets (RWAs)** | **6,276.4** | 5,821.6 | **6,276.4** | 5,821.6 |
| **Pillar 1 capital requirement (RWAs x 8%)** | **502.1** | 465.7 | **502.1** | 465.7 |
| **Excess capital over minimum Pillar 1 requirement** | **674.6** | 596.0 | **594.6** | 515.3 |
| **Capital Ratios** | | | | |
| Common equity tier 1 (%) | **16.80** | 16.04 | **16.80** | 16.09 |
| Tier 1 (%) | **17.80** | 17.28 | **16.80** | 16.09 |
| Total Capital (%) | **18.75** | 18.24 | **17.47** | 16.85 |

| **Individual Consolidation Group** | **CRD IV Transitional** | | **CRD IV Fully Loaded** | |
|---|---|---|---|---|
| | | Restated | | Restated |
| | **2015** | 2014 | **2015** | 2014 |
| | **£m** | £m | **£m** | £m |
| Total common equity tier 1 | **1,038.9** | 924.8 | **1,038.9** | 927.5 |
| Total tier 1 capital | **1,101.9** | 996.8 | **1,038.9** | 927.5 |
| Total tier 2 capital | **59.4** | 55.7 | **42.4** | 44.4 |
| **Total own funds** | **1,161.3** | 1,052.5 | **1,081.3** | 971.9 |
| **Risk weighted assets** | | | | |
| Credit risk | **5,808.0** | 5,458.0 | **5,808.0** | 5,458.0 |
| Operational risk | **260.4** | 199.9 | **260.4** | 199.9 |
| Market risk | **-** | - | **-** | - |
| **Total risk weighted assets (RWA)** | **6,068.4** | 5,657.9 | **6,068.4** | 5,657.9 |
| **Pillar 1 capital requirement (RWA x 8%)** | **485.5** | 452.6 | **485.5** | 452.6 |
| **Excess capital over minimum Pillar 1 requirement** | **675.8** | 599.9 | **595.8** | 519.3 |
| **Capital Ratios** | | | | |
| Common equity tier 1 (%) | **17.12** | 16.35 | **17.12** | 16.39 |
| Tier 1 (%) | **18.16** | 17.62 | **17.12** | 16.39 |
| Total Capital (%) | **19.14** | 18.60 | **17.82** | 17.18 |

The capital required for credit risk increased during the year due to an increase in residential mortgage balances of £1.5bn for the prudential group and £1.4bn for the individual group as a result of new lending during the year. The operational risk capital requirement increased in 2015 as a result of an increase in business volumes across the Group rather than any significant changes in the operating or control environment.

Capital Ratios have improved consistently across the prudential and individual group reflecting a surplus of capital resources during 2015 after allowing for the additional capital requirements to support annual balance sheet growth.

### 5.1.1 Individual Consolidation Group disclosures

The difference between the total own funds figure and capital requirements for the individual consolidation group and the prudential consolidation group is £15.4m and £16.6m respectively. As these differences are not significant, we have not presented any further information at the individual consolidation group level within these disclosures.

## 5.2 Capital reporting

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

## 5.3 Internal capital adequacy assessment process

The Group holds capital to absorb losses which may occur in the economic cycle. The Internal Capital Adequacy Assessment Process (ICAAP) is the means by which the Group ensures it has:

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

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

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

The results of the ICAAP are articulated in a single document which is reviewed and approved by the Board and updated at least annually and more frequently should a significant change in the Group's risk profile occur. Section 7 sets out the additional risks considered in the Pillar 2 assessment.

# 6 MINIMUM CAPITAL REQUIREMENT- PILLAR 1

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

## 6.1 Credit risk

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

The Group faces this risk from its lending to:

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

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

The controlled management of credit risk is critical to the Group's overall strategy. The Group has, therefore, embedded a comprehensive and robust risk management framework with clear lines of accountability and oversight as part of its overall governance framework. Substantial further investment has been made in the management of credit risk over the last 12 months as part of our application to the Prudential Regulatory Authority (PRA) for Internal Ratings Based (IRB) status. The benefits of this investment and achieving IRB status are to further improve the processes and controls used by the Group to monitor, mitigate and manage credit risk and allocate capital within the Group's risk appetite.

RCC provides oversight to the effectiveness of all retail credit risk management across the Group and the controls in place ensure lending is within the Board approved credit risk appetite. ALCO, through the Group Wholesale Credit Committee, similarly manages treasury credit exposures.

The establishment of MGC to oversee the governance of our credit risk models, combined with investment in the Society's credit risk modelling capability, ensures that the Group has the right analytic tools to facilitate the appropriate management of credit risk.

The following tables detail the minimum capital requirements calculated under the standardised approach for credit risk for the prudential consolidation group as at 31 December 2015 broken down by exposure class:

| Prudential Consolidation Group | Exposure Value[note1] £m | Risk Weighted Assets £m | Capital Requirement £m |
|---|---|---|---|
| Corporates (Note 2) | 72.0 | 57.1 | 4.6 |
| Retail | 1.0 | 0.5 | - |
| Secured by mortgages on immovable property | 14,170.3 | 5,250.6 | 420.0 |
| Exposures in default (Note 3) | 134.1 | 134.8 | 10.8 |
| **Totals loans and advances to customers** | **14,377.4** | **5,443.0** | **435.4** |
| Central governments or central bank | 1,532.6 | 9.9 | 0.8 |
| Multilateral Development Banks | 149.1 | - | - |
| Institutions | 516.1 | 169.4 | 13.6 |
| Covered Bonds | 19.3 | 1.9 | 0.2 |
| Claims on institutions and corporates with a short-term credit assessment (Note 4) | 342.0 | 75.9 | 6.1 |
| Securitisation positions (Note 5) | 170.5 | 34.1 | 2.7 |
| Credit Valuation Adjustment (Note 6) | 84.6 | 52.7 | 4.2 |
| **Total Wholesale Credit Exposures** | **2,814.2** | **343.9** | **27.6** |
| Equity | 80.9 | 83.4 | 6.7 |
| Other Items | 65.1 | 59.8 | 4.8 |
| **Total Other** | **146.0** | **143.2** | **11.5** |
| **Total** | **17,337.6** | **5,930.1** | **474.5** |

**Notes**

1. The exposure value includes items which are off balance sheet, such as our mortgage pipeline which have a capital requirement but do not appear in the accounting balance sheet of the regulated group. Derivatives and repos are adjusted in accordance with regulatory requirements. The exposure balance is also adjusted for credit risk mitigation techniques such as netting, for further details see sections 6.1.10 to 6.1.11.
2. This balance is primarily made up of exposures related to debt factoring and invoice discounting in Skipton Business Finance (SBF).
3. Exposures in default refers to those accounts greater than three months in arrears.
4. This balance relates to exposures to institutions and corporates with a maturity of less than three months and a short-term credit rating.
5. This balance relates to purchased Residential Mortgage Backed Securities (RMBSs) excluding retained holdings.
6. The Group is already required to hold regulatory capital in order to cover potential losses which could arise if the counterparties to its derivative contracts fail to meet their financial obligations before the maturity date; this is known as the counterparty credit risk. It places a valuation on the risk that the counterparty will default on its obligations before the maturity of the contract. CRD IV extends this concept by introducing the requirement to hold additional regulatory capital in order to protect the Group from exposure to potential mark to market losses that could arise if the creditworthiness of those same counterparties were to deteriorate: this is known as a credit valuation adjustment charge.

The following table sets out exposure classes by geographic distribution. This shows that the majority of the Group's exposures are in the UK. Further regional breakdowns are provided for our mortgage lending in sections 6.1.3 and 6.1.4.

| **Prudential Consolidation Group** | **UK** £m | **Channel Islands** £m | **EU** £m | **Rest of World** £m | **Total Exposure Value** £m |
|---|---|---|---|---|---|
| Corporates | 72.0 | - | - | - | **72.0** |
| Retail | 1.0 | - | - | - | **1.0** |
| Secured by mortgages on immovable property | 13,326.2 | 844.1 | - | - | **14,170.3** |
| Exposures in default | 134.1 | - | - | - | **134.1** |
| **Totals loans and advances to customers** | **13,533.3** | **844.1** | **-** | **-** | **14,377.4** |
| Central governments or central bank | 1,517.6 | - | 15.0 | - | **1,532.6** |
| Multilateral Development Banks | - | - | 149.1 | - | **149.1** |
| Institutions | 350.3 | 41.7 | 44.7 | 79.4 | **516.1** |
| Covered Bonds | 19.3 | - | - | - | **19.3** |
| Claims on institutions and corporates with a short-term credit assessment | 187.8 | - | 122.1 | 32.1 | **342.0** |
| Securitisation positions | 170.5 | - | - | - | **170.5** |
| Credit Valuation Adjustment | 26.8 | - | 18.8 | 39.0 | **84.6** |
| **Total Wholesale Credit Exposures** | **2,272.3** | **41.7** | **349.7** | **150.5** | **2,814.2** |
| Equity | 80.9 | - | - | - | **80.9** |
| Other Items | 65.1 | - | - | - | **65.1** |
| **Total Other** | **146.0** | **-** | **-** | **-** | **146.0** |
| **Total** | **15,951.6** | **885.8** | **349.7** | **150.5** | **17,337.6** |

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

| Prudential Consolidation Group | On call and at short notice £m | < three months £m | 3mth to 1 year £m | 1 to 5 years £m | In more than five years £m | Total £m |
|---|---|---|---|---|---|---|
| Corporates | 70.1 | 1.8 | 0.1 | - | - | **72.0** |
| Retail | 1.0 | - | - | - | - | **1.0** |
| Secured by mortgages on immovable property | 3.3 | 26.4 | 71.6 | 520.6 | 13,548.4 | **14,170.3** |
| Exposures in default | - | 0.2 | 0.7 | 4.9 | 128.3 | **134.1** |
| **Total loans and advances to customers** | **74.4** | **28.4** | **72.4** | **525.5** | **13,676.7** | **14,377.4** |
| Central governments or central bank | 1,174.6 | 20.1 | 20.8 | 184.5 | 132.6 | **1,532.6** |
| Multilateral Development Banks | - | 30.1 | 7.0 | 79.0 | 33.0 | **149.1** |
| Institutions | 285.6 | 0.9 | 98.3 | 95.0 | 36.3 | **516.1** |
| Covered Bonds | - | - | - | 19.3 | - | **19.3** |
| Claims on institutions and corporates with a short-term credit assessment | 20.0 | 322.0 | - | - | - | **342.0** |
| Securitisation positions | - | 15.0 | 20.3 | 135.2 | - | **170.5** |
| Credit Valuation Adjustment | - | 5.0 | 2.9 | 51.9 | 24.8 | **84.6** |
| **Total Wholesale Credit Exposures** | **1,480.2** | **393.1** | **149.3** | **564.9** | **226.7** | **2,814.2** |
| Equity | - | - | - | 1.7 | 79.2 | **80.9** |
| Other Items | 6.2 | 7.1 | 7.0 | 22.5 | 22.3 | **65.1** |
| **Total Other** | **6.2** | **7.1** | **7.0** | **24.2** | **101.5** | **146.0** |
| **Total** | **1,560.8** | **428.6** | **228.7** | **1,114.6** | **14,004.9** | **17,337.6** |

### 6.1.1 Credit Risk Weighted Assets flow statement

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

| | Total Loans and advances to customers £m | Total Wholesale Credit Exposures £m | Total Other £m | Total £m |
|---|---|---|---|---|
| **Credit Risk RWAs at 31 December 2014** | **4,952.5** | **420.5** | **151.6** | **5,524.6** |
| Book size growth/(reduction) | 526.7 | (46.7) | (8.4) | 471.6 |
| Book quality (improvement)/deterioration | (36.2) | (29.9) | - | (66.1) |
| **Credit Risk RWAs at 31 December 2015** | **5,443.0** | **343.9** | **143.2** | **5,930.1** |

The table above shows that the organic growth in loans and advances to customers has increased the total value of risk weighted assets. The quality of loans to mortgage customers has improved as a result of positive house price movements and reduced arrears in line with the improved economic conditions during the year and ongoing effective arrears management. Wholesale risk weighted credit exposures have reduced in volume, driven by a reduction in derivative, securities funding transactions and non-central bank exposures. The reduction is further driven by improvements in the quality of the underlying exposures.

### 6.1.2 Credit Risk Exposures

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

The table below shows the mix of the loans and advances to customers at the reporting date. The average exposure is based on the average of the last two reporting positions.

| **Loans and Advances to customers** | **Average 2014/2015 £m** | **2015 £m** | 2014 £m |
|---|---|---|---|
| Total Residential Mortgages | 12,975.4 | 13,742.4 | 12,208.4 |
| Commercial Loans | 368.1 | 354.0 | 382.1 |
| Debt Factoring Loans | 67.7 | 71.7 | 63.8 |
| Other loans | 44.2 | 44.4 | 44.0 |
| **Gross Balances** | **13,455.4** | **14,212.5** | 12,698.3 |
| Impairment provisions | (60.3) | (61.8) | (58.9) |
| Fair Value Adjustments for hedged risk | 214.4 | 224.9 | 203.8 |
| **Total** | **13,609.5** | **14,375.6** | 12,843.2 |

The commercial loans balance includes £35.5m of exposures identified as being to Small and Medium Enterprises (SMEs). The debt factoring loans balance also has an exposure to SMEs of

£64.1m. The Group has increased its overall lending throughout the year with both the Society and SIL growing their mortgage books whilst the Amber and NYM mortgage books continue to run-off.

### 6.1.3 Retail credit risk

The Group currently lends in the prime residential UK mortgage market, including buy-to-let mortgages, through the Society. SIL lends in the Channel Islands mortgage markets and to UK expatriates purchasing buy-to-let properties in the UK. The Group has established comprehensive risk management processes in accordance with the Board's credit risk appetite which defines a number of limits regarding concentration risk as well as customer and collateral credit quality to which all lending activity must adhere. The Group maintains a low risk approach to new lending and will continue to do so.

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

The Group also has credit exposures through Amber and NYM which comprise residential UK mortgages, including buy-to-let, across prime and non-prime lending markets. In light of the deteriorating economic conditions at the time, we ceased new lending in these portfolios in March 2008, and continue to see the value of these portfolios reduce by around 9% per annum.

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

The majority of loans and advances to customers are secured on UK residential properties and are geographically diverse as set out in the table below.

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

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

| Lending Analysis | Prudential consolidation group | | | |
|---|---|---|---|---|
| | **2015** | | 2014 | |
| | **£m** | **%** | £m | % |
| **Prime:** | | | | |
| Residential | **10,189.5** | **74.1** | 8,725.8 | 71.6 |
| Buy-to-let | **2,323.1** | **16.9** | 2,146.0 | 17.6 |
| Self build | **58.4** | **0.4** | 67.1 | 0.5 |
| Fast track | **69.2** | **0.5** | 86.0 | 0.7 |
| Self certified | **555.9** | **4.1** | 613.8 | 5.0 |
| **Sub-Prime:** | | | | |
| Residential | **55.3** | **0.4** | 60.8 | 0.5 |
| Buy-to-let | **48.3** | **0.4** | 53.7 | 0.4 |
| Self build | **0.5** | **-** | 0.5 | - |
| Self certified | **169.2** | **1.2** | 180.8 | 1.5 |
| **Equity release** | **273.0** | **2.0** | 273.9 | 2.2 |
| **Total** | **13,742.4** | **100.0** | 12,208.4 | 100.0 |

Prime mortgages are those granted to the most credit worthy category of borrower. Sub-prime mortgages are loans to borrowers typically having weakened credit histories that include payment delinquencies and in some cases potentially more severe problems such as court judgements and discharged bankruptcies.

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

| Geographical Analysis | Prudential consolidation group | | | |
|---|---|---|---|---|
| | **2015** | | 2014 | |
| | **£m** | **%** | £m | % |
| North | **529.8** | **3.9** | 463.0 | 3.8 |
| Yorkshire | **1,329.1** | **9.7** | 1,221.8 | 10.0 |
| East Midlands | **936.7** | **6.8** | 834.1 | 6.8 |
| East Anglia | **858.2** | **6.2** | 770.2 | 6.3 |
| London | **1,609.0** | **11.7** | 1,381.6 | 11.3 |
| South East | **2,554.4** | **18.6** | 2,299.4 | 18.9 |
| South West | **1,225.1** | **8.9** | 1,063.9 | 8.7 |
| West Midlands | **889.0** | **6.5** | 732.9 | 6.0 |
| North West | **1,460.9** | **10.6** | 1,296.9 | 10.6 |
| Wales | **307.2** | **2.2** | 250.9 | 2.1 |
| Scotland | **1,197.1** | **8.7** | 1,099.1 | 9.0 |
| Northern Ireland | **50.1** | **0.4** | 57.1 | 0.5 |
| Channel Islands | **795.8** | **5.8** | 737.5 | 6.0 |
| **Total** | **13,742.4** | **100.0** | 12,208.4 | 100.0 |

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

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

| **Indexed loan-to-value analysis** | **Prudential consolidation group** | | | |
|---|---|---|---|---|
| | **2015** | | 2014 | |
| | **£m** | **%** | £m | % |
| <40% | **2,007.3** | **14.6** | 1,607.7 | 13.2 |
| 40%-50% | **1,478.7** | **10.8** | 1,131.8 | 9.3 |
| 50%-60% | **2,190.9** | **15.9** | 1,717.7 | 14.1 |
| 60%-70% | **3,049.6** | **22.2** | 2,383.5 | 19.5 |
| 70%-80% | **2,884.0** | **21.0** | 2,749.7 | 22.5 |
| 80%-90% | **1,664.9** | **12.1** | 1,802.5 | 14.8 |
| 90%-100% | **386.4** | **2.8** | 590.7 | 4.8 |
| >100% | **80.6** | **0.6** | 224.8 | 1.8 |
| **Total** | **13,742.4** | **100.0** | 12,208.4 | 100.0 |

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

At 31 December 2015, the average indexed loan-to-value of prudential consolidation group residential mortgages was 48.5% (2014: 50.3%).

### 6.1.4 Commercial credit risk

The Society has a commercial mortgage portfolio which is UK-based and, following a reduction in the Group's risk appetite, was closed to new lending in November 2008. We have retained an appropriately skilled team of people to manage these loans through a combination of annual reviews, borrower/property visits, revaluation exercises and maintenance of a watchlist for all borrowers where additional risk has been identified. As with residential lending, we consider forbearance options on a case-by-case basis in line with industry guidance and best practice. The impact of any such forbearance is recognised within our provisioning policy.

In respect of commercial mortgage exposures, there exists an impairment model based on a set of assumptions but, due to the non-standard nature of the properties, each account is also individually reviewed on a monthly basis and suitably qualified commercial underwriters objectively assess additional impairment provisions as required. However, one assumption contained within the commercial impairment model is an assumed 'forced sale discount', and the impact of an additional 5% discount compared to that assumed (e.g. from a forced sale discount assumption of 25% to 30%) would be to increase the specific impairment provision by £0.5m (2014: £0.4m).

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

| | Prudential consolidation group | | | |
|---|---|---|---|---|
| | **2015** | | 2014 | |
| | **£m** | **%** | £m | % |
| Leisure and hotel | **39.1** | **11.0** | 45.3 | 11.9 |
| Retail | **12.9** | **3.6** | 13.3 | 3.5 |
| Nursing / residential homes | **16.7** | **4.7** | 19.1 | 5.0 |
| Offices | **8.9** | **2.5** | 11.1 | 2.9 |
| Commercial investment and industrial units | **265.8** | **75.2** | 281.7 | 73.7 |
| Miscellaneous | **10.6** | **3.0** | 11.6 | 3.0 |
| **Total** | **354.0** | **100.0** | **382.1** | **100.0** |

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

| | Prudential consolidation group | | | |
|---|---|---|---|---|
| | **2015** | | 2014 | |
| **Geographical Analysis** | **£m** | **%** | £m | % |
| North | **18.1** | **5.1** | 19.2 | 5.0 |
| Yorkshire | **31.0** | **8.8** | 34.0 | 8.9 |
| East Midlands | **24.4** | **6.9** | 27.2 | 7.1 |
| East Anglia | **13.7** | **3.9** | 14.8 | 3.9 |
| London | **81.6** | **23.0** | 87.0 | 22.8 |
| South East | **68.7** | **19.4** | 75.5 | 19.7 |
| South West | **41.7** | **11.8** | 45.5 | 11.9 |
| West Midlands | **25.2** | **7.1** | 26.7 | 7.0 |
| North West | **36.9** | **10.4** | 39.0 | 10.2 |
| Wales | **7.3** | **2.1** | 7.5 | 2.0 |
| Scotland | **5.4** | **1.5** | 5.7 | 1.5 |
| **Total** | **354.0** | **100.0** | 382.1 | 100.0 |

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

| | Prudential consolidation group | | | |
|---|---|---|---|---|
| | **2015** | | 2014 | |
| **Loan to Value Analysis** | **£m** | **%** | £m | % |
| <40% | **46.6** | **13.1** | 44.0 | 11.5 |
| 40%-50% | **39.4** | **11.1** | 37.1 | 9.7 |
| 50%-60% | **52.4** | **14.8** | 63.2 | 16.5 |
| 60%-70% | **68.6** | **19.4** | 94.2 | 24.7 |
| 70% - 80% | **42.8** | **12.1** | 38.3 | 10.0 |
| 80% - 90 % | **28.3** | **8.0** | 30.8 | 8.1 |
| 90% - 100 % | **17.9** | **5.1** | 21.3 | 5.6 |
| >100% | **58.0** | **16.4** | 53.2 | 13.9 |
| **Total book** | **354.0** | **100.0** | 382.1 | 100.0 |

At 31 December 2015, the average loan-to-value of commercial loans was 56.1% (2014: 56.7%). The average loan to value is based on the latest external valuation of the properties within the portfolio. The increase in balances of loans with an LTV greater than 100% is due to the significant revaluation exercise that continues to be undertaken on higher value commercial properties, and reflects the reduction in value of certain types of commercial properties.

### 6.1.5 Debt factoring / invoice discounting

This relatively small portfolio of loans relates to loans made by our factored debt and invoice discounting business, Skipton Business Finance (SBF). This successful business, managed and run by a highly experienced team, continues to grow profitably in line with the Society risk appetite.

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

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

### 6.1.6 Wholesale lending credit risk

The Group's wholesale credit risk arises principally from assets held for prudential liquidity and general business purposes. The risk is that counterparties with whom the Group invests fail to repay the capital or interest obligations when they fall due. This element of credit risk is managed by the Treasury function in line with the Board approved risk appetite and wholesale credit policies. Wholesale counterparty limits are reviewed monthly by the Group Wholesale Credit Committee (a sub-committee of the ALCO) based on analyses of counterparties' financial performance, ratings and other market information to ensure that limits remain within our risk appetite. The allocation of credit limits uses a composite of external credit ratings alongside an internal credit assessment to assign limits based upon a percentage of the Group's capital. The processes for limit allocation and credit assessment are documented within the Treasury Policy.

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

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

Netting and collateralisation agreements are used to reduce credit exposure, these are discussed further in section 6.1.10 and 6.1.11. The exposure values shown in this section are net of these credit risk mitigation techniques. The following table sets out the liquidity book by industry sector / asset class as at 31 December 2015. The average exposure is based on the average of the last two reporting positions.

| **Asset class** | **Prudential consolidation group** | |
|---|---|---|
| | average 2014/2015 | **2015 £m** |
| Cash in hand and balances with Bank of England | 1,128.4 | **1,180.8** |
| Loans and advances to Banks and Building Societies | 375.3 | **378.3** |
| Gilts | 307.1 | **325.8** |
| Certificates of deposit | 300.6 | **342.7** |
| Fixed rate bonds | 183.7 | **156.0** |
| Floating rate bonds | 114.2 | **90.1** |
| Residential mortgage backed securities (Note 1) | 188.9 | **170.5** |
| Covered Bonds | 34.0 | **19.3** |
| **Total** | 2,632.2 | **2,663.5** |

**Notes:**

1. Residential Mortgage backed securities are available for sale assets and the accounting policy can be found in note 1)e Financial assets, Available-for-sale, in the Annual Report and Accounts.

The table below sets out the capital held for the liquidity book by credit rating. The capital requirement is equal to the risk weighted asset multiplied by 8%. The lower of Moody's or Fitch ratings is applied if both agencies rate the same asset.

| **Liquidity by credit rating** | **Prudential Consolidation Group** | | |
|---|---|---|---|
| | **Exposure Value** | **Risk weighted Assets** | **Capital Requirement** |
| **Rating** | **£m** | **£m** | **£m** |
| Aaa / AAA | 344.5 | 35.9 | 2.9 |
| Aa1 / AA+ | 1,523.9 | 0.1 | - |
| Aa2 / AA | 2.0 | 0.4 | - |
| Aa3 / AA- | 201.9 | 40.4 | 3.3 |
| A1 / A+ | 215.1 | 51.2 | 4.1 |
| A2 / A | 259.5 | 76.5 | 6.1 |
| A3 / A- | 41.4 | 17.7 | 1.4 |
| Baa1 / BBB+ | 72.5 | 36.2 | 2.9 |
| Unrated: | | | |
| Building societies | 2.7 | 4.3 | 0.3 |
| **Total** | **2,663.5** | **262.7** | **21.0** |

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

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

Within the treasury investments portfolio the Group had no direct sovereign exposure to Greece, Ireland, Italy, Portugal, Cyprus and Spain at 31 December 2015.

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 Group's preference is to use the long-term rating, however, if this is unavailable the short-term rating is used. For asset-backed securities (including covered bonds and RMBSs), the issue rating is used. This process is documented within the Treasury Policy and is supported by Treasury credit procedures.

The table below sets out exposure values, the risk weightings and the corresponding capital requirement (equal to the exposure multiplied by the risk weighting percentage multiplied by 8%) associated with each credit quality step under the standardised approach for the prudential consolidation group. The credit quality step is assigned based upon the type of exposure and its associated lowest credit rating from either Moody's or Fitch.

| Exposure Type | Credit quality step | Maturity | Risk weight percent | Lowest External Credit Rating | Exposure £m | Capital Req'ment £m |
|---|---|---|---|---|---|---|
| Central governments and central banks | 1 | All | 0% | Aaa to Aa3 / AAA to AA- | **1,529.2** | **-** |
| Multilateral development banks | 1 | All | 0% | Aaa to Aa3 / AAA to AA- | **149.3** | **-** |
| Financial institutions | 1 | All | 20% | Aaa to Aa3 / AAA to AA- | 204.0 | 3.3 |
| | 2 | Residual / original maturity < 3 months | 20% | A1 to A3 / A+ to A- | 374.9 | 6.0 |
| | 2 | Original maturity > 3 months | 50% | A1 to A3 / A+ to A- | 141.1 | 5.6 |
| | 3 | Original maturity > 3 months | 50% | Baa1 to Baa3 / BBB+ to BBB- | 72.5 | 2.9 |
| | Unrated | All | 20% | Unrated | 1.0 | - |
| | Unrated | All | 250% | Unrated | 1.7 | 0.3 |
| | | | | | **795.2** | **18.1** |
| Covered Bonds | 1 | All | 10% | Aaa to Aa3 / AAA to AA- | **19.3** | **0.2** |
| Residential Mortgage backed securities | 1 | All | 20% | Aaa to Aa3 / AAA to AA- | **170.5** | **2.7** |
| **Total** | | | | | **2,663.5** | **21.0** |

### 6.1.7 Concentration risk

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

Both retail mortgage and commercial lending concentration risk is managed within the risk appetite set by the Board, including specific sectoral, geographic and product type limits. RCC monitors and reports on concentration risk monthly. Exposure limits are monitored and controlled within the operational underwriting area via system driven limits and strong mandate controls. These are independently reviewed by the Credit Risk team.

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

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

### 6.1.8 Impairment provisions

The Group carries out an assessment of impairment of loans and advances to customers at each reporting date. Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession or where fraud or negligence has been identified. Objective evidence of impairment may include indications that the borrower or group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, or the debt being renegotiated to reduce the burden on the borrower. The key drivers influencing this objective evidence predominantly relate to affordability issues driven by unemployment and increased costs of living. Based upon these assessments an individual impairment provision is made in one of two ways. For properties that are either in possession or where sufficient information is available to calculate a specific provision on an account-by-account basis (for example, accounts that are on a defined ‘watch list’), the provision is calculated as the difference between the existing carrying value and the present value of the estimated future cash flows, discounted at the asset’s original effective interest rate. Alternatively, for other individual loans that have reached the point at which an impairment provision is needed but where it is not possible to specifically determine the amount ultimately likely to be received, assumptions are used from groups of loans with similar characteristics, based on historical data including the probability of possession given default and average forced sale discounts, and a provision calculated accordingly against this group of loans.

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

The impairment model also takes into account the level of forbearance applied to loans such as payment reductions, term extensions, conversion to interest only and capitalisation of arrears, and reflects the relative performance of each of these pools.

In line with our strategic focus on credit risk management, enhancements have been made to our credit risk loan impairment models during the year that are used to calculate impairment provisions for losses on loans and advances to customers.

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

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

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

## Residential impairment provisions

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

| | Residential | | Buy-to-let | | Other[1] | | Total | |
|---|---|---|---|---|---|---|---|---|
| | Prime £m | Sub Prime £m | Prime £m | Sub Prime £m | Prime £m | Sub Prime £m | Prime £m | Sub Prime £m |
| Neither past due nor individually impaired | 10,350.3 | 40.9 | 2,301.0 | 45.2 | 606.8 | 115.6 | **13,258.1** | **201.7** |
| Past due but not individually impaired: | | | | | | | | |
| Up to 3 months | 54.3 | 5.2 | 12.2 | 2.0 | 35.7 | 22.3 | **102.2** | **29.5** |
| Individually impaired: | | | | | | | | |
| Low risk | 30.0 | 3.9 | 3.2 | 0.2 | 14.0 | 7.8 | **47.2** | **11.9** |
| High risk | 26.2 | 5.3 | 4.7 | 0.7 | 25.5 | 23.8 | **56.4** | **29.8** |
| Possessions | 1.7 | - | 2.0 | 0.2 | 1.5 | 0.2 | **5.2** | **0.4** |
| **Total** | | | | | | | **13,469.1** | **273.3** |
| Collective impairment | (27.2) | (0.3) | (0.8) | (0.1) | (3.1) | (1.5) | **(31.1)** | **(1.9)** |
| Individual impairment | (4.9) | (0.7) | (1.8) | (0.2) | (4.8) | (3.8) | **(11.5)** | **(4.7)** |
| **Total lending to individuals** | | | | | | | **13,426.5** | **266.7** |

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

During the year the methodology for defining accounts that are regarded as individually impaired for the purposes of the table above has been revised in order to align with the industry standard. Mortgage accounts are now regarded as individually impaired in the table above if they are in arrears by three months or more, whereas previously they were regarded as individually impaired if they were in arrears by one month or more. Low risk accounts in the table above relate to loans with an indexed loan-to-value of less than or equal to 70%. High risk accounts relate to loans with an indexed loan-to-value of more than 70%.

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

| **Geographical Analysis** | **Neither past due nor individually impaired £m** | **Past due but not individually impaired £m** | **Individually impaired £m** | **Total £m** |
|---|---|---|---|---|
| North | 520.3 | 4.3 | 5.2 | **529.8** |
| Yorkshire | 1,301.7 | 12.5 | 14.9 | **1,329.1** |
| East Midlands | 917.6 | 10.5 | 8.6 | **936.7** |
| East Anglia | 841.3 | 7.5 | 9.4 | **858.2** |
| London | 1,572.8 | 16.0 | 20.2 | **1,609.0** |
| South East | 2,496.8 | 25.3 | 32.3 | **2,554.4** |
| South West | 1,207.1 | 9.2 | 8.8 | **1,225.1** |
| West Midlands | 866.9 | 10.6 | 11.5 | **889.0** |
| North West | 1,426.8 | 17.8 | 16.3 | **1,460.9** |
| Wales | 296.1 | 4.9 | 6.2 | **307.2** |
| Scotland | 1,177.2 | 8.7 | 11.2 | **1,197.1** |
| Northern Ireland | 41.7 | 2.1 | 6.3 | **50.1** |
| Channel Islands | 793.5 | 2.3 | - | **795.8** |
| **Total** | 13,459.8 | 131.7 | 150.9 | **13,742.4** |

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

The table below provides further information on residential mortgages at 31 December 2015 by the type of account renegotiations applied to customers over the last two years. For clarity, this table includes all accounts where the terms have been renegotiated during the last two years where the customer has encountered payment difficulties, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms but does not include accounts where terms have not been renegotiated in the last two years which may still be on renegotiated terms from a previous arrangement prior to this two year period. The total column relates to total loans to customers including those that have not been renegotiated.

| **Account renegotiations** | **Total** | **Capital-isation** | **Reduced payment** | **Transfer to interest only** | **Term extension** | **Total renegot-iations** | |
|---|---|---|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** | **%** |
| Neither past due nor individually impaired | **13,459.8** | 7.1 | 40.8 | 37.8 | 10.2 | 95.9 | 0.7 |
| Past due but not individually impaired: | | | | | | | |
| Up to 3 months | **131.7** | 1.5 | 8.7 | 3.1 | 0.7 | 14.0 | 10.6 |
| | **13,591.5** | **8.6** | **49.5** | **40.9** | **10.9** | **109.9** | **0.8** |
| Individually impaired: | | | | | | | |
| Low risk | 59.1 | 0.4 | 6.3 | 4.3 | 0.9 | 11.9 | 20.1 |
| High risk | 86.2 | 0.3 | 7.7 | 2.4 | 1.1 | 11.5 | 13.3 |
| Possessions | 5.6 | - | 0.4 | 0.4 | 0.1 | 0.9 | 16.1 |
| | **13,742.4** | **9.3** | **63.9** | **48.0** | **13.0** | **134.2** | **1.0** |
| Collective impairment | (33.0) | - | (0.2) | - | - | (0.2) | 0.6 |
| Individual impairment | (16.2) | - | (1.4) | (0.5) | (0.2) | (2.1) | 13.0 |
| | **13,693.2** | **9.3** | **62.3** | **47.5** | **12.8** | **131.9** | **1.0** |

Account renegotiation options are considered on a case-by-case basis in line with industry guidance and best practice to support customers through a temporary period of financial difficulty. The impact of any such forbearance is recognised within our provisioning approach. The proportion of renegotiated mortgage accounts within the portfolios has reduced during the year to the end of 2015, a trend that is in line with the overall reduction in mortgage arrears.

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

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

| | Loans fully secured on residential property | Other loans | Total |
|---|---|---|---|
| | £m | £m | £m |
| At 1 January 2015 | | | |
| Individual impairment | 19.9 | 0.9 | 20.8 |
| Collective impairment | 26.9 | - | 26.9 |
| | 46.8 | 0.9 | 47.7 |
| Amounts written off during the year | | | |
| Individual impairment | (4.6) | (0.3) | (4.9) |
| Collective impairment | (0.1) | - | (0.1) |
| | (4.7) | (0.3) | (5.0) |
| Income statement | | | |
| Impairment losses on loans and advances | | | |
| Individual impairment | 1.5 | - | 1.5 |
| Collective impairment | 6.2 | - | 6.2 |
| | 7.7 | - | 7.7 |
| Adjustment to impairment losses on loans and advances resulting from recoveries during the year | | | |
| Individual impairment | (0.6) | - | (0.6) |
| Charge for the year | 7.1 | - | 7.1 |
| At 31 December 2015 | | | |
| Individual impairment | 16.2 | 0.6 | 16.8 |
| Collective impairment | 33.0 | - | 33.0 |
| | 49.2 | 0.6 | 49.8 |

The collective impairment includes £24.0m that relates to an equity release residential mortgage book. Under the terms of these mortgages the Group is required to provide a ‘no negative equity guarantee’ to its customers (for more detail see Note 15 of the Group’s Annual Report and Accounts). The collective impairment is a function of the actual and projected interrelationship between market-wide long term house prices and retail price inflation and the specific behaviour of this portfolio. During the year we have updated the associated key assumptions including future house price increases and the level of voluntary redemptions we expect to observe within this portfolio, resulting in a charge of £6.5m for the year (2014: £5.7m).

The guarantee is impacted by the interaction of a number of factors, not all of which also impact on the performance of the underlying equity release book. These factors include future expected house prices, future expected interest rates, mortality rates and estimated redemption profiles.

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

## Residential lending credit risk mitigation

The Group has available to it a variety of methods and techniques to reduce the credit risk of its lending. New lending policy is prudent, assessing both the overall risk of the customer and their ability to service the debt in a higher interest rate environment. This includes the use of application scorecards, income verification and an affordability model. The credit risk of the mortgage portfolios is controlled using the suite of models previously described in section 6.1.

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

Possession balances represent loans against which the Group has taken ownership of properties pending their sale. Possession is generally considered only as a last resort, once all other options for the customer have been exhausted. As at 31 December 2015 the balance of residential loans where the property in question has been taken into possession represents less than 0.1% of total outstanding loans for the Group (2014: 0.1%), and less than 0.1% of total outstanding loans for the Society (2014: less than 0.1%). The Group does not occupy repossessed properties for business use, or use such assets acquired in its operations.

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

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

## Commercial Impairment Provisions

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

A collective impairment allowance is made against performing loans where objective evidence indicates that it is likely that credit losses have been incurred but not yet identified at the reporting date. This impairment allowance is calculated using third party valuation indices which are discounted further to assume a forced sale value in addition to default propensity modelling.

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

| | Leisure and Hotel | Retail | Nursing / Resi Homes | Offices | Commercial inv and Industrial | Misc | Total |
|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m |
| Neither past due nor individually impaired | 37.8 | 12.6 | 16.7 | 8.9 | 257.3 | 10.3 | **343.6** |
| Past due but not individually impaired: | | | | | | | |
| Up to 3 months | 1.0 | - | - | - | 8.4 | - | **9.4** |
| | - | - | - | - | - | - | **-** |
| Individually impaired: | | | | | | | |
| Low risk | - | - | - | - | - | 0.3 | **0.3** |
| High risk | 0.3 | 0.3 | - | - | 0.1 | - | **0.7** |
| **Total** | | | | | | | **354.0** |
| | | | | | | | **-** |
| Collective impairment | (1.3) | - | - | - | (2.3) | - | **(3.6)** |
| Individual impairment | (0.3) | (0.1) | - | - | (7.3) | (0.7) | **(8.4)** |
| **Total Commercial Lending** | **37.5** | **12.8** | **16.7** | **8.9** | **256.2** | **9.9** | **342.0** |

During the year, the methodology for defining accounts that are regarded as individually impaired in the table above has been revised in order to align with the industry standard. Mortgage accounts are now regarded as individually impaired in the table above if they are in arrears by three months or more, whereas previously they were regarded as individually impaired if they were in arrears by one month or more.

Low risk accounts in the table above relate to loans with an indexed loan-to-value of less than or equal to 70%. High risk accounts relate to loans with an indexed loan-to-value of more than 70%.

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

| **Geographical Analysis** | **Neither past due nor individually impaired £m** | **Past due but not individually impaired £m** | **Individually impaired £m** | **Total £m** |
|---|---|---|---|---|
| North | 17.8 | - | 0.3 | **18.1** |
| Yorkshire | 27.9 | 2.7 | 0.4 | **31.0** |
| East Midlands | 24.4 | - | - | **24.4** |
| East Anglia | 13.7 | - | - | **13.7** |
| London | 80.1 | 1.5 | - | **81.6** |
| South East | 67.1 | 1.6 | - | **68.7** |
| South West | 38.7 | 2.7 | 0.3 | **41.7** |
| West Midlands | 25.1 | 0.1 | - | **25.2** |
| North West | 36.7 | 0.2 | - | **36.9** |
| Wales | 7.3 | - | - | **7.3** |
| Scotland | 4.8 | 0.6 | - | **5.4** |
| **Total** | **343.6** | **9.4** | **1.0** | **354.0** |

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

The table below provides further information on commercial mortgages at 31 December 2015 by the type of account renegotiations applied to customers over the last two years. For clarity, this table includes all accounts where we have renegotiated terms during the last two years where the customer has encountered payment difficulties, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms, but does not include accounts where terms have not been renegotiated in the last two years which may still be on renegotiated terms from a previous arrangement prior to this two year period.

| **Account renegotiations** | **Total** | **Capitalisation** | **Reduced payment** | **Transfer to interest only** | **Total re-negotiations** | |
|---|---|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **£m** | **£m** | **%** |
| Neither past due nor individually impaired | 343.6 | 1.6 | - | 13.9 | 15.5 | 4.5 |
| Past due but not individually impaired: | | | | | **-** | |
| Up to 3 months | 9.4 | - | - | 2.2 | 2.2 | 23.4 |
| | **353.0** | **1.6** | **-** | **16.1** | **17.7** | **5.0** |
| Individually impaired: | | | | | | |
| Low risk | 0.3 | - | - | 0.3 | 0.3 | 100.0 |
| High risk | 0.7 | - | 0.3 | - | 0.3 | 42.9 |
| | **354.0** | **1.6** | **0.3** | **16.4** | **18.3** | **5.2** |
| Collective impairment | (3.6) | - | - | (1.9) | (1.9) | 52.8 |
| Individual impairment | (8.4) | (0.8) | (0.1) | (1.4) | (2.3) | 27.4 |
| | **342.0** | **0.8** | **0.2** | **13.1** | **14.1** | **4.1** |

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

| Group | Loans fully secured on land £m |
|---|---|
| At 1 January 2015 | |
| Individual impairment | **6.6** |
| Collective impairment | **4.6** |
| | **11.2** |
| Amounts written off during the year | |
| Individual impairment | **(0.5)** |
| Collective impairment | **-** |
| | **(0.5)** |
| Income statement | |
| Impairment losses on loans and advances | |
| Individual impairment | **2.3** |
| Collective impairment | **(1.0)** |
| | **1.3** |
| Adjustment to impairment losses on loans and advances resulting from recoveries during the year | |
| Individual impairment | **-** |
| Charge for the year | **1.3** |
| At 31 December 2015 | |
| Individual impairment | **8.4** |
| Collective impairment | **3.6** |
| | **12.0** |

## Commercial lending credit risk mitigation

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

For all commercial securities, valuations were undertaken prior to inception of the loan by suitably qualified professionals with relevant expertise in commercial properties. In addition to the requirement set out in the EU Capital Requirements Regulation to revalue all commercial properties with a balance greater than €3m every three years, the Group may seek subsequent valuations as it is deemed appropriate. The legal documentation is performed by reference to selected solicitors acting for the Group and appointed to ensure that the covenants are robust and enforceable in addition to the validity of any additional security afforded or required as a condition of our loan.

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

### 6.1.9 Impairment of treasury assets

The Treasury asset loan impairment position for the Group for the year ended 31 December 2015 is the same for all levels of consolidation with no additional impairment posted during the year outside of the £2.5m already held in respect of a Financial Institution asset.

### 6.1.10 Wholesale counterparty credit risk mitigation

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

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

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

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

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

### 6.1.11 Derivative counterparty credit risk mitigation

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

A credit exposure could arise in respect of derivative contracts entered into by the Group if the counterparty was unable to fulfil its contractual obligations. The Group addresses this risk by using legal documentation for counterparty derivative transactions that grants legal rights of set-off for those transactions. Accordingly, the credit risk associated with such contracts is reduced to the extent that negative mark to market valuations on derivatives will be offset by positive mark to market values on derivatives, subject to a minimum exposure of zero.

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

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

The exposure value on derivative counterparty credit risk exposures at 31 December 2015 was:

| **Exposure to Derivative Counterparty Credit Risk** | **Prudential Consolidation Group**<br>£m |
|---|---|
| Interest rate contracts | **149.1** |
| Foreign exchange contracts | **-** |
| Other contracts | **16.3** |
| **Gross positive fair value of contracts** | **165.4** |
| Netting benefits and potential credit add-ons | **(80.8)** |
| **Netted current credit exposure** | **84.6** |
| Collateral held | **(29.6)** |
| **Net derivative credit exposure** | **55.0** |

Note 13 of the Group's Annual Report and Accounts disclose Mark To Market's (MTM's) on all derivatives and the notionals (face value of the contracts). The purpose of Pillar 3 is to disclose replacement costs of those derivatives and, therefore, we include calculated add-ons to the MTM hence the difference in value. The add-ons are additional amounts to recognise potential future credit exposure and are currently calculated based on the notional, residual maturity and type of contract.

As at 31 December 2015, the external counterparties with whom the Group held derivative instruments had Moody's or equivalent credit ratings of Baa1 and above.

If the Society is downgraded, there would be no impact on the collateral required to be posted in relation to existing swap and repo agreements. Wrong-way risk may occur when the credit risk related to an exposure to a counterparty is adversely correlated with the credit quality of the counterparty. The Society is not exposed to this type of risk as it only accepts cash as collateral.

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

### 6.1.12 Securitisation and Term Secured Wholesale Funding

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

This following section discusses securitisation and term secured wholesale funding activity concerning mortgage assets owned by the Group and subject to the issue of securitisation notes or other secured funding. For information about the Group's exposure to purchased Mortgage Backed Securities see section 6.1.6.

The Group has securitised certain residential mortgage loans by the transfer of the beneficial interest in such loans to four special purpose vehicles (SPVs). The legal title to the mortgages remains with the Group and would only transfer to the SPVs in limited circumstances, including the insolvency of the Society. The securitisation and term secured wholesale funding transactions enables a subsequent raising of debt to investors or lenders who gain the security of the underlying assets as collateral. The SPVs are fully consolidated into the Group's Accounts in accordance with IFRS 10.

At 31 December 2015, the SPVs named Darrowby No. 1 plc (Darrowby 1), Darrowby No. 2 plc (Darrowby 2) and Darrowby No. 3 plc (Darrowby 3) and Beckindale No. 2 Limited (Beckindale 2), constituted wholesale funding of £589m (net of amortised costs). Securitisations and term secured funding transaction capability allows the Group to access this source of funding and provides further opportunity for wholesale funding in the future.

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

| | **Society's role in the securitisation process** | | | |
|---|---|---|---|---|
| Securitisation Company | Originator, Seller, Administrator, Cash Manager | Subordinated Loan Provider | Holder of AAA rated Notes | Holder of Class B Notes |
| Darrowby 1 | ✓ | ✓ | ✓ | ✓ |
| Darrowby 2 | ✓ | **Repaid** | | ✓ |
| Darrowby 3 | ✓ | **Repaid** | | ✓ |

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

Darrowby 1 was incorporated in November 2010. In March 2011, Darrowby 1 issued £1,032m of AAA rated debt securities. The Notes are rated by both Fitch and Moody's. As at 31 December 2015, rated debt securities totalled £243m of which £83m was held by the Group.

Darrowby 2 was incorporated in June 2011. In May 2012, Darrowby 2 issued £475m of AAA rated debt securities. The Notes are rated by both Fitch and Moody's. As at 31 December 2015, rated debt securities totalled £184m.

Darrowby 3 was incorporated in July 2013. In April 2014, Darrowby 3 issued £400m of AAA rated debt securities. The Notes are rated by both Fitch and Moody's. As at 31 December 2015, rated debt securities totalled £244m.

Beckindale 2 was incorporated in November 2015. As at 31 December 2015 Beckindale 2 raised £300m of term secured wholesale funding.

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

**31 December 2015**

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

31 December 2014

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

**Notes**
1. Excludes accrued interest
2. Retained rated Class A Notes (and those partially pledged in a repurchase agreement) and Class B Notes
3. A mortgage account where one or more monthly payments have become due and remain unpaid.

## 6.2 Conduct and Operational risk

### 6.2.1 Conduct and Operational risk definition and approach

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

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

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

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

**Risk mitigation**

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

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

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

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

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

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

### 6.2.2 Operational Risk Management Framework

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

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

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

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

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

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

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

As at 31 December 2015 this approach resulted in the Pillar 1 minimum risk weighted assets as follows:

| | **Prudential Consolidation Group** | |
|---|---|---|
| | **2015 £m** | 2014 £m |
| Operational Risk Weighted Asset (RWA) | **346.3** | 297.0 |
| Operational Risk Capital Requirement (RWA x 8%) | **27.7** | 23.8 |

The Operational Risk Capital Requirement (ORCR) increased in 2015 as a result of an increase in business volumes across the Group rather than any significant changes in the operating or control environment.

## 6.3 Market risk

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk; foreign currency risk; and equity risk. Currency risk is included in the Society's Pillar 1 capital requirement calculations; the other market risks are considered under Pillar 2 capital requirements in sections 7.8 and 7.9. The Society is not impacted by commodity price risk. Market risk arises only in the banking book (apart from the Group's defined benefit pension schemes which is managed by the Trustees of the schemes – see section 7.6) as the Group does not have a trading book.

The Society's Treasury function is responsible for managing the Group's exposure to all aspects of market risk within the operational limits set out in the Group's Treasury Policy. The Market and Liquidity Risk function (second line of defence) monitors the interest rate exposure of the Group through a variety of interest rate risk metrics e.g. static earnings at risk and historical value at risk and meet on a regular basis with the Treasury function to ensure they measure the continued effectiveness of the hedges.

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

Market risk also exists within the Group's defined benefit pension schemes and is managed by the Trustees of the schemes, working closely with the sponsoring employers Skipton Building Society and Connells. Pension obligation risk is covered in more detail in section 7.6.

### 6.3.1 Currency risk

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

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

The Group has equity investments in Jade Software Corporation Limited, Wynyard Group Limited and Northwest Investments NZ Limited which are denominated in New Zealand Dollars. The foreign currency fluctuations in relation to these equity investments are not hedged, but are recognised in the Group's translation reserve. All these entities sit outside the prudential group, however the prudential group does have an exposure totalling £6.2m, which represents the cost of investment in these entities. Jade is held as a subsidiary investment and a 56.4% stake is held. Jade also provides the technology which supports the Society's core IT platform. Wynyard was spun-off from Jade in 2013 and floated on the New Zealand stock exchange in July 2013. The Group retains a 17.8% shareholding, which has reduced from 24.5% at flotation.

The Group's exposure to foreign exchange risk is calculated in accordance with CRD IV, representing 8% of the net sterling equivalent of the foreign currency assets and liabilities. As at 31 December 2015, the capital required for the foreign currency risk was immaterial at both the prudential and individual consolidation levels and disclosures in relation to this have been omitted in accordance with Article 432 regarding the disclosure of non-material information.

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

# 7 Other risks faced by the business

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

## 7.1 Business risk

Business risk is the risk of changes in the environment in which the Group operates or the occurrence of events which damage the franchise or operating economics of the Group's businesses. The Group addresses these risks within its corporate plan which is approved by the Board along with the Group's key strategies. The Board Risk Committee is also provided with the results of stress and scenario tests to assess the potential impact on the Group of a stressed business environment such as a severe economic downturn. This enables the Committee to monitor the risk impact of business strategies and to determine whether changes to these may be required to protect the sustainability of the Group. In addition, potential sources of business risk include revenue volatility due to factors such as macro-economic conditions, inflexible cost structures, uncompetitive products or pricing and structural inefficiencies.

## 7.2 Reputational risk

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

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

## 7.3 Regulatory risk

Regulatory risk arises from a failure or inability of the Group to fully comply with the laws, regulations or Codes of Practice applicable to the Group. Non-compliance could lead to damage to reputation, public censure, fines and increased prudential requirements. Key changes on the horizon include the results of the FCA's Cash Savings Market Study, the EU Data Protection Directive and the Bank Recovery and Resolution Directive (BRRD) which includes the Minimum Required Eligible Liabilities requirements. In addition the Group will be impacted in 2016 by a number of taxation changes. A reduction in tax reliefs for buy-to-let landlords and the new 3% stamp duty surcharge may impact on market growth and the Group will closely monitor any changing trends in this area. Also, the Society will be materially impacted by the introduction of the bank corporation tax surcharge of 8%, which may impact the Society's capacity to lend. The Group has allocated resource to ensure continued compliance in these and other areas.

## 7.4 Technological risk

The pace of technological development is creating a period of significant change in financial services. The Society will continue to invest in its technology provision to provide an excellent level of customer service and manage risks in this area which include:

- **Cyber crime** – Cyber risk incorporates a wide array of potential threats to Group businesses. These can include network or perimeter threats, a breach of online controls leading to increased risk of online fraud as well as data leakage. These threats are of increasing significance given the expected growth in online customer transaction levels. In response to this, Group businesses continue to focus efforts on proactively managing the evolving nature of cyber threat to ensure that the Group is best placed to protect itself and its customers.

- **Business Resilience –** Market experience has shown that executing IT change has significant risk attached to it and can lead to the loss of core systems and the ability to provide expected levels of customer care. The Society is fully aware of these inherent risks and continues to review its approach to business resilience and continuity to ensure that this is reflective of business changes over time and remains robust in the event of a disaster.

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

## 7.5 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 MGC provides a formal forum for managing and assessing model risk in the Society; ensuring that all key models:

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

Although over time all key models used by the business will be covered by MGC, at present the focus is predominately on key credit risk models.

## 7.6 Pension obligation risk

The Group had, as at 31 December 2015, funding obligations for three defined benefit schemes which had all closed to new entrants and to future accrual of benefit by 31 December 2009. Two of the schemes were subsequently merged in January 2016. Pension risk is the risk that the value of the schemes' assets, together with ongoing contributions, will be insufficient to cover their obligations over time. The return on assets, which includes equities and bonds, will vary with movements in equity prices and interest rates. The projection of the schemes' obligations includes estimates of mortality, inflation and future salary increases, the actual outcome of which may differ from the estimates. The schemes are also exposed to possible changes in pensions legislation.

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

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

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

## 7.7 Taxation risk

Taxation risk is the risk associated with changes in tax law or in the interpretation of tax law. It also includes the risk of changes in tax rates and the risk of failure to comply with procedures required by tax authorities. Failure to manage tax risks could lead to an additional tax charge. It could also lead to reputational damage or financial penalties.

The Group has effective, well-documented and controlled processes in place to ensure compliance with tax disclosure and filing obligations and employs its own tax professionals who take appropriate advice from reputable professional firms when necessary.

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

## 7.8 Interest rate risk

Interest rate risk is the risk of loss arising from adverse movements in market interest rates. Interest rate risk arises from the mortgage, savings and other financial products that we offer. This risk is managed through the use of appropriate financial instruments, including derivatives, with established risk limits, reporting lines, mandates and other control procedures. As part of the Interest Rate Risk Calculation, there are a series of assumptions concerning prepayment of loans of different durations. These proprietary assumptions are based on historical prepayment profiles of our mortgages, for each specific duration. In addition, it is assumed that non-maturing deposits are stable.

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

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

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

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

### *Repricing Gap Analysis*

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

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

### *Earnings-at-Risk and Market Value Sensitivity*

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

Although these measures provide valuable insights to the market risk to which the Group is exposed, they need to be viewed in the context of the following limitations:

- Historical data is not necessarily a good guide to future events;
- The use of 95% confidence levels, by definition, does not take account of changes that may occur beyond this level of confidence and therefore may not fully take into account extreme events. As previously mentioned, the 99% confidence levels are also monitored to try to mitigate this limitation;
- Exposures are calculated on static Statement of Financial Position positions and, therefore, future changes in the structure of the Statement of Financial Position are ignored; however, analysis on dynamic positions is now being performed.

The interest rate exposures during 2015 were as follows:

| | **As at 31 December £m** | Average £m | High £m | Low £m |
|---|---|---|---|---|
| Static Earnings-at-risk | **9.6** | 9.3 | 11.4 | 8.1 |
| Historical Value-at-risk | **0.4** | 1.3 | 2.9 | 0.4 |
| -2% Parallel Interest rate shift | **0.9** | 5.9 | 14.0 | (3.1) |
| +2% Parallel interest rate shift | **(0.1)** | (2.3) | 2.0 | (5.9) |

**Notes:**

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

## 7.9 Equity risk

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

As at 31 December 2015 the Group had £69.2m of equity related savings balances which were appropriately hedged.

Following its flotation in July 2013, the Group holds a 17.8% stake in Wynyard Group Limited, which is listed on the New Zealand Stock Exchange. The equity risk in relation to this investment is not material to the Group results. The market value of our shareholding in Wynyard Group Limited, based on the share price at 31 December 2015, is £20.7m (2014: £24.5m) whilst the carrying value at 31 December 2015 is £11.5m. Further details concerning the investment in Wynyard can be found in Note 16d on page 115 of the Group Annual Report and Accounts.

On 22 February 2016, Wynyard Group Limited halted trading of its shares and announced that it was considering raising capital to support its operations. As at the date of signing the Society’s Annual Report and Accounts, Wynyard Group Limited had requested and been granted an extension to the trading halt on its shares in order to finalise the anticipated structure of the capital raise. The Group has agreed to provide a NZ$10m short term credit facility to the company to give it sufficient capital, if required, pending receipt of proceeds of the capital raise. In addition, the Board has committed in principle to participate in a rights issue to existing Wynyard Group Limited shareholders. The carrying value of the Group’s investment as at 31 December 2015 was £11.5m and the Group will continue to monitor developments during 2016.

## 7.10 Liquidity Risk

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

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

The Group continues to satisfy both the Individual Liquidity Guidance (ILG) requirement, provided by the PRA for regulatory purposes, and its own internal liquidity risk appetite. In line with the implementation of the new LCR liquidity regime, the internal liquidity appetite of the Society will be reassessed in the context of the new metrics during the course of 2016.

Liquidity regulation is changing towards the international CRD IV measures, namely the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). The Society has been measuring and monitoring its compliance against these ratios, and has both an LCR and NSFR comfortably in excess of 100%. The LCR measure was implemented in October 2015 and the NSFR is due to come into force in January 2018.

Liquidity stress testing is carried out against a number of scenarios including those prescribed by the PRA, considering a wide range of liquidity and economic factors. Early warning indicators are regularly assessed by a variety of functions across the Society to ensure liquidity is maintained at appropriate levels.

The Group's main source of funding is retail deposits which, at 31 December 2015, accounted for 87.8% (2014: 85.9%) of our total funding (excluding SIL). During the year, the Group supplemented its retail funding base and wholesale funding by further utilising the Funding for Lending scheme.

We have also maintained the quality of the Group's liquidity portfolio. We continue to maintain a close watching brief on the money markets and hold prudent levels of liquidity.

# 8 Leverage ratio

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

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

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

| | **CRD IV Transitional** | | **CRD IV Fully Loaded** | |
|---|---|---|---|---|
| | **2015** | Restated 2014 | **2015** | Restated 2014 |
| | **£m** | £m | **£m** | £m |
| Total Tier 1 Capital | **1,117.3** | 1,006.0 | **1,054.3** | 936.6 |
| Total Balance Sheet Assets | **17,332.3** | 15,790.9 | **17,332.3** | 15,790.9 |
| Derivatives[1] | **(40.0)** | (65.0) | **(40.0)** | (65.0) |
| Securities Financing Transactions[2] | **-** | 36.5 | **-** | 36.5 |
| Regulatory Adjustments[3] | **77.0** | 27.5 | **77.0** | 27.5 |
| Total Exposure | **17,369.3** | 15,789.9 | **17,369.3** | 15,789.9 |
| **Leverage Ratio** | **6.4%** | 6.4% | **6.1%** | 5.9% |

**Notes**
1. Exposure values associated with derivatives have been adjusted in accordance with regulatory requirements. For the purpose of 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.
2. The exposure values associated with SFTs have been adjusted in accordance with regulatory requirements.
3. These are adjustments for cash flow hedge reserve, goodwill, intangible assets, AVA, mortgage pipeline, non drawn down intra group funding and current tax. These adjustments are made to ensure the denominator balance meets regulatory requirements. The exposure values used for the leverage ratio differ to those used for credit risk exposures for undrawn credit facilities.

During the year the leverage ratio increased from 5.9% to 6.1% on a fully loaded basis and remained at 6.4% on a transitional basis.

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

# 9 Remuneration

The Directors Remuneration Report outlines the arrangements for determining the remuneration policy of Skipton Building Society (SBS), the link between pay and performance and the key incentive schemes for the Society's Material Risk Takers (MRTs). This is set out on pages 57 to 72 of the Group's Annual Report and Accounts which are published on the Society's website www.skipton.co.uk. The disclosures in this document refer to Skipton Financial Services (SFS) and Skipton International Ltd (SIL).

As key subsidiaries within Skipton Building Society (SBS), SFS and SIL have been identified as being in scope of the CRD IV Remuneration Rules and have identified Material Risk Takers (MRTs) in accordance with the European Banking Authority (EBA) criteria. Information on the remuneration arrangements for these MRTs is set out in the sections below.

In the UK, firms are able to comply with the remuneration requirements of the remuneration rules in relation to their size, internal organisation and the nature, scope and complexity of their activities. Accordingly, in 2015, SBS (and consequently SFS and SIL) were grouped in Level Three with banks and building societies with total assets averaging less than £15bn over the three financial years preceding 2015. The considerable success of SBS in recent years and the consequent steady growth in its total assets means that from 2016, it will be grouped at Level Two and additional requirements, including potential deferral of incentive pay, will apply to remuneration awarded in respect of 2016 onwards.

### *Remuneration Committees*

Details of the Board Remuneration Committee are set out in section 2.8. SFS and SIL have their own Remuneration Committees which oversee remuneration practices in their respective businesses and ensure that they comply with the agreed remuneration principles.

The SFS Remuneration Committee comprised one Non Executive Director, the Managing Director, Finance Director, Marketing & Technical Director plus the Group's Chief Human Resource Officer and Human Resource Manager. The Committee met four times in 2015. Its remit is to ensure that remuneration policies and practices enable SFS to attract, retain and reward people with the right skills, experience, knowledge and behaviours to support the achievement of business goals and objectives, that they support the right culture and adhere to agreed remuneration principles and conduct risk appetite.

The remuneration of the SFS Senior Management group (who are all MRTs), was approved by the Group Chief Executive and overseen by the Group Remuneration Committee.

The SIL Remuneration Committee, which comprises three Non-Executive Directors and two SBS Shareholder Directors, has adopted the agreed remuneration principles and policies for SIL. The Committee met twice in 2015, firstly to approve the 2014 bonus payment and 2015 salary increases and secondly to agree the 2015 bonus scheme and to approve the 2015 list of MRTs.

Due to its regulatory position (SIL is regulated by the Guernsey Financial Services Commission), the remuneration of the SIL MRTs is approved by the SIL Remuneration Committee, in accordance with the agreed remuneration principles, and is reported to the Group Remuneration Committee.

### *Remuneration of material risk takers (MRTs)*

The basic salary of MRTs is set according to the size of the role and responsibilities, individual performance (assessed annually), salary levels of similar positions in comparable organisations and internal benchmarks. Salaries are reviewed annually and individual increases are awarded based on the individual's performance against personal objectives measured in accordance with the performance management framework in each business.

#### *SFS*

SFS operates its own independent bonus schemes and has two annual bonus schemes which apply to different members of the MRT population. Both schemes follow similar principles and in 2015, were weighted 25% on financial metrics and 75% on commercial, employee, customer and quality measures. The maximum award does not exceed 50% of basic salary for either scheme.

In 2015 SFS MRTs who are members of the Company's Senior Management Group were also eligible to participate in a Medium Term Incentive Plan (MTIP) based on a three year performance period ending in 2017. The plan was based 50% on the achievement of financial measures (Group contribution over the three year period) and 50% on business quality and customer strategy measures.

Payments from the 2015 scheme, subject to meeting the appropriate performance levels, were due to be phased over a three year period commencing in 2018. However, the proposed integration of SFS into the Society (subject to regulatory approval) means that it will no longer be viable for the 2015 MTIP scheme and the 2014 MTIP scheme (which operates in a similar fashion, over a three year performance period ending in 2016) to run to the end of their planned performance periods. A payment in settlement of these schemes (detailed in the SFS table below) will be made to participants based on performance against the scheme metrics to date.

The table below sets out the aggregate remuneration for MRTs in SFS for the year ended 31 December 2015.

| **2015** | **Number of beneficiaries** | **Fixed remuneration £000** | **Current year annual performance pay (1) £000** | **Total £000** |
|---|---|---|---|---|
| **SFS Material Risk Takers** | 8 | 1,208 | 230 | 1,438 |

**Notes:**

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

***SIL***

The SIL Annual Bonus Scheme is based on a mixture of corporate objectives including financial, commercial and audit quality measures. The remainder of the bonus award is based on performance against personal objectives which is assessed through the annual appraisal process. In 2015, bonus payments to SIL MRTs were capped at 50% of base salary.

In 2015 the Managing Director was also eligible to participate in a Medium Term Incentive Plan (MTIP) based on a two and three year performance cycle from 2015 to 2016 and 2015 to 2017. The plan is based 60% on the achievement of financial measures and 40% on commercial and risk measures. A maximum award of 20% of salary can be made based on performance at the end of year two and 20% of salary can be awarded at the end of year three. Payments are phased over a three year period from the end of the performance periods.

The table below sets out the aggregate remuneration for MRTs in SIL for the year ended 31 December 2015.

**2015**

| | Number of beneficiaries | Fixed remuneration £000 | Current year annual performance pay [2] £000 | Total £000 |
|---|---|---|---|---|
| **SIL Material Risk Takers[1]** | 8 | 619 | 215 | 834 |

**Notes:**

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

# Appendix 1 RECONCILIATION OF BALANCE SHEET CAPITAL TO REGULATORY CAPITAL

The table below shows how the full Group balance sheet capital values translate to a regulatory capital equivalent for the prudential consolidation group at 31 December 2015. The regulatory capital figures are shown on a transitional basis in accordance with Annex I of the European Commission Implementing Technical Standard on disclosure of own funds under article 437 (1) (a) of the CRR. In the table below the numbered rows match those in the Own Funds disclosure template required under article 437 (1) (d) and (e) and 492 (3) of the CRR.

| **Reconciliation from Accounting Balance sheet to Regulatory Own Funds** | | Accounting Balance Sheet Value 2015 £m | Adjustments and Adjusted Accounting Value 2015 £m | **Own Funds Value 2015 £m** |
|---|---|---|---|---|
| **Members' interests** | | | | |
| | General Reserve | 1,146.3 | | |
| | Available-for-Sale Reserve | 31.7 | | |
| | Cash flow hedging reserve | (3.2) | | |
| | Translation reserve | 4.4 | | |
| | Attributable to members of Skipton Building Society | 1,179.2 | | |
| | Non-Controlling interests | (1.6) | | |
| | Total members' interests | 1,177.6 | | |
| **Less:** | Reserves attributable to non regulatory subsidiaries | | (118.2) | |
| | Accounting Balance Sheet value after adjustments | | **1,059.4** | |
| **Common Equity Tier 1 (CET1) Capital: instruments and reserves** | | | | |
| 2 | Retained Earnings | | | **1,062.6** |
| 3 | Accumulated other comprehensive income (and other reserves), to include unrealised gains and losses under the applicable accounting standards | | | **(3.2)** |
| 6 | Common Equity Tier 1 (CET1) capital before regulatory adjustments | | | **1,059.4** |
| **Common Equity Tier 1 (CET1) capital: regulatory adjustments** | | | | |
| 7 | Additional value adjustments (negative amount) | | | **(0.9)** |
| | Intangible Assets (per the Accounting Balance Sheet) | (153.2) | | |

| | | | | | |
|---|---|---|---|---|---|
| **Less:** | | Intangible Assets attributable to non regulatory subsidiaries | | 145.8 | |
| | | Accounting Balance Sheet value after adjustments | | **(7.4)** | |
| | 8 | Intangible assets (net of related tax liability) (negative amount) | | | **(7.4)** |
| | | Cash flow hedging reserve (per the Accounting Balance Sheet) | 3.2 | | |
| **Less:** | | Cash flow hedging reserve attributable to non regulatory subsidiaries | | - | |
| | | Accounting Balance Sheet value after adjustments | | **3.2** | |
| | 11 | Fair value reserves related to gains or losses on cash flow hedges | | | **3.2** |
| | 28 | **Total regulatory adjustments to Common Equity Tier 1 (CET1)** | | | **(5.1)** |
| | 29 | **Common Equity Tier 1 (CET1) capital** | | | **1,054.3** |
| **Liabilities eligible for Regulatory Own Funds** | | | | | |
| | | Subscribed Capital | 93.5 | | |
| **Less:** | | Removal of accrued interest | | (2.4) | |
| | | Removal of fair value adjustment for hedged risk | | (2.8) | |
| | | Removal of Fair Value of PIBS | | 1.7 | |
| | | Transfer of PIBS to Tier 2 capital | | (27.0) | |
| | | Accounting Balance Sheet value after adjustments | | **63.0** | |
| **Additional Tier 1 (AT1) capital: instruments** | | | | | |
| | 33 | Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1 | | | **63.0** |
| | 36 | **Additional Tier 1 (AT1) capital before regulatory adjustments** | | | **63.0** |
| **Additional Tier 1 (AT1) capital: regulatory adjustments** | | | | | |
| | 44 | Additional Tier 1 (AT1) capital | | | **63.0** |
| | 45 | Tier 1 capital (T1 = CET1 + AT1) | | | **1,117.3** |
| **Liabilities eligible for Regulatory Own Funds** | | | | | |
| | | Subordinated Liabilities | 78.5 | | |
| | | Removal of accrued interest | | (1.5) | |
| | | Removal of fair value adjustment for hedged risk | | (1.9) | |
| | | Reversal of amortised discount on issue | | 0.2 | |

| | | | |
|---|---|---|---|
| | Amortisation of subordinated liabilities with less than five years to maturity | (7.6) | |
| | Subordinated liabilities not eligible for regulatory capital | (35.3) | |
| | Transfer of PIBS from Additional Tier 1 capital | 27.0 | |
| | Accounting Balance Sheet value after adjustments | **59.4** | |
| **Tier 2 (T2) capital: instruments and provisions** | | | |
| 46 | Capital instruments and the related share premium accounts | | **29.4** |
| 47 | Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2 | | **30.0** |
| 51 | **Tier 2 (T2) capital before regulatory adjustments** | | **59.4** |
| **Tier 2 (T2) capital: regulatory adjustments** | | | |
| 58 | **Tier 2 (T2) capital** | | **59.4** |
| 59 | **Total capital (TC = T1 + T2)** | | **1,176.7** |

# Appendix 2 CAPITAL INSTRUMENTS KEY FEATURES

The table below shows the capital instruments currently held by the Group with the key details of these capital instruments. These have been disclosed in line with Annex III of the European Commission Implementing Technical Standards on disclosure for own funds by institutions under Article 437(1) and 492(3) of the Capital Requirements Regulation. The terms and conditions of these capital instruments can be found at www.skipton.co.uk/investorrelations.

| **1** | **Issuer** | **Skipton Building Society** | **Skipton Building Society (Scarborough Building Society)** | **Skipton Building Society (Scarborough Building Society)** | **Skipton Building Society** | **Skipton Building Society** |
|---|---|---|---|---|---|---|
| 2 | ISIN | GB008194119 | GB00B1VYCN43 | GB004440623 | XS0148344608 | Private Loan Facility |
| 3 | Gov. law(s) | English | English | English | English | English |
| **Regulatory treatment** | | | | | | |
| 4 | Trans. CRR rules | Additional Tier 1 up to headroom* | Additional Tier 1 up to headroom* | Additional Tier 1 up to headroom* | Tier 2 | Tier 2 |
| 5 | Post-transitional CRR rules | Tier 2 | Ineligible | Tier 2 | Ineligible | Tier 2 |
| 6 | Eligible at Solo/Sub-consolidated/Solo & Sub-consolidated | Solo | Solo | Solo | Solo | Solo |
| 7 | Instrument type (types to be specified by each jurisdiction) | PIBS | PIBS | PIBS | Subordinated Debt | Subordinated Debt |
| 8 | Regulatory capital value (£m) | 25,000,000* | 50,000,000* | 15,000,000* | 30,000,000 | 2,400,000 |
| 9 | Nominal amount of instrument | 25,000,000 | 50,000,000 | 15,000,000 | 30,000,000 | 10,000,000 |
| 9a | Issue px | 100.476 | 99.239 | 100.000 | 98.728 | 100.000 |
| 9b | Redemption px | 100.000 | 100.000 | 100.000 | 100.000 | 100.000 |
| 10 | Accounting classification | Liability - amortised cost | Liability - amortised cost | Liability - amortised cost | Liability - amortised cost | Liability - amortised cost |
| 11 | Date of issue | 05/03/1992 | 13/04/2007 | 26/04/2000 | 30/05/2002 | 27/03/1997 |
| 12 | Perpetual or dated | Perpetual | Perpetual | Perpetual | Dated | Dated |
| 13 | Original maturity | No maturity | No maturity | No maturity | 30/05/2022 | 27/03/2017 |
| 14 | Issuer call | No | Yes | No | Yes | Yes |

| | | | | | | |
|---|---|---|---|---|---|---|
| 15 | Optional call date, contingent call dates and redemption amount | No Issuer call | Issuer call date 13/04/2017 (par) | No Issuer call | Issuer call date 30/05/2017 (par) | Issuer call date 27/03/2012 (par) |
| 16 | Subsequent call dates, if applicable | n/a | On each Quarterly Interest Payment Date after 13/04/2017 | n/a | On each Quarterly Interest Payment Date after 30/05/2017 | On each semi-annually Interest Payment Date after 27/03/2012 |
| **Coupons / dividends** | | | | | | |
| 17 | Fixed or floating dividend/coupon | Fixed | Fixed-to-Float | Fixed | Fixed-to-Float | Fixed |
| 18 | Coupon rate and any related index | 12.875% | 6.875% | 8.500% | 6.750% | 4.027% |
| 19 | Existence of a dividend stopper | $Yes_1$ | $Yes_1$ | $Yes_1$ | No | No |
| 20a/b | Fully discretionary, partially or mandatory (in terms of timing) | Partially Discretionary | Partially Discretionary | Partially Discretionary | n/a | n/a |
| 21 | Existence of step up or other incentive to redeem | No | Yes | No | Yes | Yes |
| 22 | Noncumulative or cumulative | Noncumulative | Noncumulative | Noncumulative | n/a | n/a |
| 23 | Convertible or non-convertible | Nonconvertible | Nonconvertible | Nonconvertible | Nonconvertible | Nonconvertible |
| 24 | If convertible, conversion trigger(s) | n/a | n/a | n/a | n/a | n/a |
| 25 | If convertible, fully or partially | n/a | n/a | n/a | n/a | n/a |
| 26 | If convertible, conversion rate | n/a | n/a | n/a | n/a | n/a |
| 27 | If convertible, mandatory or optional conversion | n/a | n/a | n/a | n/a | n/a |
| 28 | Specify output instrument | n/a | n/a | n/a | n/a | n/a |
| 29 | Specify issuer of output instrument | n/a | n/a | n/a | n/a | n/a |
| 30 | Write-down features | None contractual, statutory via bail-in | None contractual, statutory via bail-in | None contractual, statutory via bail-in | None contractual, statutory via bail-in | None contractual, statutory via bail-in |
| 31-34 | If w/d, trigger(s), full/partial, PWD/TWD | n/a | n/a | n/a | n/a | n/a |
| 35 | Instrument type immediately senior | Subordinated debt | Subordinated debt | Subordinated debt | Senior Unsecured | Senior Unsecured |
| 36 | Non-compliant transitioned features | Yes | Yes | Yes | Yes | No |

| | | | | | | |
|---|---|---|---|---|---|---|
| 37 | If yes, specify non-compliant features | No conversion to CET1 | No conversion to CET1 | No conversion to CET1 | Step-up reset rate | n/a |

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

* As at 31 December 2015 30% of the regulatory capital value of these instruments are classified as Tier 2 under the transitional CRR rules.

# Appendix 3 OWN FUNDS DISCLOSURE TEMPLATE

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

| **Own Funds Disclosure Template** | | **Prudential Group** | | | |
|---|---|---|---|---|---|
| | | **(A) Amount at Disclosure date** | | **(C) Amounts to be subject to Pre-CRR treatment or CRR prescribed residual amount*** | |
| | | **2015 £m** | 2014 £m | **2015 £m** | 2014 £m |
| **Common Equity Tier 1 (CET1) Capital: instruments and reserves** | | | | | |
| 1 | Capital instruments and the related share premium accounts | **-** | - | **-** | - |
| 2 | Retained Earnings | **1,062.6** | **949.0** | **-** | **-** |
| 3 | Accumulated other comprehensive income (and other reserves), to include unrealised gains and losses under the applicable accounting standards | **(3.2)** | **(8.3)** | **-** | **-** |
| 3a | Funds for general banking risk | **-** | - | **-** | - |
| 4 | Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET1 | **-** | **-** | **-** | **-** |
| | Public sector capital injections grandfathered until 1 January 2018 | **-** | **-** | **-** | **-** |
| 5 | Minority Interests (amount allowed in consolidated CET1) | **-** | **-** | **-** | **-** |
| 5a | Independently reviewed interim profits net of any foreseeable charge or dividend | **-** | **-** | **-** | **-** |
| 6 | Common Equity Tier 1 (CET1) capital before regulatory adjustments | **1,059.4** | **940.7** | **-** | **-** |
| **Common Equity Tier 1 (CET1) capital: regulatory adjustments** | | | | | |
| 7 | Additional value adjustments (negative amount) | **(0.9)** | (0.9) | **-** | - |
| 8 | Intangible assets (net of related tax liability) (negative amount) | **(7.4)** | (11.1) | **-** | - |

| | | | | | |
|---|---|---|---|---|---|
| 10 | Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38(3) are met) (negative amount) | **-** | - | **-** | - |
| 11 | Fair value reserves related to gains or losses on cash flow hedges | **3.2** | 5.3 | **-** | - |
| 12 | Negative amounts resulting from the calculation of expected loss amounts | **-** | - | **-** | - |
| 13 | Any increase in equity that results from securitised assets (negative amount) | **-** | - | **-** | - |
| 14 | Gains or losses on liabilities valued at fair value resulting from changes in own credit standing | **-** | - | **-** | - |
| 15 | Defined-benefit pension fund assets (negative amount) | **-** | - | **-** | - |
| 16 | Direct and indirect holdings by an institution of own fund CET1 instruments (negative amount) | **-** | - | **-** | - |
| 17 | Holdings of the CET1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount) | **-** | - | **-** | - |
| 18 | Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above the 10% threshold and net of eligible short positions) (negative amount) | **-** | - | **-** | - |
| 19 | Direct and indirect synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount) | **-** | - | **-** | - |
| 20a | Exposure amount of the following items which qualify for a RW of 1250%, where the institution opts for the deduction alternative | **-** | - | **-** | - |
| 20b | of which: qualifying holdings outside the financial sector (negative amount) | **-** | - | **-** | - |
| 20c | of which: securitisation positions (negative amount) | **-** | - | **-** | - |
| 20d | of which: free deliveries (negative amount) | **-** | - | **-** | - |
| 21 | Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the conditions in 38 (3) are met) (negative amount) | **-** | - | **-** | - |
| 22 | Amount exceeding the 15% threshold (negative amount) | **-** | - | **-** | - |
| 23 | of which: direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities | **-** | - | **-** | - |
| 25 | of which: deferred tax assets arising from temporary differences | **-** | - | **-** | - |
| 25a | Losses for the current financial year (negative amount) | **-** | - | **-** | - |
| 25b | Foreseeable tax charges relating to CET1 items (negative amount) | **-** | - | **-** | - |

| | | | | | |
|---|---|---|---|---|---|
| 26 | Regulatory adjustments applied to Common Equity Tier 1 in respect of amounts subject to pre-CRR treatment | **-** | - | **-** | 2.6 |
| 26a | Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468 | **-** | - | **-** | 2.6 |
| | Of which: … filter for unrealised gain - Available for Sale Reserve | **-** | - | **-** | 2.6 |
| 26b | Amount to be deducted from or added to Common Equity Tier 1 capital with regard to additional filters and deductions required pre-CRR | **-** | - | **-** | - |
| 27 | Qualifying AT1 deductions that exceed the AT1 capital of the institution (negative amount) | **-** | - | **-** | - |
| 28 | **Total regulatory adjustments to Common Equity Tier 1 (CET1)** | **(5.1)** | (6.7) | **-** | 2.6 |
| 29 | **Common Equity Tier 1 (CET1) capital** | **1,054.3** | 934.0 | **-** | 2.6 |
| **Additional Tier 1 (AT1) capital: instruments** | | | | | |
| 30 | Capital instruments and the related share premium accounts | **-** | - | **-** | - |
| 31 | of which: classified as equity under the applicable accounting standards | **-** | - | **-** | - |
| 32 | of which: classified as liabilities under the applicable accounting standards | **-** | - | **-** | - |
| 33 | Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1 | **63.0** | 72.0 | **(63.0)** | (72.0) |
| | Public sector capital injections grandfathered until 1 January 2018 | **-** | - | **-** | - |
| 34 | Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties | **-** | - | **-** | - |
| 35 | of which: instruments issued by subsidiaries subject to phase out | **-** | - | **-** | - |
| 36 | **Additional Tier 1 (AT1) capital before regulatory adjustments** | **63.0** | 72.0 | **(63.0)** | (72.0) |
| **Additional Tier 1 (AT1) capital: regulatory adjustments** | | | | | |
| 37 | Direct and indirect holdings by an institution of own AT1 instruments (negative amount) | **-** | - | **-** | - |
| 38 | Holdings of the AT1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount) | **-** | - | **-** | - |
| 39 | Direct and indirect holdings of the AT1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount) | **-** | - | **-** | - |
| 40 | Direct and indirect holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above the 10% threshold net of eligible short positions) (negative amount) | **-** | - | **-** | - |

| | | | | | |
|---|---|---|---|---|---|
| 41 | Regulatory adjustments applied to additional tier 1 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts) | **-** | - | **-** | - |
| 41a | Residual amounts deducted from Additional Tier 1 capital with regard to deduction from Common Equity Tier 1 capital during the transitional period pursuant to article 472 of Regulation (EU) No 575/2013 | **-** | - | **-** | - |
| 41b | Residual amounts deducted from Additional Tier 1 capital with regard to deduction from Tier 2 capital during the transitional period pursuant to article 475 of Regulation (EU) No 575/2013 | **-** | - | **-** | - |
| 41c | Amount to be deducted from or added to Additional Tier 1 capital with regard to additional filters and deductions required pre-CRR | **-** | - | **-** | - |
| 42 | Qualifying T2 deductions that exceed the T2 capital of the institution (negative amount) | **-** | - | **-** | - |
| 43 | Total regulatory adjustments to Additional Tier 1 (AT1) capital | **-** | - | **-** | - |
| 44 | Additional Tier 1 (AT1) capital | **63.0** | 72.0 | **(63.0)** | (72.0) |
| 45 | Tier 1 capital (T1 = CET1 + AT1) | **1,117.3** | 1,006.0 | **(63.0)** | (69.4) |
| **Tier 2 (T2)** | **capital: instruments and provisions** | | | | |
| 46 | Capital instruments and the related share premium accounts | **29.4** | 22.4 | **13.0** | 22.0 |
| 47 | Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2 | **30.0** | 33.3 | **(30.0)** | (33.3) |
| | Public sector capital injections grandfathered until 1 January 2018 | **-** | - | **-** | - |
| 48 | Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in row 5 or 34) issued by subsidiaries and held by third parties | **-** | - | **-** | - |
| 49 | of which: instruments issued by subsidiaries subject to phase out | **-** | - | **-** | - |
| 50 | Credit risk adjustments | **-** | - | **-** | - |
| 51 | **Tier 2 (T2) capital before regulatory adjustments** | **59.4** | 55.7 | **(17.0)** | (11.3) |
| **Tier 2 (T2)** | **capital: regulatory adjustments** | | | | |
| 52 | Direct and indirect holdings by an institution of own T2 instruments and subordinated loans (negative amounts) | **-** | - | **-** | - |
| 53 | Holdings of the T2 instruments and subordinated loans of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount) | **-** | - | **-** | - |

| | | | | | | |
|---|---|---|---|---|---|---|
| 54 | Direct and indirect holdings of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount) | **-** | - | **-** | - |
| 54a | Of which new holdings not subject to transitional arrangements | **-** | - | **-** | - |
| 54b | Of which holdings existing before 1 January 2013 and subject to transitional arrangements | **-** | - | **-** | - |
| 55 | Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount) | **-** | - | **-** | - |
| 56 | Regulatory adjustments applied to tier 2 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts) | **-** | - | **-** | - |
| 56a | Residual amounts deducted from Tier 2 capital with regard to deduction from Common Equity Tier 1 capital during the transitional period pursuant to article 472 of Regulation (EU) No 575/2013 | **-** | - | **-** | - |
| 56b | Residual amounts deducted from Tier 2 capital with regard to deduction from Additional Tier 1 capital during the transitional period pursuant to article 475 of Regulation (EU) No 575/2013 | **-** | - | **-** | - |
| 56c | Amount to be deducted from or added to Tier 2 capital with regard to additional filters and deductions required pre-CRR | **-** | - | **-** | - |
| 57 | **Total regulatory adjustments to Tier 2 (T2) capital** | **-** | - | **-** | - |
| 58 | **Tier 2 (T2) capital** | **59.4** | 55.7 | **(17.0)** | (11.3) |
| 59 | **Total capital (TC = T1 + T2)** | **1,176.7** | 1,061.7 | **(80.0)** | (80.7) |
| 59a | Risk weighted assets in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts) | **-** | - | **-** | - |
| 60 | **Total risk weighted assets** | **6,276.4** | 5,821.6 | **-** | - |
| **Capital ratios and buffers** | | | | | |
| 61 | Common Equity Tier 1 (as a percentage of risk exposure amount) | **16.80%** | 16.04% | **-** | 0.05% |
| 62 | Tier 1 (as a percentage of risk exposure amount) | **17.80%** | 17.28% | **(1.00%)** | (1.19%) |
| 63 | Total capital ( as a percentage of risk exposure amount) | **18.75%** | 18.24% | **(1.28%)** | (1.39%) |

| | | | | | |
|---|---|---|---|---|---|
| 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) | **4.50%** | 4.50% | **-** | - |
| 65 | of which: capital conservation buffer requirement | **-** | - | **-** | - |
| 66 | of which: countercyclical buffer requirement | **-** | - | **-** | - |
| 67 | of which: systemic buffer requirement | **-** | - | **-** | - |
| 67a | of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer | **-** | - | **-** | - |
| 68 | Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount) | **10.75%** | 10.24% | **(1.28%)** | (1.39%) |
| **Amounts below the thresholds for deduction (before risk weighting)** | | | | | |
| 72 | Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions) | **1.7** | 1.7 | **-** | - |
| 73 | Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions) | **-** | - | **-** | - |
| 75 | Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in 38 (3) are met) | **-** | - | **-** | - |
| **Applicable caps on the inclusion of provisions in Tier 2** | | | | | |
| 76 | Credit risk adjustments included in T2 in respect of exposures subject to standardized approach (prior to the application of the cap) | **-** | - | **-** | - |
| 77 | Cap on inclusion of credit risk adjustments in T2 under standardised approach | **73.5** | 68.0 | **-** | - |
| 78 | Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap) | **-** | - | **-** | - |
| 79 | Cap for inclusion of credit risk adjustments in T2 under internal ratings-based approach | **-** | - | **-** | - |
| **Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2013 and 1 Jan 2022)** | | | | | |
| 80 | Current cap on CET1 instruments subject to phase out arrangements | **-** | - | **-** | - |
| 81 | Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities) | **-** | - | **-** | - |
| 82 | Current cap on AT1 instruments subject to phase out arrangements | **63.0** | 72.0 | **-** | - |

| | | | | | |
|---|---|---|---|---|---|
| 83 | Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities) | **27.0** | 18.0 | **-** | - |
| 84 | Current cap on T2 instruments subject to phase out arrangements | **132.2** | 151.1 | **-** | - |
| 85 | Amount excluded from T2 due to cap (excess over cap after redemptions and maturities) | **-** | - | **-** | - |

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

# Appendix 4 LEVERAGE TEMPLATES

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

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

| **Template LRSum:** **Summary reconciliation of accounting assets and leverage ratio exposures** | | **Applicable amount** **2015** **£m** | 2014 £m |
|---|---|---|---|
| 1 | Total assets as per published financial statements | 17,511.4 | 15,962.1 |
| 2 | Adjustments for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation | (179.1) | (171.2) |
| 3 | (Adjustments for fiduciary assets recognised on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio total exposure measure in accordance with Article 429(13) of Regulation (EU) No 575/2013) | - | - |
| 4 | Adjustments for derivative financial instruments[1] | (40.0) | (65.0) |
| 5 | Adjustments for securities financing transactions "SFTs" | - | 36.5 |
| 6 | Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off balance sheet exposures) | 112.9 | 77.7 |
| EU-6a | (Adjustment for intragroup exposures excluded from the leverage ratio total exposure measure in accordance with Article 429 (7) of Regulation (EU) No 575/2013) | - | - |
| EU 6b | (Adjustment for exposures excluded from the leverage ratio total exposure measure in accordance with Article 429 (14) of Regulation (EU) No 575/2013) | - | - |
| 7 | Other adjustments | (35.9) | (50.2) |
| 8 | **Leverage ratio total exposure measure** | **17,369.3** | **15,789.9** |

**Notes**

1. Row 4 above includes the Derivative asset from the Group Annual Report and Accounts of £95.1m (£133.4 in 2014) as well as the total derivative exposure from row 11 in Template LR Com below.

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

| **Template LRCom: Leverage ratio common disclosure** | | **CRR leverage ratio exposures** | |
|---|---|---|---|
| | | **2015** | 2014 |
| | | **£m** | £m |
| | **On-balance sheet exposures (excluding derivatives and SFTs)** | | |
| 1 | On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral) | 17,237.2 | 15,657.5 |
| 2 | (Asset amounts deducted in determining Tier 1 capital) | (35.9) | (50.2) |
| 3 | **Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)** | **17,201.3** | **15,607.3** |
| | **Derivative exposures** | | |
| 4 | Replacement cost associated with *all* derivatives transactions (ie net of eligible cash variation margin) | 2.5 | 15.0 |
| 5 | Add-on amounts for PFE associated with *all* derivatives transactions (mark-to-market method) | 52.6 | 53.4 |
| EU-5a | Exposure determined under Original Exposure Method | - | - |
| 6 | Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework | - | - |
| 7 | (Deductions of receivables assets for cash variation margin provided in derivatives transactions) | - | - |
| 8 | (Exempted CCP leg of client-cleared trade exposures) | - | - |
| 9 | Adjusted effective notional amount of written credit derivatives | - | - |
| 10 | (Adjusted effective notional offsets and add-on deductions for written credit derivatives) | - | - |
| 11 | **Total derivative exposures (sum of lines 4 to 10)** | **55.1** | **68.4** |
| | **SFT exposures** | | |
| 12 | Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions | - | - |
| 13 | (Netted amounts of cash payables and cash receivables of gross SFT assets) | - | - |
| 14 | Counterparty credit risk exposure for SFT assets | - | - |
| EU-14a | Derogation for SFTs: Counterparty credit risk exposure in accordance with Article 429b (4) and 222 of Regulation (EU) No 575/2013 | - | 36.5 |
| 15 | Agent transaction exposures | - | - |

| | | | |
|---|---|---|---|
| EU-15a | (Exempted CCP leg of client-cleared SFT exposure) | - | - |
| 16 | Total securities financing transaction exposures (sum of lines 12 to 15a) | - | 36.5 |
| | **Other off-balance sheet exposures** | | |
| 17 | Off-balance sheet exposures at gross notional amount | 1,128.9 | 776.8 |
| 18 | (Adjustments for conversion to credit equivalent amounts) | (1,016.0) | (699.1) |
| 19 | Other off-balance sheet exposures (sum of lines 17 to 18) | 112.9 | 77.7 |
| | **Exempted exposures in accordance with Article 429 (7) and (14) of Regulation (EU) No 575/2013 (on and off balance sheet)** | | |
| EU-19a | (Intragroup exposures (solo basis) exempted in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet)) | - | - |
| EU-19b | (Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No 575/2013 (on and off balance sheet)) | - | - |
| | **Capital and total exposure measure** | | |
| 20 | Tier 1 capital | **1,054.3** | **936.6** |
| 21 | Leverage ratio total exposure measure (sum of lines 3, 11, 16, 19, EU-19a and EU-19b) | **17,369.3** | **15,789.9** |
| | **Leverage ratio** | | |
| 22 | Leverage ratio | **6.1%** | **5.9%** |
| | **Choice on transitional arrangements and amount of derecognised fiduciary items** | | |
| EU-23 | Choice on transitional arrangements for the definition of the capital measure | **Fully loaded** | **Fully loaded** |
| EU-24 | Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation (EU) NO 575/2013 | - | - |

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

**Template LRSpl:**
**Split-up of on-balance sheet exposures (excluding derivatives, SFTs and exempted exposures)**

| | | CRR leverage ratio exposures | |
|---|---|---|---|
| | | **2015** | 2014 |
| | | **£m** | £m |
| EU-1 | Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which: | 17,237.2 | 15,657.5 |
| EU-2 | Trading book exposures | - | - |
| EU-3 | **Banking book exposures, of which:** | 17,237.2 | 15,657.5 |
| EU-4 | Covered bonds | 19.3 | 48.5 |
| EU-5 | Exposures treated as sovereigns | 1,530.9 | 1,404.2 |
| EU-6 | Exposures to regional governments, MDB, international organisations and PSE **not** treated as sovereigns | 149.3 | 175.7 |
| EU-7 | Institutions | 454.4 | 539.1 |
| EU-8 | Secured by mortgages of immovable properties | 14,171.5 | 12,605.0 |
| EU-9 | Retail exposures | 1.0 | 2.0 |
| EU-10 | Corporate | 72.0 | 69.1 |
| EU-11 | Exposures in default | 134.1 | 176.9 |
| EU-12 | Other exposures (eg equity, securitisations, and other non-credit obligation assets) | 704.7 | 637.0 |

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

## Template LRQua:

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

The Skipton prudential group has a leverage ratio of 6.1%. Although there is currently no statutory minimum leverage ratio for the Society it is expected each financial institution regardless of size within the EU will shortly be required to have a leverage ratio of no less than 3.9%. 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 Skipton only stress events. It is recognised that such forward planning is essential to the successful management of the Group's leverage and capital ratios. The Board are satisfied that the risk appetite, controls and planning framework will prevent the Group from taking excessive leverage within its balance sheet.

**2. Description of the factors that had an impact on the leverage ratio during the year to 31 December 2015**

The Group's fully loaded leverage ratio has improved by 0.2% to 6.1% during the year to 31 December 2015. Tier 1 capital has increased by 13% in the year largely due to profits added to general reserves. This has improved the leverage ratio despite a 10% growth in exposures. Exposures continue to be mainly in residential mortgages.

# Appendix 5 ASSET ENCUMBRANCE

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

The Society's Treasury department use repurchase agreements/securities lending transactions as an everyday liquidity tool and has a range of counterparties whereby assets may be encumbered in order to raise funding.  Typically these encumbered assets are Treasury instruments, but may also include mortgage assets to act as collateral. Treasury regularly test the liquidity of certain instruments by entering into such transactions and it is often that a small over collateralisation amount (known as a haircut) is required by the market counterparty to cover volatility in the market valuation of the instruments in these transactions.

The Group's level of encumbrance has been variable over recent years in response to the Group's funding requirement. During 2015, there was a small increase in the Group's encumbrance as it increased its repurchase agreements activity and drawings under the Funding for Lending Scheme.

Mortgage assets are also used in long term secured funding transactions. At the end of December 2015, the Group has three securitisation transactions outstanding and one further term secured funding transaction, whereby the beneficial interest in certain mortgages is transferred to special purpose vehicles (SPVs). These transactions enable a subsequent raising of debt, by the SPVs, to investors who gain the security of the underlying assets as collateral. The transfers of the beneficial interest in these loans to the SPVs are not treated as sales by the Society.  The Society continues to recognise these assets within its own Statement of Financial Position after the transfer because it retains the risks and rewards of the portfolio. In the accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the SPVs.

The Group has an asset encumbrance limit which is set by the Board of Directors and reviewed on a regular basis. In addition to monitoring asset encumbrance, the Board of Directors assess encumbrance strategies and activities, which have not changed significantly in recently years.

The following tables have been compiled in order to comply with the European Banking Authority's guidelines on disclosure of encumbered and unencumbered assets, as adopted by the Prudential Regulation Authority under Supervisory Statement 11/14. Under this supervisory statement the Group is not required to provide details about collateral received if the amount is less than £100bn.

The table below details, as a median calculation rather than point in time, for different classes of assets, the level of encumbrance and both the carrying and fair value of those assets on a Prudential consolidation group basis in the year ended 2015. Measuring on an Individual consolidation group basis would highlight the inclusion of an inter-company loan whereby the Society holds £166.4m of securities pledged as collateral with Skipton International Limited, in a repurchase agreement.

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

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

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

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 2014.

| Prudential Group 2014 | **Carrying amount of encumbered assets** | **Fair value of encumbered assets** | **Carrying amount of unencumbered assets** | **Fair value of unencumbered assets** |
|---|---|---|---|---|
| | **010** | **040** | **060** | **090** |
| **Assets** | **£m** | **£m** | **£m** | **£m** |
| 010 Assets of the reporting institution | 2,158.6 | -[1] | 13,613.8 | -[1] |
| 030 Equity instruments | - | - | 1.7 | 1.7 |
| 040 Debt securities | 213.9 | 213.9 | 937.1 | 938.3 |
| 120 Other assets[3] | - | -[1] | 453.4[2] | -[1] |

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

| Prudential Group 2014 | Matching liabilities, contingent liabilities or securities lent | Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered |
|---|---|---|
| | **010** | **030** |
| **Encumbered assets/collateral received and associated liabilities** | **£m** | **£m** |
| 010 Carrying amount of selected financial liabilities | 1,670.5 | 2,558.2 |

**Notes:**
1. The EBA has released guidance on the reporting of Fair Values per Article 443 of the CRR stating that the fair value of these assets should not be reported.
2. "Other assets" include loans and advances (excluding mortgages) and other balance sheet items not listed above including derivative financial assets, property, plant and other fixed assets, intangible assets including goodwill, and deferred tax assets. These assets would not be available for encumbrance in the normal course of business.
3. In the Pillar 3 Disclosures 2014, "Other assets" included mortgages. In line with note 2 above, this table has been restated to exclude mortgages.

# 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:

| Term | Definition |
|---|---|
| **Arrears** | A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue. |
| **Asset backed securities (ABS)** | An asset backed security is a security whose value and income payments are derived from and collateralised (or ‘backed’) by a specified pool of underlying assets. Typically these assets are pools of residential or commercial mortgages. |
| **Basel II** | Basel II is the second of the Basel Accords, issued by the Basel Committee on Banking Supervision, which defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the PRA Handbook. |
| **Basel III** | Basel III became effective in the UK on 1 January 2014 and sets out details of strengthened global regulatory standards on bank capital adequacy and liquidity. |
| **Buy-to-let mortgages** | Mortgages offered to customers purchasing residential property to be rented to others to generate a rental income. |
| **Common Equity Tier 1 Capital** | Common Equity Tier 1 (CET 1) capital primarily comprises internally generated capital from retained profits. An adjustment is made to deduct intangible assets and goodwill. CET 1 capital is fully loss absorbing. |
| **Contractual maturity** | The final payment date of a loan or other financial instrument, at which point the entire remaining outstanding principal and interest is due to be repaid. |
| **CRD IV** | CRD IV is made up of the Capital Requirements Regulation (CRR), which is directly applicable to firms across the EU, and the Capital Requirements Directive (CRD), which must be implemented through national law. CRD IV became effective in the UK from 1 January 2014. |
| **Debt securities** | Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings. |
| **Debt securities in issue** | Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit. |
| **Derivative financial instruments** | A derivative financial instrument is a type of financial instrument (or an agreement between two parties) that has a value based on the underlying asset, index or reference rate it is linked to. The Group uses derivative financial instruments to hedge its exposures to market risks such as interest rate, equity and currency risk. |
| **Effective interest rate method (EIR)** | The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period. |
| **Fair value** | Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction. |

| Term | Definition |
|---|---|
| **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. |
| **Funding for lending Scheme** | A scheme launched by the Bank of England and HM Treasury in August 2012 which provides funding to participating banks and building societies with the aim of stimulating lending within the economy. |
| **Goodwill** | Goodwill arises on the acquisition of subsidiary undertakings, joint ventures, associates or other businesses and represents the excess of the fair value of consideration over the fair value of identifiable net assets and contingent liabilities acquired at the date of acquisition. |
| **Impaired loans** | Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due. |
| **Internal Capital Adequacy Assessment Process (ICAAP)** | The Group's own assessment, as part of regulatory requirements, of the levels of capital that it needs to hold in respect of the risks it faces under a business as usual scenario and a variety of stress scenarios. |
| **Individual Liquidity Adequacy Assessment (ILAA)** | The Group's own assessment that current and projected levels of liquidity are sufficient and appropriate for the Group's plans, under a variety of stress scenarios. It also details the Group's compliance with the PRA's regulatory BIPRU 12 requirements. |
| **Internal ratings-based approach (IRB)** | An advanced approach to measuring capital requirements in respect of credit risk under Basel II and, from 1 January 2014, CRD IV. The IRB approach may only be used with permission from the PRA. |
| **International Swaps and Derivatives Association (ISDA) Master Agreement** | A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions. |
| **Investment grade** | The range of credit ratings, from Aaa to Baa3, as measured by external credit rating agencies. |
| **Leverage ratio** | The ratio of Tier 1 capital divided by total exposure, which includes on and off balance sheet assets, after netting derivatives. |
| **Liquid assets** | The total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities. |
| **Liquidity ratio** | Liquid assets as a percentage of shares, deposits and borrowings. |
| **Loan-to-value ratio (LTV)** | A ratio which expresses the balance of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTVs on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in a house price index). |
| **Loans past due / past due loans** | Loans on which payments are overdue including those on which partial payments are being made. |
| **Material Risk Takers (MRTs)** | A group of employees to which the FCA's Remuneration Code applies. MRTs consist of Executive Directors, Non-Executive Directors and certain senior managers who could have a material impact on the firm's risk profile. |
| **Member** | A person who has a share investment or a mortgage loan with the Society. |
| **Permanent Interest Bearing Shares (PIBS) or subscribed capital** | Unsecured, deferred shares that are a form of Tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing members of Skipton Building Society. |

| Term | Definition |
|---|---|
| **Prime** | Prime mortgages are those granted to the most credit worthy category of borrower. |
| **Renegotiated loans** | Loans are classed as renegotiated, with the customer's consent, when their terms have changed during the year. Loans and advances may be renegotiated whether or not the customer is experiencing financial difficulty in repaying their loan with the Group. |
| **Repo / reverse repo** | Short to medium term funding agreements which allow a borrower to sell a financial asset, such as an ABS or government bonds as security for cash. As part of the agreement the borrower agrees to repurchase the security at some later date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo, which can typically be resold or repledged if desired. |
| **Residential loans** | Mortgage lending secured against residential property |
| **Residential mortgage backed securities (RMBS)** | A category of ABS that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal). |
| **Risk appetite** | The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Society's members whilst achieving business objectives. |
| **Risk weighted asset (RWA)** | The value of assets, after adjustment, under CRD IV rules to reflect the degree of risk they represent. |
| **Securitisation** | A process by which a group of assets, usually loans, are aggregated into a pool which is used to back the issuance of new securities. A firm transfers these assets to a special purpose vehicle which then issues securities backed by the assets. The Group has established securitisation structures as part of its funding activities. These securitisation structures use retail / residential mortgages as the asset pool. |
| **Subordinated debt / liabilities** | A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors and investing members (other than holders of PIBS). |
| **Sub-prime** | Loans to borrowers typically having weakened credit histories that include payment delinquencies and in some cases potentially more severe problems such as court judgements and discharged bankruptcies. |
| **Tier 1 capital** | A measure of financial strength. Tier 1 capital is divided into Common Equity Tier 1 and other Tier 1 capital. Common Equity Tier 1 capital comprises general reserves from retained profits. The book values of goodwill and other intangible assets are deducted from Common Equity Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as PIBS are included in other Tier 1 capital (i.e. not Common Equity Tier 1). |
| **Tier 2 capital** | Tier 2 capital comprises regulated subordinated liabilities and PIBS that have been transitioned out of additional Tier 1 capital. |
| **Wholesale funding** | Amounts owed to credit institutions, amounts owed to other customers and debt securities in issue excluding balances deposited by offshore customers. |

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