Pillar 3 Disclosures
2017

SKIPTON
BUILDING SOCIETY
For your life ahead

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1 EXECUTIVE SUMMARY

1.1 Introduction

This document presents the consolidated Pillar 3 disclosures of the Skipton Building Society Group (the ‘Group’) as at 31 December 2017.

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

1.2 Summary of key disclosures

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

The tables below set out the capital adequacy as at 31 December 2017 under CRD IV applying both the transitional and end-point rules for the prudential consolidation group and individual consolidation group.

The capital ratios are calculated as the relevant capital divided by risk weighted assets at 31 December.

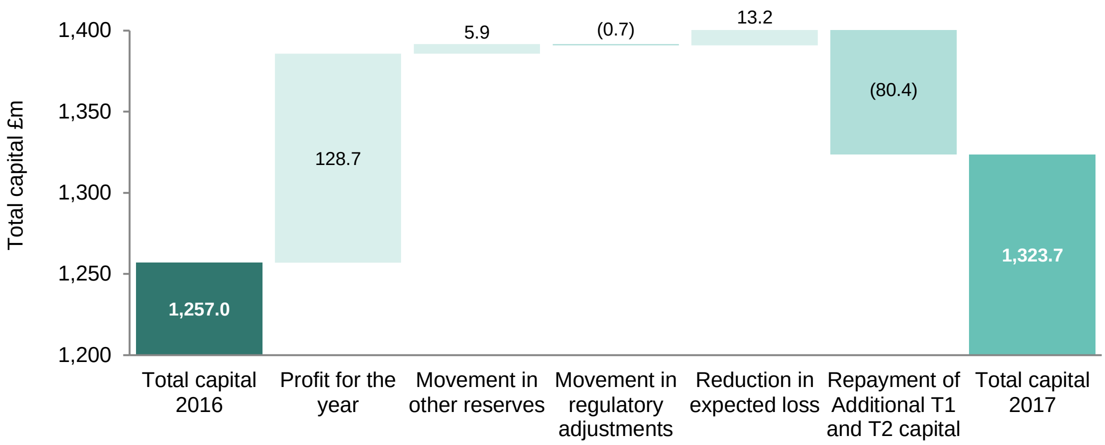
Table 1 Capital adequacy

	Transitional		End-point	
	2017	2016	2017	2016
Prudential consolidation group	£m	£m	£m	£m
Total Common Equity Tier 1	1,283.7	1,136.6	1,283.7	1,136.6
Additional Tier 1 capital	40.0	54.0	-	-
Total Tier 2 capital	-	66.4	40.0	40.4
Total regulatory capital	1,323.7	1,257.0	1,323.7	1,177.0
Total risk weighted assets (RWAs)	3,864.7	4,763.2	3,864.7	4,763.2
Pillar 1 capital requirement (RWAs x 8%)	309.2	381.1	309.2	381.1
Capital ratios (as a percentage of RWAs)				
Common Equity Tier 1 capital (%)	33.2	23.9	33.2	23.9
Tier 1 capital (%)	34.3	25.0	33.2	23.9
Total capital (%)	34.3	26.4	34.3	24.7

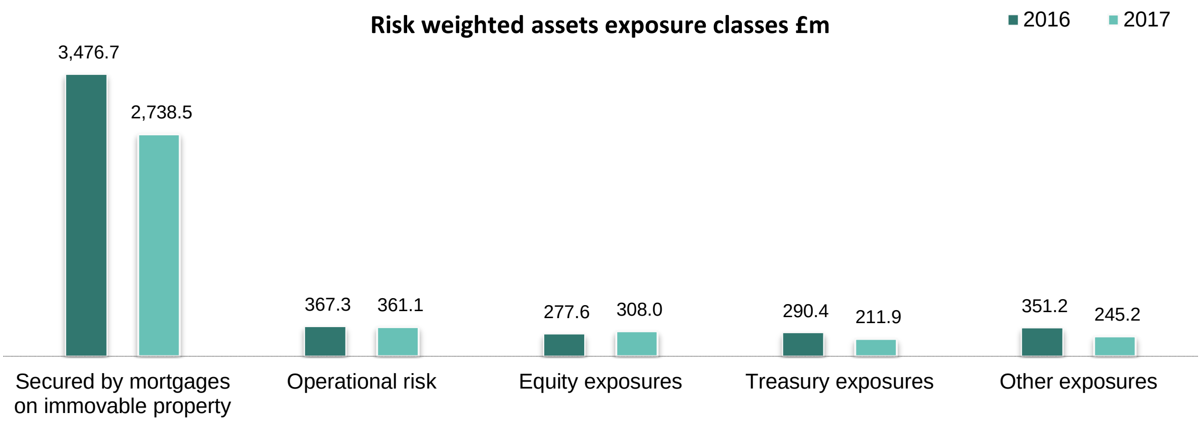
	Transitional		End-point	
	2017	2016	2017	2016
Individual consolidation group	£m	£m	£m	£m
Total Common Equity Tier 1	1,243.4	1,112.5	1,243.4	1,112.5
Additional Tier 1 capital	40.0	54.0	-	-
Total Tier 2 capital	-	66.4	40.0	40.4
Total regulatory capital	1,283.4	1,232.9	1,283.4	1,152.9
Total risk weighted assets (RWAs)	3,583.9	4,481.8	3,583.9	4,481.8
Pillar 1 capital requirement (RWAs x 8%)	286.7	358.5	286.7	358.5
Capital ratios (as a percentage of RWAs)				
Common Equity Tier 1 capital (%)	34.7	24.8	34.7	24.8
Tier 1 capital (%)	35.8	26.0	34.7	24.8
Total capital (%)	35.8	27.5	35.8	25.7

During 2017 the total capital of the prudential group increased by £66.7m primarily driven by an increase in retained profits of £128.7m and a decrease in excess expected losses of £13.2m, offset by the repayment of

£80.4m of Additional Tier 1 and Tier 2 capital. The graph below illustrates the movement in total capital during 2017.



In addition to the improvement in capital, risk weighted assets reduced by £898.5m during the year driven by the disposal of £220m of non-performing or recently non-performing mortgage assets combined with an improvement in the performance of our residential mortgages supported by the relatively stable economy throughout 2017.



Leverage ratio

The table below sets out the leverage ratio under both the transitional and the end-point rules for the prudential consolidation group.

	Transitional		End-point	
	2017 £m	2016 £m	2017 £m	2016 £m
Total Tier 1 capital	1,323.7	1,190.6	1,283.7	1,136.6
Total exposure	21,159.6	19,304.8	21,159.6	19,304.8
Leverage ratio (%)	6.3	6.2	6.1	5.9

The leverage ratio has increased during the year showing that whilst the Group increased lending throughout 2017 it also increased its capital base. See section 4.5 for further details.

Liquidity coverage ratio

The Liquidity Coverage Ratio was 179% as at 31 December 2017 and was above both the regulatory and internal limits set by the Board throughout the period. See section 13.1 for further details.

Asset 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. This may be done to attain funding and/or to collateralise derivative exposures. As at 31 December 2017 the level of encumbrance was within our risk appetite. See Appendix 5 for further details.

	Carrying amount of encumbered assets 2017 £m	Carrying amount of encumbered assets 2016 £m	**Carrying amount of unencumbered assets 2017 £m**	Carrying amount of unencumbered assets 2016 £m
Assets	**2,889.1**	2,974.2	**17,389.0**	15,764.1

2 INTRODUCTION

2.1 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.

These disclosures have been prepared under CRR Part Eight (Articles 431 to 455) of Regulation (EU) No 575/2013. Some of the regulations introduced under the CRR are being phased in over the period to 1 January 2022 under transitional arrangements. These arrangements impact the eligibility of some of the Group's capital instruments which is set out in detail in section 4.3.

2.2 Pillar 3 policy

The Board has adopted a formal policy for the production of the Pillar 3 disclosures. The policy sets out the principles which ensure that the Pillar 3 disclosures satisfy the regulatory reporting requirements in respect of the basis, frequency, verification and appropriateness of disclosures, and the governance framework applied in the preparation of the disclosures. The policy also ensures that the Group's risk profile is comprehensively disclosed and that our disclosures are comparable to other market participants.

2.3 Basis and frequency of disclosure

These Pillar 3 disclosures are based upon the Group's Annual Report and Accounts for the year ended 31 December 2017, unless otherwise stated. The frequency of disclosure has been assessed in accordance with European Banking Authority (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.

2.4 Media and location of publication

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

2.5 Verification of disclosure

The design of specific controls surrounding the preparation of these disclosures has been independently reviewed and independent external advice on compliance with regulatory reporting requirements has been received. These disclosures have also been reviewed and approved by the Board Risk Committee on behalf of the Board.

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 2017 Annual Report and Accounts which are externally audited.

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

2.6 Scope of application

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

- Prudential consolidation group
- Individual consolidation group

Prudential consolidation group	Individual consolidation group
Skipton Building Society (Society)	Skipton Building Society (Society)
Amber Homeloans Limited (Amber)	Amber Homeloans Limited (Amber)
North Yorkshire Mortgages Limited (NYM)	North Yorkshire Mortgages Limited (NYM)
Darrowby No. 2 plc	
Darrowby No. 3 plc	
Darrowby No. 4 plc	
Beckindale No. 2 Limited (liquidated during the year)	
Skipton Covered Bonds Limited Liability Partnership	
Skipton Financial Services Limited (SFS)	
Skipton Business Finance Limited (SBF)	
Skipton International Limited (SIL)	
Skipton Investments Limited	
Skipton Group Holdings Limited	

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

The following entities, whose activities are not closely aligned to the core business, 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 and its subsidiaries
- Northwest Investments NZ Limited

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

Table 2 provides a reconciliation of the full Group consolidated balance sheet to the prudential group balance sheet as at 31 December 2017. It also sets out the regulatory adjustments applied to derive the exposure amount for which capital is required to be held, the 'credit risk exposure'.

Table 2 Reconciliation of accounting balance sheet assets to regulatory credit risk exposure

Assets	Accounting balance sheet assets as published in financial statements £m	Deconsolidation of entities outside the regulatory group £m	Prudential group balance sheet assets £m	Assets deducted from own funds[1] £m	Regulatory capital adjustments[2] £m	Regulatory exposure of off-balance sheet items post CCF[3] £m	IRB provisions[4] £m	Exposure to counterparty credit risk for derivatives[5] £m	Prudential group credit risk exposure £m
Cash in hand and balances with the Bank of England	2,396.9	-	2,396.9	-	-	-	-	-	2,396.9
Loans and advances to credit institutions	345.3	(19.6)	325.7	-	(21.1)	-	-	-	304.6
Debt securities	791.1	-	791.1	-	(0.6)	-	-	-	790.5
Derivative financial instruments	94.2	-	94.2	-	-	-	-	82.8	177.0
Loans and advances to customers	16,972.7	16.0	16,988.7	-	-	677.5	7.3	-	17,673.5
Deferred tax asset	30.4	(17.2)	13.2	-	0.8	-	-	-	14.0
Investments in Group undertakings	-	83.7	83.7	-	-	-	-	-	83.7
Investments in joint ventures	12.8	(12.8)	-	-	-	-	-	-	-
Equity share investments	0.4	(0.4)	-	-	-	-	-	-	-
Property, plant and equipment	78.2	(43.6)	34.6	-	-	-	-	-	34.6
Investment property	14.4	(0.2)	14.2	-	-	-	-	-	14.2
Intangible assets	164.4	(153.1)	11.3	(11.3)	-	-	-	-	-
Other assets	122.8	(44.2)	78.6	-	(39.7)	-	-	-	38.9
Total assets	21,023.6	(191.4)	20,832.2	(11.3)	(60.6)	677.5	7.3	82.8	21,527.9

As set out above the balance sheet exposure is adjusted for the following items to derive the credit risk exposure:

1. Under PRA rules intangible assets (including goodwill) must be deducted from regulatory capital.
2. Specific regulatory capital adjustments relate to the alignment of balance sheet exposures to the prudential credit risk exposure.
3. Regulatory exposure of off balance sheet items post credit conversion factor (CCF) relates to undrawn credit facilities.
4. Exposures for residential mortgages measured under the IRB Approach are not adjusted for loan impairment in accordance with Article 166 and therefore loan impairment provisions are added back.
5. Counterparty credit risk relates to derivative contracts and its associated credit valuation adjustments.

2.7 Scope of permission of Internal Ratings Based Approach

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

The IRB Approach allows the Society to calculate capital requirements using internally developed models rather than the standardised percentages set out in the CRR. The IRB models are subject to a robust monitoring process on an ongoing basis to ensure that they reflect regulatory and economic developments. See section 6.5 and 6.6 for further detail on the IRB models and the associated governance framework.

2.8 Disclosure levels

In accordance with Article 432 of the CRR an institution may omit one or more of the disclosures required if the information provided is not regarded as material or if it is regarded as proprietary or confidential.

2.8.1 Non material information

As shown in Table 1 in section 1.2 the difference between the individual consolidation group and the prudential consolidation group is not material; the granular analysis throughout these disclosures has therefore been disclosed at a prudential group level only.

Table 1 also sets out the capital adequacy under CRD IV applying both the transitional rules and CRD IV end-point rules. The difference between the transitional and end-point position is that under the end-point rules all existing Additional Tier 1 (AT 1) capital that becomes ineligible as AT 1 under CRD IV is transitioned into Tier 2 in full (namely a £40m tranche of Permanent Interest Bearing Shares (PIBS)). As this difference is not significant, we have not presented any further information relating to capital adequacy on an end-point basis.

The Group's exposure to foreign currency risk leads to an immaterial capital requirement; see section 12.2 for further detail.

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

2.8.2 Proprietary information

An overview of our approach to interest rate risk is set out in section 12.1, however certain specific details concerning our calculations and assumptions in respect of interest rate risk have been omitted on the basis of their proprietary nature. An omission is made in accordance of the Article 432 (2) of the CRR.

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

2.8.3 Transferability of capital

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

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

2.9 Regulatory developments

In December 2016 the EBA published its final guidelines EBA/GL/2016/11[2] on disclosure requirements under Part Eight of the CRR. These guidelines provide further guidance and support to institutions mainly from a presentational aspect. By introducing more specific guidance and formats for disclosures through the use of tables and templates, the guidelines represent a significant step towards enhancing the consistency and comparability of institutions' regulatory disclosures in accordance with Part Eight of the CRR.

These guidelines apply to Globally and Other Systemically Important Institutions ('G-SII' and 'O-SII' respectively) from 31 December 2017. The Group is not a G-SII or O-SII but has given due and proportionate consideration to the guidelines in the current Pillar 3 disclosures taking account of its risk profile and use of materiality. Notwithstanding the above, paragraph 8 of the above guidelines lists requirements that are applicable to all institutions and are included in this document.

The Group is fully compliant with Part Eight of the CRR and continues to consider the EBA guidelines in future Pillar 3 disclosures to increase transparency and ensure that it follows best practice.

In March 2017 the EBA published its final regulatory technical standards EBA/RTS/2017/03 on disclosure of encumbered and unencumbered assets under Article 433 of the CRR. These regulatory technical standards were approved by the European Commission in September 2017 with the effective date 2 January 2018, but have been adopted by the Group in this document. Further information has been set out in Appendix 5.

2.9.1 Implementation of IFRS 9 and impact on capital planning

The principal impacts on the Group's regulatory capital of the implementation of IFRS 9 will arise from the following:

- The reclassification of the Group's equity release portfolio from amortised cost to fair value through profit or loss; and
- The new impairment requirements.

The PRA has announced transitional provisions under which the capital impact that arises from implementing the new impairment requirements of IFRS 9 may be phased in over a five year period; the Group has applied these transitional provisions from 1 January 2018.

The Group estimates that the impact of IFRS 9 implementation will reduce its Common Equity Tier 1 (CET 1) ratio at 1 January 2018 by approximately 0.8% to approximately 32.4% (before transitional relief) and will reduce its total capital ratio at 1 January 2018 by approximately 0.8% to approximately 33.5% (before transitional relief). Further detail on the impact of IFRS 9 is set out in note 41 in the Annual Report and Accounts.

[2] The Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013 (published on 16 December 2016) are available at: www.eba.europa.eu/regulation-and-policy/transparency-and-pillar-3/guidelines-on-disclosure-requirements-under-part-eight-of-regulation-eu-

3 RISK MANAGEMENT OBJECTIVES AND POLICIES

3.1 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 credit risk, liquidity risk, operational risk, market risk, interest rate risk, pension obligation risk, conduct risk, model risk, reputational risk and business risk. These risks are explained in detail in sections 6 to 13 of these disclosures and in the Risk Management Report of the Annual Report and Accounts, pages 64 to 71.

3.2 Risk culture

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

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

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

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

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

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

3.3 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.

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

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

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 3.4.4.

3.4 Group risk management framework

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

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

- **Second line of defence**, comprising independent risk functions (Operational, Credit and Market & Liquidity) and related independent compliance functions. These functions challenge, monitor, guide and support the business in managing its risk exposure. The risk framework includes the four sub-committees of the Board Risk Committee, namely, the Conduct and Operational Risk Committee, the Asset and Liability Committee, the Retail Credit Committee and the Model Governance Committee, details of which are set out in section 3.4.4. These sub-committees are responsible for recommending and monitoring the Group's adherence to policy. The independent risk functions are represented on each of these sub-committees. The Board Risk Committee Chairman is responsible for maintaining the independence of the second line of defence to ensure there are no obstacles to its independent challenge of first line operations.

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

Further details on the specific responsibilities of the Board and the Executive Committees are summarised in this section and set out in detail in the Directors' Report on Corporate Governance and in the Risk Management Report of the Annual Report and Accounts on pages 48 to 65.

3.4.1 Board

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

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

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

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

  The governance framework clarifies the respective roles and responsibilities of Directors and senior executives in order to facilitate Board and management accountability to both the Society and its members. This ensures a balance of authority such that no single individual has unfettered powers. It has clear lines of sight into activities to enable challenge and oversight, allowing the Board to obtain assurance over performance, the integrity of reporting and effectiveness of control implementation.

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

  This framework identifies, assesses, manages and monitors risk on an ongoing basis. It informs 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 known risks crystallising.

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

The Board considers that the risk management systems in place are adequate and aligned to the profile and strategy of the Group. The Directors' Report on Corporate Governance and the Risk Management Report of the Annual Report and Accounts, see pages 48 and 65 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.

3.4.2 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.

3.4.3 Board members

The recruitment policy for Board members and the diversity policy with respect to all employees including directors and senior managers can be found in the Annual Report and Accounts on pages 54, 55 and 22 respectively. Details of the Board members' other directorships can be found in the Annual Report and Accounts on pages 191 to 193.

3.4.4 Board Risk Committee

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

The members of the BRC during the period were:

Mr R D East	Non-Executive Director (former Committee Chairman) (stepped down 31 August 2017 following appointment as Chairman of the Board)
Mr D A Hall	Non-Executive Director (appointed Committee Chairman 1 September 2017 having joined the Committee in May 2017)
Mr M J Lund	Non-Executive Director
Mr G E Picken	Non-Executive Director
Ms H C Stevenson	Non-Executive Director

The BRC met seven times during 2017.

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

In accordance with the Capital Requirements Directive (CRD) regulations, the Committee's membership comprises only Non-Executive Directors.

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

The BRC also has a number of executive committees, which have day-to-day responsibility for risk management oversight, as outlined in the diagram below:

Board Risk Committee

Conduct and Operational Risk Committee (CORC)	Asset and Liability Committee (ALCO)	Retail Credit Committee (RCC)	Model Governance Committee (MGC)
Chaired by the **Chief Conduct Risk Officer**	Chaired by the **Group Finance Director**	Chaired by the **Group Chief Executive**	Chaired by the **Chief Financial Risk Officer**
Develops and maintains the Group conduct and operational risk frameworks to ensure that robust processes are in place to deliver an ongoing high quality service to customers.	Develops and maintains policies on structural risk management, liquidity, funding and wholesale credit risk to ensure the prudential strength of the Group, and monitors adherence to the policies to ensure the Group remains within risk appetite.	Develops and maintains policies on credit quality of retail loan books and monitors implementation to ensure that Group lending does not create credit risk outside the agreed appetite.	Develops and maintains model build standards and reviews key models against these to ensure that the output from models can be relied on in decision making.

Further information regarding the sub-committees can be found in the Risk Management Report of the Annual Report and Accounts on pages 64 to 65.

3.4.5 Executive Committee

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

3.4.6 Audit Committee

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

Ms M Cassoni	Non-Executive Director (Committee Chairman)
Mrs D P Cockrem	Non-Executive Director
Mr G E Picken	Non-Executive Director
Mr J R Coates	Non-Executive Director (appointed to the Committee 1 August 2017)

The Committee met five times during 2017.

The responsibilities of the Committee are delegated by the Board and are set out in its written terms of reference which are available on our website at www.skipton.co.uk/about-us/governance/board-committees. These are in line with the provisions of the Financial Reporting Council's 'Guidance on Audit Committees' which was last updated in April 2016. The Committee's primary responsibilities are:

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

Further information of the Audit Committee can be found in the Audit Committee Report of the Annual Report and Accounts on pages 58 to 63.

3.4.7 Remuneration Committee

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

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

- Ensure that remuneration arrangements support and encourage desired behaviours and culture; and
- Ensure appropriate governance of remuneration practices across the Society and its subsidiary companies and exercise effective oversight of these.

Among its other duties, the Committee specifically:

- Determines and agrees, on behalf of the Board, the Society's Remuneration Principles and Policy, ensuring alignment to the business strategy, risk profile, corporate values, regulatory requirements and the long term interests of the Society and its members;
- Provides adequate oversight arrangements to ensure policies are operating as intended;
- Works closely with the Board Audit and Board Risk Committees to ensure that Remuneration Policy promotes sound and effective risk management;
- Maintains an effective risk adjustment policy and process which takes into account the Board Risk Appetite, capital and liquidity levels and ensures remuneration levels reflect overall performance;
- Assesses with regard to variable pay, the achievement of performance targets and the need for ex-ante or ex-post risk adjustments, including the application of malus and clawback arrangements;
- Determines and agrees remuneration for the Chairman of the Society Board and Society Executive Directors which shall be subject to the Remuneration principles;
- Oversees the remuneration of the senior officers in the Risk and Compliance functions;
- Receives recommendations from the Group Chief Executive for approval of the remuneration for Senior Executives which shall be subject to the Remuneration Principles;
- Determines the policy, term, objectives and content of Society Executive Directors and Society Senior Executive service contracts to ensure they remain aligned to the Committee's overarching Remuneration Policy, regulatory requirements and good practice guidance; and
- Reviews any proposed remuneration structures or pay proposals which fall outside the parameters of the agreed Remuneration Principles.

The Committee has established clear remuneration principles for the Society and its Group subsidiaries. For those businesses regulated by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), the principles, which are reviewed annually, set appropriate standards for remuneration governance, risk management, variable pay structures (and the link to performance) and remuneration for Material Risk Takers (MRTs). The Committee receives annual reports from the Group Remuneration Oversight Committee on compliance with the principles and a report from the Chief Risk Officers on risk performance during the year.

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 https://www.skipton.co.uk/about-us/governance/board-committees.

The members of the Remuneration Committee during 2017 were:

Ms H C Stevenson	Non-Executive Director (Chairman of the Committee)
Miss A J Burton	Non-Executive Director (appointed 1 January 2017)
Mrs D P Cockrem	Non-Executive Director
Mr R D East	Non-Executive Director (resigned from the Committee 26 September 2017)
Mr D A Hall	Non-Executive Director (appointed 1 October 2017)

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

The Remuneration Committee met five times during 2017.

In discharging its duties, the Committee reviews and takes into account independently produced data in relation to similar financial services organisations.

Details of remuneration arrangements for the Society's Executive Directors are set out in detail in the Directors' Remuneration Report on pages 72 to 88 of the 2017 Annual Report and Accounts. Remuneration arrangements for other MRTs, and the link between pay and performance; are set out in section 14 of this document.

3.4.8 Nominations Committee

The Nominations Committee, which comprises all the Society's Non-Executive Directors and is chaired by the Society Chairman, leads the process for Board appointments and succession planning.

3.4.9 Non-Executive Directors' Remuneration Committee

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

4 CAPITAL RESOURCES

4.1 Total capital resources

Capital is ultimately held for the protection of depositors and other creditors by providing a buffer against unexpected losses. During 2017 the Society satisfied all of the current capital requirements under CRD IV.

All disclosures are on a transitional basis as outlined in section 2.8 unless explicitly stated.

4.2 Common Equity Tier 1 capital

Common Equity Tier 1 (CET 1) capital comprises principally the general reserve (accumulated profit) and unrealised gains and losses on available-for-sale assets. In line with CRD IV, the cash flow hedging reserve is excluded from CET 1.

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

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

- Goodwill and intangible assets are deducted from regulatory capital in accordance with CRD IV.

- A deduction is made for excess expected losses. Expected loss is the forecast loss for mortgage accounts that are likely to default over the next 12 months. The extent by which this exceeds the impairment amounts derived by the IFRS accounting regulations is called the 'excess expected loss' and is deducted from CET 1 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 (AT 1) capital comprises issued capital in the form of Permanent Interest Bearing Shares (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.

In April 2017, the Society repaid and cancelled £50m of its PIBS on its call date. The remaining PIBS of £40m are perpetual and will remain eligible for regulatory capital but will be phased out of AT 1 capital into Tier 2 capital over a transitional period to 1 January 2022 in accordance with CRD IV.

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

4.4 Tier 2 capital

In 2016 Tier 2 capital comprised subordinated liabilities and PIBS that has been transitioned out of AT 1 capital under CRD IV. In April 2017, the Society repaid and cancelled £50m of its PIBS on its call date and in May 2017 the Society repaid and cancelled £30.4m of its subordinated debt on its call date bringing Tier 2 capital down to zero as at 31 December 2017.

Table 3 shows the composition of regulatory capital as at 31 December 2017.

Table 3 Capital composition

	Notes	2017 £m	2016 £m
Common Equity Tier 1			
General reserve		1,307.2	1,171.7
Available-for-sale reserve		3.1	4.0
Cash flow hedging reserve		0.1	3.3
Common Equity Tier 1 prior to regulatory adjustments		1,310.4	1,179.0
Regulatory adjustments			
Fair value adjustments	1	-	(0.4)
Prudential adjustments	2	(0.6)	(0.8)
Intangible assets	3	(11.0)	(9.7)
Cash flow hedging reserve	4	(0.1)	(3.3)
Excess of expected loss over impairment provisions	5	(15.0)	(28.2)
Total Common Equity Tier 1 capital		1,283.7	1,136.6
Additional Tier 1			
Permanent Interest Bearing Shares	6	40.0	54.0
Total Tier 1 capital		1,323.7	1,190.6
Tier 2			
Subordinated liabilities	6	-	30.4
Permanent Interest Bearing Shares	7	-	36.0
Total Tier 2 capital		-	66.4
Total regulatory capital		1,323.7	1,257.0
Risk weighted assets (RWAs)			
IRB Approach			
Credit risk			
Secured by mortgages on immovable property		1,961.8	2,721.0
Non-credit obligation assets	8	36.5	129.4
Equity	9	308.0	277.6
Standardised Approach			
Credit risk			
Secured by mortgages on immovable property	10	776.7	755.7
Corporates and retail		64.3	60.6
Treasury	11	196.9	268.1
Other	12	144.4	161.2
Operational risk		361.1	367.3
Market risk		-	-
Credit valuation adjustment	13	15.0	22.3
Total risk weighted assets		3,864.7	4,763.2
Pillar 1 capital requirement (RWAs x 8%)		309.2	381.1
Capital ratios (as a percentage of RWAs)			
Common Equity Tier 1 (%)		33.2	23.9
Tier 1 (%)		34.3	25.0
Total capital (%)		34.3	26.4

Notes

1. The associated merger fair value adjustments are due to the fact the PIBS and subordinated liabilities which applied in 2016 are disclosed at par value.
2. Prudential adjustments relate to a deduction to capital for an Additional Valuation Adjustment ('AVA') on fair value assets. AVA has been applied to provide for the downside of fair value exposures that are intrinsically subjective in nature.
3. Under PRA rules intangible assets (including goodwill) must be deducted for regulatory purposes..
4. Under PRA rules the cash flow hedging reserve must be deducted for regulatory purposes.
5. Under PRA rules the excess of expected loss, as calculated under the IRB approach, over accounting impairment provisions is deducted from CET 1 capital.
6. In April 2017, the Society repaid and cancelled £50.0m of its Permanent Interest Bearing Shares and £35.4m of its subordinated debt on their call dates. In May 2017, the Society also repaid and cancelled £30.0m of subordinated liabilities on its call date. £30.4m of the subordinated debt repaid counted towards regulatory capital at the end of 2016.
7. Under CRD IV end-point rules all existing Additional Tier 1 and Tier 2 instruments that become ineligible as capital under CRD IV are excluded in full. On a transitional basis £40m of PIBS are being phased into Tier 2 over the period to 2022.
8. Non-credit obligation assets relate to property, plant and equipment and fair value adjustments for hedged assets associated with exposures measured under the IRB approach.
9. Equity exposures primarily relate to investments in subsidiary companies outside the regulatory group.
10. Risk weighted assets on immovable property under the Standardised Approach include £279.0m in relation to commercial mortgages as at 31 December 2017 (31 December 2016: £307.9m).
11. Treasury risk weighted assets include exposures to central government, institutions, covered bonds and securitisations balances.
12. Other risk weighted assets include fair value adjustments for hedged assets associated with exposures measured under the standardised approach.
13. The Credit Valuation Adjustment is held in order to protect the Group from exposure to potential mark to market losses that could arise if the creditworthiness of counterparties to the Society's derivative contracts were to deteriorate.

The total capital ratio has increased to 34.3% during the year. This increase is driven by an increase in capital resources of £66.7m primarily due to an increase in retained profits of £128.7m and decrease in excess expected losses of £13.2m, offset by a reduction of £80.4m in AT 1 and Tier 2 capital which was repaid and cancelled during the year.

Risk weighted assets (RWAs) have reduced by £898.5m during 2017 to £3,864.7m (31 December 2016: £4,763.2m). The key driver for the reduction in RWAs relates to the disposal of non-performing or recently non-performing mortgage assets, resulting in a decrease of £463m. In addition, whilst Group mortgage balances grew by 8.3% in 2017, house price inflation and the continuation of low levels of arrears have led to a re-calibration of our point in time credit risk models. This has reduced effective risk weights resulting in a lower level of RWAs.

The reduction in treasury RWAs is due to the continued and extended use of central clearing counterparties for derivative exposures that attract a lower risk weight. Further information regarding the movement in RWAs is set out in section 5.2.

4.4.1 Regulatory capital flow statement

Table 4 below shows the flow of regulatory capital and associated movements that have occurred from 31 December 2016 to 31 December 2017 and shows how the Group's strong financial performance has strengthened our capital position.

Table 4 Capital flow statement

	Notes	Common Equity Tier 1 capital	Additional Tier 1 capital	Tier 2 capital
At 1 January 2017		1,136.6	54.0	66.4
Profit for the year		128.7	-	-
Actuarial gain on retirement benefit obligation		3.0	-	-
Movement in available-for-sale reserve		(0.9)	-	-
Other items in general reserves		4.5	-	-
Tax on items taken directly to general reserves		(0.7)	-	-
Net increase in intangible assets		(1.3)	-	-
Reduction in AVA		0.2	-	-
Net reduction in excess expected loss over impairment provisions	1	13.2	-	-
Movement in fair value for PIBS and subordinated liabilities	2	0.4	-	-
Repayment of PIBS	3	-	(14.0)	(36.0)
Repayment of subordinated debt	4	-	-	(30.4)
At 31 December 2017		1,283.7	40.0	-

Notes
1. Expected losses are the forecast losses for exposures likely to default in the next twelve months as calculated by the IRB models. Excess expected loss is the difference between the expected losses calculated under the IRB Approach and the amount of accounting provisions held for those exposures. The excess expected loss is deducted from CET 1 capital in accordance with Article 159 of the CRR.
2. 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.
3. In April 2017, the Society repaid and cancelled £50.0m of its PIBS.
4. In April 2017, the Society repaid and cancelled £35.4m of its subordinated debt on its call date, of which £30.4m was capital eligible.

4.5 Leverage ratio

The leverage ratio is defined as the ratio of Tier 1 capital to total exposure which includes both on and off balance sheet items. This metric is a non-risk based measure used to manage the risk of excessive leverage. The EU is expected to formalise a binding leverage ratio for all institutions as part of its amendments to CRR expected in 2019.

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 Group's leverage ratio is a key financial indicator monitored closely by the Board each month. The forecast ratio is incorporated into the Society's strategy and risk appetite framework.

Table 5 below sets out the leverage ratio for the prudential consolidation group under the CRD IV transitional and end-point definition as at 31 December.

Table 5 Leverage ratio

	Notes	Transitional 2017 £m	Transitional 2016 £m	End-point 2017 £m	End-point 2016 £m
Total Tier 1 capital		**1,323.7**	1,190.6	**1,283.7**	1,136.6
Total balance sheet assets		**20,832.2**	18,777.6	**20,832.2**	18,777.6
Derivatives	1	**(301.9)**	(374.9)	**(301.9)**	(374.9)
Securities financing transactions	2	**-**	2.0	**-**	2.0
Regulatory adjustments	3	**629.3**	900.1	**629.3**	900.1
Total exposure		**21,159.6**	19,304.8	**21,159.6**	19,304.8
Leverage ratio		**6.3%**	6.2%	**6.1%**	5.9%

Notes

1. Exposure values associated with derivatives have been adjusted in accordance with regulatory requirements. For the leverage ratio, the derivative measure is calculated as the replacement cost less cash collateral for the current exposure plus an add-on for potential future exposure.
2. The exposure values associated with securities financing transactions have been adjusted in accordance with regulatory requirements.
3. Regulatory adjustments relate to undrawn credit commitments, cash flow hedging reserve, goodwill, intangible assets, AVA, current tax and excess expected loss. These adjustments are made to ensure the denominator balance meets regulatory requirements.

During the year the leverage ratio increased from 5.9% to 6.1% on an end-point basis and from 6.2% to 6.3% on a transitional basis. The ratio is above the regulator's expected minimum of 3%.

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

5 CAPITAL REQUIREMENTS

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

5.1 Pillar 1 capital

Under PRA rules a minimum level of capital (Pillar 1) must be held for credit risk, operational risk, market risk and the credit valuation adjustment[3] for the individual and prudential consolidation groups.

Credit risk

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

IRB Approach for:

- Residential mortgage exposures within the Society and its subsidiary companies Amber and NYM;
- Fair value adjustments for hedged assets associated with underlying exposures measured under the IRB Approach;
- Cost of investment in subsidiary companies outside the regulatory group;
- Property, plant and equipment (non-credit obligation assets); and
- Cash in hand.

Standardised Approach for:

- Residential mortgage exposures within SIL;
- Commercial mortgage exposures within the Society;
- Equity release mortgage exposures within the Society;
- Wholesale credit exposures within the regulatory group; and
- Other assets including prepayments and fair value adjustments for hedged assets associated with underlying exposure measured under the Standardised Approach.

Section 6 sets out further information on credit risk.

Operational risk

Operational risk is calculated under the Standardised Approach and further information can be found in section 11.

Market risk

Foreign exchange risk is the only Pillar 1 market risk incurred by the individual and prudential groups. The Group's exposure to foreign currency risk is calculated in accordance with Article 83 of CRD IV and is immaterial. Further information on market risk and currency risk can be found in section 12.

Credit valuation adjustment

Within Pillar 1 credit risk the Group holds regulatory capital in order to cover potential losses which could arise if the counterparties to its derivative contracts fail to meet their financial obligations before the maturity date; this is known as the counterparty credit risk. This assessment places a valuation on the risk that the counterparty will default on its obligations before the maturity of the contract. In addition to this CRD IV requires additional regulatory capital to be held to protect the Group from exposure to potential mark to market losses that could arise if the creditworthiness of those same counterparties were to deteriorate: this is known as a credit valuation adjustment charge.

[3] The Credit Valuation Adjustment is held in order to protect the Group from exposure to potential mark to market losses that could arise if the creditworthiness of counterparties to the Society's derivative contracts were to deteriorate.

Summary of Pillar 1 capital requirements

Table 6 below provides an overview of RWAs and minimum capital requirements for Pillar 1 capital broken down by exposure class as at 31 December 2017.

Pillar 1 credit risk exposures include balances which are off balance sheet, such as undrawn credit commitments relating to mortgages not yet drawn down. These exposures have a capital requirement but do not appear in the accounting balance sheet of the regulated group. In addition, exposures in relation to derivatives and repurchase transactions are adjusted in accordance with regulatory requirements and adjustments are made for credit risk mitigation techniques such as netting. Further detail is set out in sections 7.3 and 8.3.

The 2016 figures have been restated to reclassify the risk weighted assets and capital required in relation to exposures to fair values on hedged assets from 'secured by mortgages on immovable property' under the standardised approach to 'other items'.

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

Table 6 Pillar 1 capital requirements

	Notes	Risk weighted assets 2017 £m	Risk weighted assets 2016 £m	Capital requirement 2017 £m	Capital requirement 2016 £m
IRB Approach					
Secured by mortgages on immovable property		1,745.5	2,248.2	139.6	179.9
Exposures in default	1	216.3	472.8	17.3	37.8
Non-credit obligation assets	2	36.5	129.4	2.9	10.4
Equity	3	308.0	277.6	24.6	22.2
		2,306.3	3,128.0	184.4	250.3
Standardised Approach					
Secured by mortgages on immovable property		774.9	753.7	62.0	60.3
Exposures in default	1	1.8	2.0	0.1	0.2
Corporates	4	63.7	61.5	5.1	4.9
Retail		0.6	0.9	0.1	0.1
Central governments or central bank		14.0	14.1	1.1	1.1
Multilateral development banks		-	-	-	-
Institutions		118.1	148.9	9.5	11.9
Covered bonds		8.7	3.9	0.7	0.3
Claims on institutions and corporates with a short-term credit assessment	5	16.3	76.7	1.3	6.1
Securitisation positions	6	39.8	38.3	3.2	3.1
Other items	7	144.4	145.6	11.6	11.6
		1,182.3	1,245.6	94.7	99.6
Total credit risk RWAs		3,488.6	4,373.6	279.1	349.9
Operational risk		361.1	367.3	28.9	29.4
Market risk		-	-	-	-
Credit valuation adjustment		15.0	22.3	1.2	1.8
Total RWAs		3,864.7	4,763.2	309.2	381.1

Notes

1. Exposures in default refer to those accounts greater than or equal to three months in arrears. It also takes into account potential indications that the borrower is unlikely to pay such as the borrower being made bankrupt.
2. Non-credit obligation assets relate to property plant and equipment and fair value adjustments for hedged assets associated with underlying exposures measured under the IRB Approach.
3. Equity exposures primarily relate to investments in subsidiary companies outside the regulatory group.
4. Corporate exposures relate primarily to debt factoring and invoice discounting in Skipton Business Finance.
5. Claims on institutions and corporates with a short-term credit assessment relate to exposures with a maturity of less than three months and a short-term credit rating.
6. Securitisation positions relate to purchased Residential Mortgage Backed Securities (RMBSs) excluding retained holdings. Further information on exposures relating to securitisations is set out in section 10.
7. Other items include fair value adjustments for hedged assets associated with exposures measured under the Standardised Approach.

5.2 Credit risk weighted assets flow statement

Table 7 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.

Table 7 Credit risk weighted assets flow statement

	IRB credit risk		Standardised credit risk			
	Mortgages and loans £m	Other assets £m	Mortgages and loans £m	Treasury assets £m	Other assets £m	Total £m
RWAs at 31 December 2016	2,721.0	407.0	755.7	304.2	208.0	4,395.9
(Reduction) / Increase in RWA volume	56.3	(62.5)	21.1	(44.4)	2.8	(26.7)
Improvement in RWA quality	(297.1)	-	(0.1)	(47.9)	(2.1)	(347.2)
Reduction due to model changes	(55.4)	-	-	-	-	(55.4)
Reduction due to disposal of assets	(463.0)	-	-	-	-	(463.0)
RWAs at 31 December 2017	1,961.8	344.5	776.7	211.9	208.7	3,503.6

RWAs relating to credit risk have reduced by £892.3m during 2017 to £3,503.6m (31 December 2016: £4,395.9m).

Movement in RWAs - Volume

The increase in volume in mortgage RWAs relates to the growth in lending in the Society and SIL, offset by the continued run-off of the Amber and NYM portfolios.

The reduction in volume in other assets RWAs measured under the IRB approach relates to the reduction in the fair value of hedged assets in relation to the mortgage exposures due to movement in yield curve during the year.

The reduction in volume in treasury assets RWAs is primarily driven by an increased exposure to low risk balances with the Bank of England.

Movement in RWAs - Quality

The improvement in RWA quality in relation to residential mortgages is mainly driven by the continued improvement in the performance of the residential mortgages supported by the relatively stable economy. Of key relevance are UK house prices, employment and interest rates.

The improvement in RWA quality in relation to treasury exposures is due to the use of central clearing counterparties for derivative exposures.

Movement due to model changes

The methodology for calculating the capital required under the IRB approach for new mortgage accounts has been enhanced. This has driven a reduction in RWA due to a more accurate representation of risk for new lending.

Disposal of assets

The reduction is due to the disposal of a portfolio of £220m of non-performing or recently non-performing mortgage assets, resulting in a decrease in our RWAs of £463m which further strengthened our capital position.

5.3 Capital reporting

Capital adequacy at an individual and prudential consolidation group level is reported to the PRA quarterly in our Common Reporting (COREP) returns. It is also reported to the Board on a monthly basis along with forecast positions.

5.4 Pillar 2 capital

Pillar 2 is provided to cover specific risks faced by the Group or the risks that have not been covered by Pillar 1.

Pillar 2A capital

At 31 December 2017 the capital requirement for Pillar 2A was 3.4% of risk weighted assets, a point in time estimate set by the PRA. The Group maintains capital levels which exceed this requirement.

5.5 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 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 called Pillar 2B capital. The PRA requires the amount relating to Pillar 2B capital to remain confidential between the Group and the PRA.

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

5.6 Minimum Requirement for Own funds and Eligible Liabilities

Minimum Requirement for Own Funds and Eligible Liabilities (MREL) is being phased in over a transitional period to 1 January 2022.

The MREL set for the Society, by the Bank of England, for the transitional period is equal to the regulatory capital requirements for the period to 31 December 2019, increasing to 18% of risk-weighted assets by 1 January 2020 for the period to 31 December 2021. MREL at the end of the transitional period is subject to review by the Bank of England and may change.

Compliance with MREL is reflected in the Society's strategic plans.

6 Credit risk

6.1 Credit risk overview

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

The Group faces this risk from its lending to:

- Individual customers (retail mortgages);
- Businesses through historical commercial lending and ongoing debt factoring and invoice discounting; and
- Wholesale counterparties for the purposes of liquidity management.

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

The Group has embedded a comprehensive risk management framework with clear lines of accountability and oversight as part of its overall governance framework.

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

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

As noted, the Group sold c.£220m of our specialist lending portfolio during 2017, with the objective of further reducing our exposure to an economic downturn, and freeing up a material value of capital to support our preparations for the new capital regime being introduced by the regulators to ensure financial institutions are appropriately prepared for any future economic downturn.

6.2 Credit risk exposures

The Group's overall credit risk exposures have increased by £1.8bn to £21.5bn as at 31 December 2017 driven primarily by an increase in mortgage lending during the year.

Table 8 below sets out the credit risk exposures by class split by those measured under the IRB Approach and those measured under the Standardised Approach. The balances include off-balance sheet items relating to undrawn credit facilities. The average exposure is based on the average of the last two reporting positions. The majority of exposures (72.7%) relate to residential mortgages measured under the IRB approach. See sections 6.3 and 6.4 for further detail on the IRB approach.

The 2016 figures have been restated to reclassify £283.4m in relation to exposures to fair values on hedged assets from 'secured by mortgages on immovable property' to 'other items'.

Table 8 Credit risk exposures by class

	2017 £m	2016 £m	Average 16/17 £m
IRB Approach			
Secured mortgages on immovable property	**15,577.8**	14,622.5	15,100.1
Exposures in default	**63.4**	130.6	97.0
Non-credit obligation assets	**38.4**	129.4	83.9
Equity	**83.2**	75.0	79.1
	15,762.8	14,957.5	15,360.1
Standardised Approach			
Secured mortgages on immovable property	**1,689.6**	1,568.3	1,628.9
Exposures in default	**2.0**	2.2	2.1
Corporates	**155.4**	119.6	137.5
Retail	**1.1**	1.6	1.4
Central governments or central bank	**2,669.7**	1,611.4	2,140.5
Multilateral development banks	**128.4**	154.9	141.6
Institutions	**379.2**	478.4	428.8
Covered bonds	**87.3**	39.2	63.2
Claims on institutions and corporates with a short-term credit assessment	**50.6**	205.4	128.0
Securitisation positions	**198.8**	191.6	195.2
Other items (Note 1)	**314.5**	327.3	320.9
	5,676.6	4,699.9	5,188.1
Credit valuation adjustment	**88.5**	73.4	80.9
Total credit risk exposures	**21,527.9**	19,730.8	20,629.1

Notes

1. Other items include fair value adjustments for hedged assets associated with exposures measured under the Standardised Approach.

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

Table 9 Credit risk exposures by geographical area

As at 31 December 2017	**UK £m**	**Channel Islands £m**	**EU £m**	**Rest of world £m**	**Total exposure value £m**
IRB Approach					
Secured by mortgages on immovable property	15,577.8	-	-	-	15,577.8
Exposures in default	63.4	-	-	-	63.4
Non-credit obligation assets	37.9	0.5	-	-	38.4
Equity	83.2	-	-	-	83.2
	15,762.3	0.5	-	-	15,762.8
Standardised Approach					
Secured by mortgages on immovable property	736.6	953.0	-	-	1,689.6
Exposures in default	2.0	-	-	-	2.0
Corporates	155.4	-	-	-	155.4
Retail	1.1	-	-	-	1.1
Central governments or central bank	2,654.3	-	15.4	-	2,669.7
Multilateral development banks	-	-	128.4	-	128.4
Institutions	320.4	-	14.9	43.9	379.2
Covered bonds	87.3	-	-	-	87.3
Claims on institutions and corporates with a short-term credit assessment	20.0	-	30.6	-	50.6
Securitisation positions	198.8	-	-	-	198.8
Other items	311.5	3.0	-	-	314.5
	4,487.4	956.0	189.3	43.9	5,676.6
Credit valuation adjustment	66.7	-	9.9	11.9	88.5
Total exposures	20,316.4	956.5	199.2	55.8	21,527.9

As at 31 December 2016	UK £m	Channel Islands £m	EU £m	Rest of world £m	Total exposure value £m
IRB Approach					
Secured mortgages on immovable property	14,622.5	-	-	-	14,622.5
Exposures in default	130.6	-	-	-	130.6
Non-credit obligation assets	128.9	0.5	-	-	129.4
Equity	75.0	-	-	-	75.0
	14,957.0	0.5	-	-	14,957.5
Standardised Approach					
Secured mortgages on immovable property	661.7	906.6	-	-	1,568.3
Exposures in default	2.2	-	-	-	2.2
Corporates	119.6	-	-	-	119.6
Retail	1.6	-	-	-	1.6
Central governments or central bank	1,606.4	-	5.0	-	1,611.4
Multilateral development banks	-	-	154.9	-	154.9
Institutions	378.8	-	31.2	68.4	478.4
Covered bonds	39.2	-	-	-	39.2
Claims on institutions and corporates with a short-term credit assessment	93.7	-	85.2	26.5	205.4
Securitisation positions	191.6	-	-	-	191.6
Other items	319.0	8.3	-	-	327.3
	3,413.8	914.9	276.3	94.9	4,699.9
Credit valuation adjustment	42.2	-	14.8	16.4	73.4
Total exposures	18,413.0	915.4	291.1	111.3	19,730.8

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

Table 10 Credit risk exposures by maturity

As at 31 December 2017	On demand £m	Up to 1 year £m	1 to 5 years £m	In more than 5 years £m	Total exposure value £m
IRB Approach					
Secured mortgages on immovable property	2.7	74.9	388.1	15,112.1	15,577.8
Exposures in default	-	0.3	1.7	61.4	63.4
Non-credit obligation assets	1.9	-	-	36.5	38.4
Equity	-	-	-	83.2	83.2
	4.6	75.2	389.8	15,293.2	15,762.8
Standardised Approach					
Secured by mortgages on immovable property	0.3	8.1	42.1	1,639.1	1,689.6
Exposures in default	-	-	0.1	1.9	2.0
Corporates	123.2	2.2	28.1	1.9	155.4
Retail	1.1	-	-	-	1.1
Central governments or central bank	2,394.0	170.1	48.0	57.6	2,669.7
Multilateral development banks	-	15.2	103.4	9.8	128.4
Institutions	293.8	28.8	46.8	9.8	379.2
Covered bonds	-	18.5	68.8	-	87.3
Claims on institutions and corporates with a short-term credit assessment	-	50.6	-	-	50.6
Securitisation positions	-	14.7	184.1	-	198.8
Other items	4.5	17.0	28.7	264.3	314.5
	2,816.9	325.2	550.1	1,984.4	5,676.6
Credit valuation adjustment	-	7.7	68.2	12.6	88.5
Total exposures	2,821.5	408.1	1,008.1	17,290.2	21,527.9

As at 31 December 2016	On demand £m	Up to 1 year £m	1 to 5 years £m	In more than 5 years £m	Total exposure value £m
IRB Approach					
Secured mortgages on immovable property	1.9	112.6	258.8	14,249.2	14,622.5
Exposures in default	-	1.2	4.2	125.2	130.6
Non-credit obligation assets	-	-	96.6	32.8	129.4
Equity	-	-	-	75.0	75.0
	1.9	113.8	359.6	14,482.2	14,957.5
Standardised Approach					
Secured by mortgages on immovable property	0.3	14.2	154.5	1,399.3	1,568.3
Exposures in default	-	-	0.1	2.1	2.2
Corporates	98.0	1.7	14.1	5.8	119.6
Retail	1.6	-	-	-	1.6
Central governments or central bank	1,207.1	68.4	116.2	219.7	1,611.4
Multilateral development banks	-	5.4	128.9	20.6	154.9
Institutions	343.2	49.9	74.5	10.8	478.4
Covered bonds	-	-	39.2	-	39.2
Claims on institutions and corporates with a short-term credit assessment	-	205.2	0.2	-	205.4
Securitisation positions	-	47.3	144.3	-	191.6
Other items	3.7	13.6	10.0	300.0	327.3
	1,653.9	405.7	682.0	1,958.3	4,699.9
Credit valuation adjustment	-	5.3	51.4	16.7	73.4
Total exposures	1,655.8	524.8	1,093.0	16,457.2	19,730.8

6.3 IRB rating system

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

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

Probability of default (PD) model

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

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

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

Exposure at default (EAD) model

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

Loss given default (LGD) model

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

The LGD model consists of a number of models which were built using internal data from the last downturn in the economy. These models assess the likelihood of repossession once an account defaults, the forced sale discount that is forecast to be experienced in selling a repossessed property and the amount of loss that the Society would incur in the event of a downturn in property valuations.

6.3.1 IRB rating system outputs

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

6.4 IRB residential lending mortgage exposures

Table 11 below provides a breakdown of the capital requirement for the residential mortgage exposures to which the IRB Approach applies.

Table 11 IRB mortgage portfolio comparison

Mortgage portfolio 2017	Original on-balance sheet gross exposure [1] £m	Off-balance sheet exposures post CCF [2] £m	% of total IRB mortgage exposures %	Portfolio average risk weight percent %	Risk weighted assets £m
Society	14,126.3	677.5	94.7	10.4	1,539.1
Amber Homeloans	548.6	-	3.5	57.4	314.7
North Yorkshire Mortgages	288.8	-	1.8	37.4	108.0
Total	14,963.7	677.5	100.0	-	1,961.8

Mortgage portfolio 2016	Original on-balance sheet gross exposure [1] £m	Off-balance sheet exposures post CCF [2] £m	% of total IRB mortgage exposures %	Portfolio average risk weight percent %	Risk weighted assets £m
Society	12,630.5	961.4	92.2	12.5	1,697.5
Amber Homeloans	741.8	-	5.0	95.1	705.6
North Yorkshire Mortgages	419.5	-	2.8	75.8	317.9
Total	13,791.8	961.4	100.0	-	2,721.0

Notes

1. The original on-balance sheet exposure is not adjusted for impairment in accordance with Article 166.
2. Regulatory exposure of off balance sheet items post credit conversion factor (CCF) relates to undrawn credit facilities.

The table above shows that 94.7% of our mortgage exposures are within the Society and attract a risk weight of 10.4% reflecting the Society's cautious approach to lending and risk management. The remaining 5.3% of the mortgage exposures are within Amber and NYM which have been closed to new lending since 2008.

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

6.5 IRB model performance

This section provides an analysis of the performance of the IRB models over the year to 31 December 2017.

PD and LGD predictions against actual results are shown below.

Table 12 IRB model performance

IRB retail mortgages 2017	**Predicted Probability of Default [1]**	**Observed Probability of Default**	**Predicted Loss Given Default**	**Observed Loss Given Default**
	%	**%**	**%**	**%**
Society	**0.20**	**0.14**	**20.89**	**8.91**
Amber Homeloans	**1.90**	**1.09**	**35.99**	**14.82**
North Yorkshire Mortgages	**1.81**	**0.73**	**29.59**	**10.51**

IRB retail mortgages 2016	Predicted Probability of Default [1]	Observed Probability of Default	Predicted Loss Given Default	Observed Loss Given Default
	%	%	%	%
Society	0.38	0.19	21.20	8.80
Amber Homeloans	5.75	1.70	37.80	17.00
North Yorkshire Mortgages	4.98	1.53	31.20	12.10

Notes

1. The predicted probability of default shows the prediction for defaults from accounts that were up-to-date in December 2016 with the observed actual default rate calculated for these accounts over the next 12 months until the end of December 2017. A separate roll-rate model is used to predict default from accounts already in arrears.

The observed probability of default has decreased year on year which reflects the continued improvement in the economy and overall risk appetite. The predicted probability of default has decreased to reflect this trend though continues to be higher than observed due to conservatism which ensures we hold a prudent level of capital. The year on year reduction in predicted probability of default for the Amber and NYM portfolios is due to the disposal of a portfolio of non-performing or recently non-performing mortgage assets during 2017.

For loss given default the predicted and observed values are fairly constant year on year as there have been no material changes to the operational processes for managing arrears or to the models that derive the estimates.

6.5.1 Use of IRB models

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

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

We will continue to enhance our IRB credit risk models to ensure effective pricing, provisioning and use of capital.

These models, along with others such as application scorecards, an affordability model and forecasting models, provide us with the tools to measure and understand the credit dynamics of our existing loan books and of new lending proposals.

This has enabled us to make improvements in a number of areas including our pricing capability and the effective deployment of credit management strategies. Managing loan impairment losses in our mortgage portfolios remains a key priority and we continue to monitor and manage mortgages that have fallen into arrears, supporting our customers wherever possible, and ensuring fair outcomes for our borrowers whilst protecting the business against financial losses for the benefit of all our members.

6.6 Controls and governance

6.6.1 Monitoring and oversight

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

All significant amendments, updates and any new models are also reviewed by the Society's independent Model Validation team and approved by the Model Governance Committee.

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

Monitoring of the IRB models is the responsibility of the Society's Modelling team who assess the performance of the models using various statistical techniques.

Oversight of all models monitoring activity is provided by the Model Governance Committee (MGC), which is chaired by the Chief Financial Risk Officer, and comprises the Group Finance Director, Chief Operating Officer, and a number of senior managers from across the Society. MGC reports into BRC and provides BRC with a quarterly update report.

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

6.6.2 Independent validation

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

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

6.7 IRB comparison to impairment

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

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

Table 13 IRB expected loss and impairment provisions

	Expected loss 2017 £m	**Provisions 2017 £m**	Expected loss 2016 £m	Provisions 2016 £m
Society	**13.2**	**4.5**	16.7	5.1
Amber Homeloans	**7.1**	**2.3**	21.9	10.8
North Yorkshire Mortgages	**2.0**	**0.5**	8.7	3.2
Total	**22.3**	**7.3**	47.3	19.1

The decrease in expected losses and provisions is primarily due to the disposal of a portfolio of non-performing or recently non-performing mortgages assets during the year combined with an improvement in the portfolio performance.

From 1 January 2018 IFRS 9 replaces IAS 39 *Financial Instruments*: *Recognition and Measurement* as the accounting standard for the calculation of accounting provisions. The impact of IFRS 9 for regulatory capital purposes is summarised in the section 2.9.1.

6.8 Residential lending credit risk

The Group currently lends in the prime residential UK mortgage market, including buy-to-let, through the Society, and in the Channel Islands and the UK through SIL.

Table 14 below shows the mix of the loans and advances to customers at the reporting date. The average exposures are based on the average of the last two reporting positions and are gross of impairment.

Table 14 Loans and advances to customers

	Average 16/17 £m	**2017 £m**	2016 £m
Total residential mortgages	**15,715.1**	**16,367.6**	15,062.7
Commercial loans	**310.3**	**293.8**	326.7
Debt factoring loans	**77.7**	**79.9**	75.4
Other loans	**55.5**	**61.9**	49.0
Gross balances	**16,158.6**	**16,803.2**	15,513.8
Impairment provisions	**(49.3)**	**(41.8)**	(56.8)
Fair Value Adjustments for hedged risk	**284.1**	**227.3**	340.8
Total	**16,393.4**	**16,988.7**	15,797.8

The commercial loans balance, which continues to run-off since lending ceased in 2008, includes £28.6m of exposures as at 31 December 2017 (2016: £30.7m) identified as being to Small and Medium Enterprises (SMEs). The debt factoring loans balance also has an exposure to SMEs of £71m as at 31 December 2017 (2016: £66m). 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.

The full group position reported in the Group’s Annual Report and Accounts eliminates intra group trading and is therefore lower than the prudential consolidation group position.

The Board’s credit risk appetite defines a number of limits regarding customer and collateral credit quality to which all lending activity must adhere.

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

The Group also has credit exposures through Amber and NYM which comprise residential UK mortgages, including buy-to-let, across prime and non-prime lending markets. These portfolios closed to new customer origination and lending in 2008 and are managed by adherence to clear policies in relation to mortgage servicing and credit management. The performance of these portfolios has continued to improve over the reporting period assisted by the sale of a mortgage portfolio of non-performing and recently non-performing mortgage assets. The residential lending to customers in the Society includes the equity release mortgage portfolio.

Table 15 below sets out the credit risk profile for residential lending and is reported gross of impairment provisions.

Table 15 Residential lending analysis

Lending analysis	2017 £m	2017 %	2016 £m	2016 %
Prime:				
Residential	**12,447.1**	**76.0**	11,315.6	75.2
Buy-to-let	**3,034.4**	**18.5**	2,617.8	17.4
Self build	**46.8**	**0.3**	52.4	0.3
Fast track	**45.9**	**0.3**	56.8	0.4
Self certified	**371.1**	**2.3**	500.4	3.3
Sub-Prime:				
Residential	**28.0**	**0.2**	49.4	0.3
Buy-to-let	**30.1**	**0.2**	40.6	0.3
Self build	**0.5**	**-**	0.5	-
Self certified	**84.7**	**0.5**	154.9	1.0
Equity release	**279.0**	**1.7**	274.3	1.8
Total	**16,367.6**	**100.0**	15,062.7	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.

Further information on geographical breakdown of the mortgage book based on the location of the property and related loan-to-value analysis is available in note 37 of the Annual Report and Accounts.

6.9 Residential lending credit risk mitigation

The Group has available a variety of methods and techniques to reduce the credit risk of its lending. New lending policy is prudent, assessing both the overall risk of the customer and their ability to service the debt in a higher interest rate environment. This includes the use of application scorecards, income verification and an affordability model. The credit risk of the mortgage portfolios is controlled using the suite of models described in section 6.3.

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 on a temporary basis. 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. Accounts that have had forbearance strategies applied do not necessarily require an impairment provision, for example where there is a low LTV or where there is a low risk of loss to the Group for the account in question.

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. At 31 December 2017 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 (2016: less than 0.1%) and less than 0.1% of total outstanding loans for the Society (2016: less than 0.1%). The Group does not occupy repossessed properties for business use or use assets acquired in its operations. All customer accounts are monitored to ensure that these strategies remain appropriate.

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

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

6.10 Commercial credit risk

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

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

Table 16 Commercial lending analysis

	2017		2016	
Industry analysis	£m	%	£m	%
Leisure and hotel	**30.1**	**10.2**	34.1	10.4
Retail	**9.6**	**3.3**	11.4	3.5
Nursing / residential homes	**13.8**	**4.7**	15.0	4.6
Offices	**3.7**	**1.3**	5.6	1.7
Commercial investment and industrial units	**230.2**	**78.3**	251.1	76.9
Miscellaneous	**6.4**	**2.2**	9.5	2.9
Total	**293.8**	**100.0**	326.7	100.0

Further information on geographical breakdown of the commercial mortgage book based on the location of the property and related loan-to-value analysis is available in note 37 of the Annual Report and Accounts.

6.11 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.

6.12 Debt factoring / invoice discounting

This relatively small portfolio relates to amounts advanced to clients by our invoice financing business, Skipton Business Finance Limited (SBF), which continues to be managed by appropriately skilled teams.

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

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

6.13 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 residential and commercial mortgage lending concentration risk is managed within the risk appetite set by the Board, including specific sectoral, geographic and product type limits. RCC monitors and reports on concentration risk 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 (a sub-committee of ALCO) and ALCO monthly.

7 Wholesale lending credit risk

Wholesale credit risk arises from the wholesale investments held by the Society's Treasury function which is responsible for managing this aspect of credit risk in line with the Board approved credit risk appetite and wholesale credit policies.

7.1 Management of wholesale credit risk

Wholesale counterparty limits are reviewed monthly by the Group Wholesale Credit Committee based on analyses of counterparties' financial performance, ratings and other market information to ensure that limits remain within our risk appetite. We regularly review and closely monitor the number of counterparties to whom we will lend and, for those counterparties whom we have lent to; we review both the amount and duration of any limits.

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

Netting and collateralisation agreements are used to reduce wholesale credit exposure; these are discussed further in section 7.3 and 8.3. The exposure values shown in Table 17 are net of these credit risk mitigation techniques.

7.2 Credit ratings for wholesale credit risk

The Group's treasury investments are held to provide liquidity. As at 31 December 2017, at a prudential consolidation group level, 98.7% (2016: 98.8%) of these investments are investment grade (i.e. are rated Baa3 / BBB- or better); the Society did not have any rated exposures below Baa1 / BBB+.

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

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

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

Table 17 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.

Table 17 Treasury exposures by class

As at 31 December 2017	Credit quality step	Lowest external credit rating	Exposure £m	Risk weight percent %	Capital requirement £m
Central governments and central banks	1	AAA to AA- / Aaa to Aa3	2,659.5	0	-
Multilateral development banks	1	AAA to AA- / Aaa to Aa3	128.5	0	-
Financial institutions	1	AAA to AA- / Aaa to Aa3	191.2	20	3.1
	2	AAA to AA- / Aaa to Aa3	10.0	50	0.4
	2 (short term)	A+ to A- / A1 to A3	59.9	20	1.0
	2 (long term)	A+ to A- / A1 to A3	64.8	50	2.6
	3	BBB+ to BBB- / Baa1 to Baa3	66.8	50	2.7
	Unrated	Unrated	45.0	4	0.1
	Unrated	Unrated	1.7	370	0.5
Covered Bonds	1	AAA to AA-/Aaa to Aa3	87.4	10	0.7
Residential Mortgage Backed Securities	1	AAA to AA-/Aaa to Aa3	198.8	20	3.2
Total			3,513.6		14.3

As at 31 December 2016	Credit quality step	Lowest external credit rating	Exposure £m	Risk weight percent %	Capital requirement £m
Central governments and central banks	1	AAA to AA- / Aaa to Aa3	1,597.4	0	-
Multilateral development banks	1	AAA to AA- / Aaa to Aa3	155.0	0	-
Financial institutions	1	AAA to AA- / Aaa to Aa3	267.8	20	4.3
	2 (short term)	A+ to A- / A1 to A3	94.3	20	1.5
	2 (short term)	A+ to A- / A1 to A3	118.6	50	4.7
	2 (long term)	A+ to A- / A1 to A3	80.1	50	3.2
	3	BBB+ to BBB- / Baa1 to Baa3	80.8	50	3.2
	Unrated	Unrated	29.0	4	0.1
	Unrated	Unrated	1.8	370	0.5
Covered Bonds	1	AAA to AA-/Aaa to Aa3	39.2	10	0.3
Residential Mortgage Backed Securities	1	AAA to AA-/Aaa to Aa3	191.6	20	3.1
Total			2,655.6		20.9

7.3 Wholesale counterparty credit risk mitigation

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.

8 Counterparty credit risk

8.1 Management of counterparty credit risk

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.

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 derivative's potential credit exposure, which is calculated by applying a multiple based on the derivative's residual maturity to the notional value of the derivative.

Table 18 below provides exposure values on derivative counterparty credit risk exposures for the prudential consolidation group.

Table 18 Derivative counterparty credit risk exposures

	2017 £m	2016 £m
Interest rate contracts	141.1	154.4
Other contracts	9.9	13.7
Gross positive fair value of contracts	151.0	168.1
Netting benefits and potential credit add-ons	(62.5)	(94.8)
Netted current credit exposure	88.5	73.3
Collateral held	(35.4)	(23.1)
Net derivative credit exposure	53.1	50.2

Note 13 of the Annual Report and Accounts discloses 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.

8.2 Credit ratings for counterparty credit risk

The credit ratings of the Society are assigned by two major credit rating agencies, Fitch and Moody's. During the year our credit ratings were affirmed by Fitch and were upgraded by Moody's. The Society's long and short term credit ratings as at 31 December 2017 were as follows:

As at 31 December 2017	Long term	Short term	Outlook	Date of last change of rating
Fitch	A-	F1	Stable	06/05/2017
Moody's	Baa1	P-2	Stable	11/10/2017

As at 31 December 2016	Long term	Short term	Outlook	Date of last change of rating
Fitch	A-	F1	Stable	26/05/2016
Moody's	Baa2	P-2	Positive	05/10/2016

8.3 Counterparty credit risk mitigation

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.

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, other than the asset swap being provided by the Society to Skipton Covered Bond LLP. 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 Society has an indirect relationship with a central counterparty (CCP) to clear standardised derivatives which are subject to mandatory clearing under EU regulatory requirements.

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

9 Impairment provisions

9.1 Impairment provisions definition

The Group carries out an assessment of impairment of loans and advances to customers at each reporting date.

For accounting purposes, past due exposures, impaired exposures and impairment provisions are defined as follows:

Credit risk categorisation	Definition
Neither past due nor individually impaired	Loans that are not in arrears and which do not meet the impaired asset definition.
Past due but not impaired	Loans on which payments are overdue by less than three months including those on which partial payments are being made.
Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue.
Impaired loans	Loans where the Group expects to collect contractual cash flows later than they are contractually due.
Impairment provisions	Impairment provisions are a provision held on the balance sheet as a result of the raising of a charge against profit for an incurred loss. An impairment provision may either be individual or collective.
Individual impairment	Individual assessments are made of all mortgage loans in arrears by three months or more and where objective evidence indicates losses are likely or the property is in possession or where fraud or negligence has been identified.
Collective impairment	A collective impairment allowance is made against performing loans where it is likely that credit losses have been incurred but not yet identified at the reporting date.

9.2 Individual assessment of impairment

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.

9.3 Collective assessment of impairment

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

Further information relating to impairment of goodwill and of investments in subsidiaries can be found in note 1 of the Annual Report and Accounts.

9.4 Use of forbearance

In certain circumstances, the Group renegotiates loans to customers in financial difficulties (referred to as 'forbearance' activities) to maximise collection opportunities and minimise the risk of default whilst ensuring the best outcome for the customer. Under the Group's forbearance policy, loan forbearance is granted on a selective basis if the customer is currently in default on their 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.

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 RCC reviews reports on forbearance activities monthly.

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.

9.5 Residential lending impairment provisions

Table 19 provides further information on residential loans and advances by payment due status. The sub prime loans relate to the Amber and NYM portfolios which have been closed to new lending since 2008. There are no sub prime loans in the Society's portfolio.

Table 19 Impairment provisions by category – Residential lending

As at 31 December 2017	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	12,652.5	25.7	3,018.4	29.9	442.4	76.1	16,113.3	131.7
Past due but not impaired:								
Up to 3 months	37.9	1.5	8.0	0.2	10.8	4.8	56.7	6.5
	12,690.4	27.2	3,026.4	30.1	453.2	80.9	16,170.0	138.2
Individually impaired:								
Low risk	24.5	0.4	4.4	-	6.2	2.4	35.1	2.8
High risk	9.1	0.4	2.8	-	4.3	1.9	16.2	2.3
Possessions	2.1	-	0.8	-	0.1	-	3.0	-
Total	12,726.1	28.0	3,034.4	30.1	463.8	85.2	16,224.3	143.3
Collective impairment	(28.6)	-	(0.3)	-	(0.5)	(0.1)	(29.4)	(0.1)
Individual impairment	(1.4)	-	(0.6)	-	(0.9)	(0.6)	(2.9)	(0.6)
Total lending to individuals	12,696.1	28.0	3,033.5	30.1	462.4	84.5	16,192.0	142.6

As at 31 December 2016	Residential		Buy-to-let		Other [1]		Total	
	Prime £m	Sub Prime £m	Prime £m	Sub Prime £m	Prime £m	Sub Prime £m	Prime £m	Sub Prime £m
Neither past due nor individually impaired	11,493.1	38.5	2,598.4	38.5	548.6	109.5	14,640.1	186.5
Past due but not impaired:								
Up to 3 months	47.7	4.7	9.7	1.6	28.4	20.1	85.8	26.4
	11,540.8	43.2	2,608.1	40.1	577.0	129.6	14,725.9	212.9
Individually impaired:								
Low risk	31.0	3.4	3.2	0.2	12.6	10.4	46.8	14.0
High risk	17.0	2.7	5.1	0.3	18.3	14.8	40.4	17.8
Possessions	1.1	0.1	1.4	-	1.7	0.6	4.2	0.7
Total	11,589.9	49.4	2,617.8	40.6	609.6	155.4	14,817.3	245.4
Collective impairment	(30.9)	(0.2)	(0.8)	(0.1)	(2.0)	(1.0)	(33.7)	(1.3)
Individual impairment	(2.8)	(0.4)	(1.4)	(0.1)	(4.1)	(3.1)	(8.3)	(3.6)
Total lending to individuals	11,556.2	48.8	2,615.6	40.4	603.5	151.3	14,775.3	240.5

Notes

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

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

Table 20 below shows the impairment charges for the year to the Income Statement for residential lending loans.

Table 20 Impairment charges – Residential lending

	Individual impairment		Collective impairment		Total	
	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m
At 1 January	11.9	16.2	35.0	33.0	46.9	49.2
Amounts written off during the year, net of recoveries	(1.7)	(3.3)	(0.4)	(0.1)	(2.1)	(3.4)
Amounts disposed of during the year	(6.0)	-	(2.7)	-	(8.7)	-
(Credit) / charge for the year	(0.7)	(1.0)	(2.4)	2.1	(3.1)	1.1
At 31 December	3.5	11.9	29.5	35.0	33.0	46.9

The collective impairment includes £25.7m (2016: £27.7m) in relation to an equity release residential mortgage book which is closed to new lending. 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 16 of the Group's Annual Report and Accounts). The no negative equity guarantee provided to equity release customers is accounted for as an embedded derivative due to its economic characteristics (as described in note 38b). The losses on this portfolio represent the fair value movement of the embedded derivative and are a function of the actual and projected interrelationship between market-wide long term house prices and retail price inflation and the specific behaviour of this portfolio. During the year the Directors have assessed the fair value of the embedded derivative, based on the performance of the wider economy and management's assessment of the specific characteristics of the portfolio, resulting in a credit of £1.8m to the Income Statement (2016: £3.8m charge).

The guarantee is impacted by the interaction of a number of factors. These factors include future expected house prices; future expected inflation, mortality rates and estimated redemption profiles.

The performance of the Society's prime residential mortgage book remains good and arrears levels within the specialist residential mortgage portfolios held in Amber and NYM have also fallen leading to a reduction in impairment held for these portfolios compared with the prior year. In addition to improving portfolio performance, the scale of the reduction was primarily driven by the sale of a portfolio of non-performing or recently non-performing Amber and NYM mortgages.

Table 21 below sets out exposures and corresponding impairments by region for the residential lending loans.

Table 21 Impairment breakdown by geographical areas – Residential lending

	Neither past due nor individually impaired		Past due but not individually impaired		Individually impaired		Total	
	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m
North	644.3	576.5	2.8	4.5	3.0	4.8	650.1	585.8
Yorkshire	1,567.7	1,503.5	7.4	12.1	6.8	12.5	1,581.8	1,528.1
East Midlands	1,157.6	1,067.1	5.4	7.9	3.7	9.0	1,166.7	1,084.0
East Anglia	517.7	537.2	1.9	5.3	1.2	6.2	520.8	548.7
London	2,234.4	1,855.5	9.6	14.2	9.7	14.8	2,253.7	1,884.5
South East	3,074.2	2,871.9	11.6	22.4	8.9	23.9	3,094.7	2,918.2
South West	1,617.5	1,418.1	4.4	8.0	4.7	8.5	1,626.6	1,434.6
West Midlands	1,175.0	1,019.8	4.2	8.3	4.7	9.7	1,183.9	1,037.8
North West	1,514.1	1,400.6	7.0	13.3	7.5	13.7	1,528.6	1,427.6
Wales	577.4	487.4	2.2	5.5	3.1	6.6	582.7	499.5
Scotland	1,244.1	1,195.5	4.7	7.7	4.7	9.6	1,253.5	1,212.8
Northern Ireland	30.6	35.5	0.8	2.1	1.4	4.6	32.8	42.2
Channel Islands	890.5	858.0	1.2	0.9	-	-	891.7	858.9
Total	16,245.1	14,826.6	63.2	112.2	59.4	123.9	16,367.6	15,062.7

Further information on residential impairments is available in note 37 of the Annual Report and Accounts.

9.6 Commercial lending impairment provisions

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

A collective impairment allowance is made against performing loans where objective evidence indicates that it is likely that credit losses have been incurred but not yet identified at the reporting date. This impairment allowance is generally based on the most recent external valuation of the mortgaged property or, where one is not available, calculated using third party valuation indices. The valuation is discounted further to assume a forced sale value in addition to default propensity modelling.

Table 22 below provides further information on commercial loans and advances by payment due status.

Table 22 Commercial lending impairments by industry

As at 31 December 2017	**Leisure and Hotel £m**	**Retail £m**	**Nursing / Residential Homes £m**	**Offices £m**	**Commercial investment and Industrial £m**	**Misc £m**	**Total £m**
Neither past due nor individually impaired	28.2	9.3	13.8	3.7	226.7	6.4	288.1
Past due but not impaired:							
Up to 3 months	0.6	-	-	-	2.2	-	2.8
	28.8	9.3	13.8	3.7	228.9	6.4	290.9
Individually impaired:							
Low risk	0.1	-	-	-	0.1	-	0.2
High risk	0.6	0.3	-	-	1.2	-	2.1
Possessions	0.6	-	-	-	-	-	0.6
Total	30.1	9.6	13.8	3.7	230.2	6.4	293.8
Collective impairment	-	-	-	-	(0.3)	-	(0.3)
Individual impairment	(1.3)	-	-	-	(5.9)	(0.5)	(7.7)
Total Commercial Lending	28.8	9.6	13.8	3.7	224.0	5.9	285.8

As at 31 December 2016	Leisure and Hotel £m	Retail £m	Nursing / Residential Homes £m	Offices £m	Commercial investment and Industrial £m	Misc £m	Total £m
Neither past due nor individually impaired	32.9	11.1	15.0	5.6	245.9	6.8	317.3
Past due but not impaired:							
Up to 3 months	0.9	-	-	-	2.5	2.2	5.6
	33.8	11.1	15.0	5.6	248.4	9.0	322.9
Individually impaired:							
Low risk	-	-	-	-	-	0.5	0.5
High risk	0.3	0.3	-	-	2.7	-	3.3
Total	34.1	11.4	15.0	5.6	251.1	9.5	326.7
Collective impairment	(0.1)	-	(0.1)	-	(0.7)	-	(0.9)
Individual impairment	(1.5)	(0.1)	-	-	(6.2)	(0.6)	(8.4)
Total Commercial Lending	32.5	11.3	14.9	5.6	244.2	8.9	317.4

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

Table 23 shows the impairment charges for the year to the Income Statement for commercial lending loans.

Table 23 Impairment charges – Commercial lending

	Individual impairment		Collective impairment		Total	
	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m
At 1 January	8.4	11.4	0.9	0.6	9.3	12.0
Amounts written off during the year, net of recoveries	(0.2)	(1.2)	-	-	(0.2)	(1.2)
(Credit) / charge for the year	(0.5)	(1.8)	(0.6)	0.3	(1.1)	(1.5)
At 31 December	7.7	8.4	0.3	0.9	8.0	9.3

Table 24 sets out exposures and corresponding impairments by region for the commercial loans.

Table 24 Impairment breakdown by geographical areas – Commercial lending

	Neither past due nor individually impaired		Past due but not individually impaired		Individually impaired		Total	
	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m
North	14.5	16.0	-	-	0.3	0.3	14.8	16.3
Yorkshire	25.1	27.3	-	-	-	0.3	25.1	27.6
East Midlands	22.0	21.1	0.1	2.6	-	-	22.1	23.7
East Anglia	6.6	7.2	-	-	-	-	6.6	7.2
London	67.4	77.9	-	1.4	-	0.2	67.4	79.5
South East	54.5	61.2	0.7	1.1	0.9	-	56.1	62.3
South West	34.1	37.7	1.8	0.4	0.7	2.1	36.6	40.2
West Midlands	21.1	23.5	-	-	0.1	-	21.2	23.5
North West	29.8	31.1	-	-	0.9	0.9	30.7	32.0
Wales	8.3	9.2	0.1	-	-	-	8.4	9.2
Scotland	4.7	5.1	0.1	0.1	-	-	4.8	5.2
Total	288.1	317.3	2.8	5.6	2.9	3.8	293.8	326.7

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

Further information on commercial loans impairments, specifically broken down by significant geographical areas is available in the note 37 of the Annual Report and Accounts.

9.7 Impairment of treasury assets

As at 31 December 2017 and 31 December 2016, none of the Group's treasury portfolio exposure was either past due or impaired. As such, no provision is held for impaired treasury assets (2016: £nil). In determining whether evidence of impairment exists, the Group considers, amongst other factors, current market conditions (including the disappearance of an active market), fair value volatility (including significant reduction in market value), any breach of contract or covenants, the financial stability or any financial difficulties of the counterparty and the country it is resident in (i.e. in order to take account of sovereign debt issues).

10 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 7.2.

The Group has securitised certain residential mortgage loans by the transfer of the beneficial interest in such loans to two (as at 31 December 2017) 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 2017, the SPVs named, Darrowby No. 3 plc (Darrowby 3) and Darrowby No. 4 plc (Darrowby 4), constituted wholesale funding of £306.1m (net of amortised costs). Access to wholesale funding allows the Group to diversify its funding sources and brings the added benefit of increasing the term of funding whilst managing its basis and refinance risk.

Table 25 sets out the roles that the Society takes in relation to each of the securitisation transactions. The Society retains the first loss element:

Table 25 Securitisation process

	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 3	✓	Repaid		✓
Darrowby 4	✓	✓	✓	✓

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

Darrowby 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 2017, rated debt securities totalled £128.7m.

Darrowby 4 was incorporated in September 2015. In February 2016, Darrowby 4 issued £450m of AAA rated debt securities. The notes are rated by both Fitch and Moody's. As at 31 December 2017, rated debt securities totalled £216.4m of which £38.2m was held by the Group.

The performance of the securitisations term secured wholesale funding transactions is monitored on a monthly basis by the Society's Secured Funding Group. Further details on the SPVs are shown in Table 26:

Table 26 Special purpose vehicles

31 December 2017

Securitisation company [1]	Gross Assets Securitised £m	Notes held by third parties [2] £m	Notes held by the Group [2,3] £m	Underlying assets in arrears [4] £m
Darrowby 3	**172.1**	**128.7**	**47.0**	**0.9**
Darrowby 4	**242.2**	**178.2**	**75.2**	**0.6**

31 December 2016

Securitisation company	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 2 [5]	187.1	121.7	71.0	1.3
Darrowby 3	223.9	180.5	47.0	1.0
Darrowby 4	347.2	218.5	146.2	0.5

Notes

1. All securitisation companies are classed as the residential mortgage backed securities.
2. Excludes accrued interest.
3. Class B notes and retained rated Class A notes (and those partially pledged in a repurchase agreement).
4. A mortgage account where one or more monthly payments have become due and remain unpaid.
5. Darrowby 2 commenced liquidation during 2017 following repayment of all of its notes.

11 Operational risk

As a business with a retail franchise in financial services, the management of operational risk is key to the ongoing success of the Group and 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.

11.1 Operational risk definition and approach

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

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

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

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

11.2 Operational risk management framework

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

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

The following principles underpin effective operational risk management across the Group:

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

11.3 Operational risk management

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

The Conduct and Operational Risk Committee (CORC) reports to BRC and ensures that an appropriate framework is in place to identify, assess and manage the operational risks that could impact the ability of the Group to meet its business objectives and serve our customers. CORC also monitors whether Group businesses are operating within the Board-approved operational risk appetite.

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

- Operational resilience
- Change management
- Customer and client experience
- Financial control and management information
- Financial crime
- Information security (inc. cyber risk)
- Information technology
- Legal and regulatory
- People and culture
- Property and facilities
- Process management
- Supplier risk

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

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

As at 31 December 2017 this approach resulted in the Pillar 1 minimum risk weighted assets at a prudential group level as follows:

	2017 £m	2016 £m
Operational risk weighted asset (RWA)	**361.1**	367.3
Operational risk capital requirement (RWA x 8%)	**28.9**	29.4

11.5 Operational risk mitigation

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

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

12 Market risk

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk and foreign currency risk. Currency risk is included in the Society's Pillar 1 capital requirement calculations; the other market risks are considered under Pillar 2 capital requirements in section 12.1. The Society is not impacted by commodity price risk. Market risk also exists within the Group's defined benefit pension schemes and is managed by the Trustees of the schemes, working closely with the sponsoring employers, Skipton Building Society and Connells. Pension obligation risk is covered in more detail in section 13.2.

12.1 Interest rate risk

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

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

12.1.1 Repricing gap analysis

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

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

12.1.2 Earnings-at-risk and market value sensitivity

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

The interest rate exposures during 2017 were as follows:

	2017				2016
	Exposure £m	Average £m	High £m	Low £m	Exposure £m
Static earnings-at-risk	5.2	4.3	5.6	2.5	3.2
Historical value-at-risk	2.2	2.2	2.8	0.6	1.5
-2% parallel interest rate shift	13.2	(4.3)	(1.1)	(6.9)	9.5
+2% parallel interest rate shift	(5.9)	11.3	15.5	4.1	(3.0)

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

Further information on market risk is available in note 36 of the Annual Report and Accounts.

12.2 Currency risk

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

Both at 31 December 2017 and during the year, the Society and its subsidiaries had no material direct exposure to foreign currency exchange fluctuations. The currency risk appetite of the Group is low and any funding issues denominated in foreign currency are immediately swapped into Sterling.

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

In addition, a number of the Group's businesses undertake transactions denominated in foreign currency as part of their normal business. Any amounts outstanding at 31 December 2017 are not material.

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 2017, the capital required for 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 of the CRR regarding the disclosure of non-material information.

The own funds requirement for foreign-exchange risk, calculated using guidance in Article 352 of the CRR, 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.

12.2.1 Other price risk

The Group had a small number of savings products outstanding as at 31 December 2017 where the return is dependent on the performance of certain equity markets. Derivative contracts to eliminate this exposure are taken out by the Group that exactly match the terms of the savings products and the market risk on such contracts is therefore fully hedged.

12.3 Market risk mitigation

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

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

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

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

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

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

Derivatives are only used to limit the extent to which the Group will be affected by changes in interest rates, foreign exchange rates or other indices which affect fair values or cash flows. Derivatives are therefore used exclusively to hedge risk exposures. The principal derivatives used by the Group are interest rate contracts such as interest rate swaps.

13 Other risks faced by the business

This section sets out the other risks faced by the business above and beyond the Pillar 1 risks set out in section 5. These risks are considered under Pillar 2A of the risk management framework.

13.1 Liquidity risk

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

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

The Liquidity Coverage Ratio (LCR), which is a measure designed to ensure that financial institutions have sufficient high quality assets available to meet their liquidity needs for a 30 day liquidity stress scenario, was 179% at 31 December 2017 (2016: 170%), well above both the regulatory and internal limits set by the Board throughout the period.

The LCR is monitored daily by the Society whilst the Net Stable Funding Ratio (NSFR) is currently measured on a monthly basis using the latest available guidance.

The Group's main source of funding is retail deposits (excluding SIL) which, at 31 December 2017, accounted for 84.6% (2016: 89.6%) of our total funding.

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

Further information on liquidity risk is available in note 35 of the Annual Report and Accounts.

13.2 Pension obligation risk

Pension obligation risk is the risk that the value of the schemes' assets, together with ongoing contributions, will be insufficient to cover their obligations over time. The schemes are also exposed to possible changes in pensions legislation.

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

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

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

- The Board regularly reviews the Group's pension risk strategy;
- The pension scheme Trustees meet 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 Trustees also monitor 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 29 in the Annual Report and Accounts outlines the steps management have undertaken to manage the Group's pension risk exposure.

Other key risks to which the Group is exposed include reputational risk and model risk. These risks are explained in the Risk Management Report of the Annual Report and Accounts, pages 67 to 71.

14 Remuneration

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

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

14.1 Decision making

As outlined in section 3.4.7, the Remuneration Committee is responsible for establishing clear Remuneration Principles and standards for the governance of remuneration which are adopted by the subsidiary businesses.

SIL, however, has its own Remuneration Committee which oversees its remuneration practices and ensures compliance with the Remuneration Principles and policies adopted by the SIL Board. The SIL Remuneration Committee, which comprises three Non-Executive Directors and two Skipton Building Society Shareholder Directors, met twice in 2017, firstly to approve the 2016 bonus payments and 2017 salary increases and secondly to agree the 2018 bonus scheme and approve the 2017 list of MRTs. Due to its regulatory position, the remuneration of the SIL MRTs is approved by the SIL Remuneration Committee, in accordance with the Remuneration Principles, and is reported to the Remuneration Committee.

14.2 Remuneration arrangements for Material Risk Takers

MRTs receive a basic salary, benefits (including pension, car/car allowance and healthcare) and variable pay. The basic salary of MRTs (other than Non-Executive Directors) is set according to the size of the role and responsibilities, individual performance (assessed annually), salary levels of similar positions in comparable organisations and internal benchmarks. Salaries are reviewed annually and individual increases are awarded based on the individual’s performance against personal objectives, measured in accordance with the performance management framework in each business.

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

14.3 Variable pay (MRTs excluding Non-Executive Directors)

Incentive awards for MRTs are designed to achieve an appropriate balance between the fixed and variable elements of remuneration, to support a high performance culture and also to encourage the right behaviours leading to sustainable performance within the Society’s agreed risk appetite. The Remuneration Principles cap overall variable pay at 100% of fixed remuneration for all MRTs but scheme maximums do not exceed 50% of basic salary. A review is conducted, one year post award, to ensure that performance has been sustained at the expected level. If it hasn’t, subsequent awards may be reduced by up to 25% subject to the discretion of the Remuneration Committee.

Executive Committee members have 50% of their annual variable awards automatically deferred for between one and five years, unless their remuneration exceeds de minimis limits (i.e. total remuneration awarded for the current performance year is greater than £500,000 or the variable amount awarded for the current year is more than 33% of total remuneration), in which case, deferral is in line with regulatory requirements. For PRA Senior Managers, this means that the deferral period increases to between three and seven years and for Executive Directors, the proportion deferred increases to 60%.

For MRTs below executive level, a proportion of variable pay is deferred in line with regulatory requirements, if remuneration for the current year exceeds the de minimis threshold. In this event, payments are made via an instrument which means that 50% of the award payable in each year will be retained for a further year and will only be paid subject to meeting the agreed capital level. The retained amount cannot increase or attract interest payments during the retention or deferral periods.

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

14.3.1 The Society

Members of the Executive Committee (who are not Executive Directors) participate in the same Single Variable Pay Arrangement (SVPA) as the Executive Directors, which is outlined in detail in the Directors' Remuneration Report in the Annual Report and Accounts. The maximum opportunity for these participants is 40% of basic salary rather than 50% as it is for the Executive Directors.

The SVPA is based 50% on financial measures which include Group and Mortgages and Savings division profit, Mortgages and Savings division management expenses and cost income ratios; 30% on Team KPIs (which include customer, risk and people metrics) and 20% on personal and strategic objectives. For participants in second and third line functions (Risk, Compliance and Audit), the weightings for profit and personal and strategic objectives are 20% and 50% respectively. As already indicated, 50% of the award from the scheme is automatically deferred for between one and five years unless a greater proportion or longer period is required by regulation.

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

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

A very small number of MRTs, who are not part of the Senior Leadership Team, participate in the All Employee Annual Incentive Scheme which is based 50% on the achievement of profit and 50% on the achievement of agreed customer measures. The bonus pool is then distributed according to performance level. The maximum payment from this scheme in 2017 was 15% of basic salary.

14.3.2 SIL

The SIL Management Committee Bonus Scheme is based on a mix of corporate objectives including financial, commercial and audit quality measures. The remainder of the bonus award is based on performance against personal objectives which is assessed through the annual appraisal process. In 2017, bonus payments to SIL MRTs were capped at 50% of basic salary. The Managing Director's bonus is paid 60% in year one and 40% in year two in accordance with the scheme rules (unless his remuneration exceeds de minimis limits in which case deferral would be for between one and five years in line with regulation).

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

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

14.3.3 Risk / performance adjustment

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

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

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

14.4 Aggregate quantitative information on remuneration

As outlined above, MRTs have been identified in the core Society and SIL. Post integration of Skipton Financial Services (outlined in the 2016 tables), roles in the Financial Advice Function (formerly within SFS) have been assessed in the context of the Society structure and the MRTs identified in 2017 have been included in the Society MRT figures below.

Table 27 Group's quantitative remuneration 2017

Group [1]	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released [3] £000
Senior management (including Executive and Non-Executive Directors)	18	3,156	929	4,085	232
Other material risk takers [2]	51	4,879	1,072	5,951	28
	69	8,035	2,001	10,036	260

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

Society	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released [1] £000
Senior management (including Executive and Non-Executive Directors)	18	3,156	929	4,085	232
Other material risk takers	42	4,198	866	5,064	-
	60	7,354	1,795	9,149	232

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

SIL	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay [2] £000	Total £000	Prior years' deferred performance pay now released [3] £000
Senior management (including Executive and Non-Executive Directors) [1]	9	681	206	887	28

Notes

1. The Material Risk Takers are all members of the SIL Management Committee and/or the SIL Board. The additional number of MRTs for 2017 is due to two NEDs having part year service. The number of MRTs at year end was 8.
2. The MTI for the Managing Director was included in the 2015 disclosures and is not reflected in the table above.
3. The prior year performance pay includes deferred payments from the 2016 annual bonus award and phased MTI award.

2016 Group[1]	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released £000
Senior management (including Executive and Non-Executive Directors)	18	3,122[3]	1,081	4,203	106
Other material risk takers [2]	47	4,715	904	5,619	-
	65	7,837	1,985	9,822	106

Notes

1. The Group table includes aggregate remuneration for MRTs in the Society (including the FA Division from 1 August 2016) SFS and SIL.
2. The members of the SFS and SIL Management Committees are included in the category 'Other Material Risk Takers'. Four MRTs from SFS transferred to the Society on 1 August 2016 and are therefore counted in both the SFS and the Society tables
3. The 2016 figures have been re-stated to reflect the changes to the pro-rating of a small number of SBS part year participants.

2016 Society (Including Financial Advice Division from 1 August)	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay [2] £000	Total £000	Prior years' deferred performance pay now released £000
Senior management (including Executive and Non-Executive Directors)	18	3,122[3]	1,081	4,203	106
Other material risk takers [1]	36	3,197	653	3,850	-
	54	6,319	1,734	8,053	106

Notes

1. Four of the SFS MRTs transferred to the Society and are included in the above tables.
2. The total includes a one off cash award and MTI awards made as compensation for remuneration forfeited by a new joiner on leaving his previous employer. The MTI payments will be phased over a three year period ending in 2019 for the 2014 – 2016 scheme and in 2020 for the 2015 – 2017 scheme.
3. The 2016 figures have been re-stated to reflect the changes to the pro-rating of a small number of SBS part year participants.

2016 SFS (to 31 July)	Number of beneficiaries	Fixed remuneration £000	Current year annual performance pay £000	Total £000	Prior years' deferred performance pay now released £000
Senior management (including Executive and Non-Executive Directors) [1]	7	865	96	961	28

Notes

1. The MRTs in SFS are all members of the SFS Senior Management team.

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

Notes

1. The MRTs in SIL are all members of the Management Committee and/or the SIL Board.
2. The MTI for the Managing Director was included in the 2015 disclosures and is not reflected in the table above.

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 2017. 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. Rows without numbers have been added to set out a transparent flow of adjustments made to the CET 1 capital. Any blank cells in the template have been removed.

		Accounting Balance Sheet Value 2017 £m	Adjustments and adjusted accounting value 2017 £m	Own Funds Value 2017 £m
Members' interests				
	General Reserve	1,396.4	-	-
	Available-for-Sale Reserve	3.1	-	-
	Cash flow hedging reserve	0.1	-	-
	Translation reserve	5.2	-	-
	Attributable to members of Skipton Building Society	1,404.8	-	-
	Total members' interests	1,404.8	-	-
Less:	Reserves attributable to non regulatory subsidiaries	-	(94.4)	-
	Accounting Balance Sheet value after adjustments	-	1,310.4	-
Common Equity Tier 1 (CET1) capital: instruments and reserves				
2	Retained Earnings	-	-	1,307.2
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			1,310.4
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
7	Additional value adjustments (negative amount)	-	-	(0.6)
	Intangible Assets (per the Accounting Balance Sheet)	(164.4)	-	-
Less:	Intangible Assets attributable to non regulatory subsidiaries	-	153.4	-
	Accounting Balance Sheet value after adjustments	-	(11.0)	-
8	Intangible assets (net of related tax liability) (negative amount)	-	-	(11.0)
	Cash flow hedging reserve (per the Accounting Balance Sheet)	(0.1)	-	-
Less:	Cash flow hedging reserve attributable to non regulatory subsidiaries	-	-	-
	Accounting Balance Sheet value after adjustments	-	(0.1)	-
11	Fair value reserves related to gains or losses on cash flow hedges	-	-	(0.1)
12	Negative amounts resulting from the calculation of expected loss amounts	-	-	(15.0)
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	-	-	(26.7)
29	**Common Equity Tier 1 (CET1) capital**			1,283.7
Additional Tier 1 (AT1) capital: instruments				
	Subscribed capital	41.6	-	-
Less:	Removal of accrued interest	-	(1.6)	-
	Accounting Balance Sheet value after adjustments		40.0	-
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	-	-	40.0
36	Additional Tier 1 (AT1) capital before regulatory adjustments	-	-	40.0
Additional Tier 1 (AT1) capital: regulatory adjustments				
44	Additional Tier 1 (AT1) capital	-	-	40.0
45	Tier 1 capital (T1 = CET1 + AT1)			1,323.7
58	Tier 2 (T2) capital	-	-	-
59	**Total capital (TC = T1 + T2)**	-	-	1,323.7
60	**Total risk weighted assets**			3,864.7

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 as at 31 December 2017. These have been disclosed in line with Annex III of the European Commission Implementing Technical Standards on disclosure for own funds by intitutions under Article 437(1) and 492(3) of the CRR.

The terms and conditions of these capital instruments can be found at www.skipton.co.uk/investorrelations.

1	Issuer	Skipton Building Society	Skipton Building Society (Scarborough Building Society)
2	ISIN	GB0008194119	GB0004440623
3	Gov. law(s)	English	English
4	Trans. CRR rules	Additional Tier 1 up to headroom	Additional Tier 1 up to headroom
5	Post-transitional CRR rules	Tier 2	Tier 2
6	Eligible at Solo/Sub-consolidated/Solo & Sub-consolidated	Solo	Solo
7	Instrument type (types to be specified by each jurisdiction)	PIBS	PIBS
8	Regulatory capital value (£m)	25,000,000[1]	15,000,000[1]
9	Nominal amount of instrument	25,000,000	15,000,000
9a	Issue px	100.476	100.000
9b	Redemption px	100.000	100.000
10	Accounting classification	Liability - amortised cost	Liability - amortised cost
11	Date of issue	05/03/1992	26/04/2000
12	Perpetual or dated	Perpetual	Perpetual
13	Original maturity	No maturity	No maturity
14	Issuer call	No	No
15	Optional call date, contingent call dates and redemption amount	No Issuer call	No Issuer call
16	Subsequent call dates, if applicable	n/a	n/a
17	Fixed or floating dividend/coupon	Fixed	Fixed
18	Coupon rate and any related index	12.875%	8.500%
19	Existence of a dividend stopper	Yes[1]	Yes[1]
20a/b	Fully discretionary, partially or mandatory (in terms of timing)	Partially Discretionary	Partially Discretionary
21	Existence of step up or other incentive to redeem	No	No
22	Noncumulative or cumulative	Cumulative	Noncumulative
23	Convertible or non-convertible	Nonconvertible	Nonconvertible
24	If convertible, conversion trigger(s)	n/a	n/a
25	If convertible, fully or partially	n/a	n/a
26	If convertible, conversion rate	n/a	n/a
27	If convertible, mandatory or optional conversion	n/a	n/a
28	Specify output instrument	n/a	n/a
29	Specify issuer of output instrument	n/a	n/a
30	Write-down features	None contractual, statutory via bail-in	None contractual, statutory via bail-in
31-34	If w/d, trigger(s), full/partial, PWD/TWD	n/a	n/a
35	Instrument type immediately senior	Subordinated debt	Subordinated debt
36	Non-compliant transitioned features	Yes	Yes
37	If yes, specify non-compliant features	No conversion to CET1	No conversion to CET1

Notes

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.

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 CRR. 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. Any blank cells in the template have been removed.

		(A) Amount at Disclosure date		(C) Amounts to be subject to Pre-CRR treatment or CRR prescribed residual amount*	
		2017	2016	2017	2016
		£m	£m	£m	£m
Common Equity Tier 1 (CET1) Capital: instruments and reserves					
2	Retained Earnings	1,307.2	1,171.7	-	-
3	Accumulated other comprehensive income (and other reserves), to include unrealised gains and losses under the applicable accounting standards	3.2	6.9	-	-
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	1,310.4	1,178.6	-	-
Common Equity Tier 1 (CET1) capital: regulatory adjustments					
7	Additional value adjustments (negative amount)	(0.6)	(0.8)	-	-
8	Intangible assets (net of related tax liability) (negative amount)	(11.0)	(9.7)	-	-
11	Fair value reserves related to gains or losses on cash flow hedges	(0.1)	(3.3)	-	-
12	Negative amounts resulting from the calculation of expected loss amounts	(15.0)	(28.2)	-	-
28	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	(26.7)	(42.0)	-	-
29	**Common Equity Tier 1 (CET1) capital**	1,283.7	1,136.6	-	-
Additional Tier 1 (AT1) capital: instruments					
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	40.0	54.0	(40.0)	(54.0)
36	**Additional Tier 1 (AT1) capital before regulatory adjustments**	40.0	54.0	(40.0)	(54.0)
Additional Tier 1 (AT1) capital: regulatory adjustments					
44	Additional Tier 1 (AT1) capital	40.0	54.0	(40.0)	(54.0)
45	Tier 1 capital (T1 = CET1 + AT1)	1,323.7	1,190.6	(40.0)	(54.0)
Tier 2 (T2) capital: instruments and provisions					
46	Capital instruments and the related share premium accounts	-	36.4	40.0	4.0
47	Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	-	30.0	-	(30.0)
51	**Tier 2 (T2) capital before regulatory adjustments**	-	66.4	40.0	(26.0)
58	**Tier 2 (T2) capital**	-	66.4	40.0	(26.0)
59	**Total capital (TC = T1 + T2)**	1,323.7	1,257.0	-	(80.0)
60	**Total risk weighted assets**	3,864.7	4,763.2	-	-

	Capital ratios and buffers				
61	Common Equity Tier 1 (as a percentage of risk exposure amount)	33.22%	23.86%	0.00%	0.00%
62	Tier 1 (as a percentage of risk exposure amount)	34.25%	25.00%	-1.04%	-1.13%
63	Total capital (as a percentage of risk exposure amount)	34.25%	26.39%	0.00%	-1.68%
64	Institution specific buffer requirement (CET1 requirement in accordance with Article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount)	5.75%	5.13%	0.00%	0.00%
65	of which: capital conservation buffer requirement	1.25%	0.63%	0.00%	0.00%
66	of which: countercyclical buffer requirement	0.00%	0.00%	0.00%	0.00%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	26.25%	18.39%	0.00%	-1.68%
	Amounts below the thresholds for deduction (before risk weighting)				
72	Direct and indirect holdings by the institution of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	1.7	1.7	-	-
	Applicable caps on the inclusion of provisions in Tier 2				
77	Cap on inclusion of credit risk adjustments in T2 under standardised Approach	43.6	54.7	-	-
	Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)	-	-	-	-
82	Current cap on AT1 instruments subject to phase out arrangements	45.0	54.0	-	-
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	-	36.0	-	-
84	Current cap on T2 instruments subject to phase out arrangements	94.4	113.3	-	-

* where ‘CRR’ refers to Regulation (EU) 575/2013

Appendix 4 Leverage ratio disclosures 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 2017 £m	2016 £m
1	Total assets as per published financial statements	**21,023.6**	19,019.7
2	Adjustments for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	**(191.4)**	(242.1)
3	(Adjustments for fiduciary assets recognised on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio exposure measure in accordance with Article 429(13) of Regulation (EU) No 575/2013 "CRR")	**-**	-
4	Adjustments for derivative financial instruments	**(301.9)**	(374.9)
5	Adjustments for securities financing transactions "SFTs"	**-**	2.0
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off balance sheet exposures)	**681.5**	966.9
7	Other adjustments	**(52.2)**	(66.8)
8	**Total leverage ratio exposure**	**21,159.6**	19,304.8

Notes

1. Row 4 above includes the Derivative asset from the Group Annual Report and Accounts of £94.2m (£116.1.1m in 2016) 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 2017 £m	2016 £m
	On-balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**20,738.0**	18,661.5
2	(Asset amounts deducted in determining Tier 1 capital)	**(52.2)**	(66.8)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**20,685.8**	18,594.7
	Derivative exposures		
4	Replacement cost associated with *all* derivatives transactions (ie net of eligible cash variation margin)	**1.8**	3.4
5	Add-on amounts for PFE associated with *all* derivatives transactions (mark-to-market method)	**51.3**	46.8
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(260.8)**	(309.0)
11	**Total derivative exposures (sum of lines 4 to 10)**	**(207.7)**	(258.8)
	Securities financing transaction exposures		
EU-14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Article 429b (4) and 222 of Regulation (EU) No 575/2013	**-**	2.0
16	Total securities financing transaction exposures (sum of lines 12 to 15a)	**-**	2.0
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	**837.5**	1,255.3
18	(Adjustments for conversion to credit equivalent amounts)	**(156.1)**	(288.4)
19	Other off-balance sheet exposures (sum of lines 17 to 18)	**681.5**	966.9
	Capital and total exposures		
20	Tier 1 capital	**1,283.7**	1,136.6
21	Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)	**21,159.6**	19,304.8
	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	**End-point**	End-point

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

Template LRSpl:

Split-up of on balance sheet exposures (excluding derivatives and SFTs)		CRR leverage ratio exposures 2017 £m	2016 £m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	20,738.0	18,661.5
EU-2	Trading book exposures	-	-
EU-3	Banking book exposures, of which:	20,738.0	18,661.5
EU-4	Covered bonds	87.4	39.2
EU-5	Exposures treated as sovereigns	2,675.2	1,611.4
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	128.5	155.0
EU-7	Institutions	392.8	443.4
EU-8	Secured by mortgages of immovable properties	16,662.6	15,493.6
EU-9	Retail exposures	-	1.6
EU-10	Corporate	45.2	103.8
EU-11	Exposures in default	65.4	132.8
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	680.9	680.7

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

Template LRQua:

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

The prudential consolidation group has a leverage ratio of 6.1%. 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 3.0%. The Group's leverage ratio is a key financial indicator monitored closely by the Board each month. The leverage ratio is projected for the next five years as part of the Corporate Plan. The Corporate Plan is subject to stress tests to ensure the Group is able to operate safely and with sufficient capital and leverage during a severe downturn in the general economy and idiosyncratic Society only stress events. It is recognised that such forward planning is essential to the successful management of the Group's leverage and capital ratios. The Board are satisfied that the risk appetite, controls and planning framework will prevent the group from taking excessive leverage within its balance sheet.

Description of the factors that had an impact on the leverage ratio during the year to 31 December 2017

The Group's end-point leverage ratio has increased by 0.2% to 6.1% during the year to 31 December 2017.

Tier 1 capital has increased in the year primarily driven by an increase in retained profits of £128.7m. The growth in Tier 1 capital has more than offset the impact of the growth in exposures of £1.8bn. Exposures continue to be mainly in residential mortgages; liquidity exposures are also created to support the group's activities.

Appendix 5 Asset encumbrance

Asset encumbrance occurs through the pledging of assets to secured creditors. The Society may encumber assets for a number of reasons, including 1) to attain short / long term funding through repo/securities lending arrangements; 2) attain long term funding through secured funding transactions, such as securitisations and covered bond issuances; and 3) to collateralise derivative exposures through credit support annexes (CSAs) with counterparts and through centralised derivative clearing.

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 2017.

Template A - Encumbered and unencumbered assets		Carrying amount of encumbered assets	of which notionally eligible EHQLA [1] and HQLA [2]	Fair value of encumbered assets	of which notionally eligible EHQLA and HQLA	Carrying amount of unencumbered assets	of which EHQLA and HQLA	Fair value of unencumbered assets	of which EHQLA and HQLA
		£m	£m	£m	£m	£m	£m	£m	£m
		010	030	040	050	060	080	090	100
010	Assets of the reporting institution	2,889.1	-	-	-	17,389.0	-	-	-
030	Equity instruments	-	-	-	-	1.7	-	1.7	-
040	Debt securities	0.5	-	0.5	-	808.6	-	808.6	-
050	of which: covered bonds	-	-	-	-	81.4	-	81.4	-
060	of which: asset-backed securities	-	-	-	-	207.6	-	207.6	-
070	of which: issued by general governments	-	-	-	-	163.7	-	163.7	-
080	of which: issued by financial corporations	0.5	-	0.5	-	355.9	-	355.9	-
120	Other assets	2,888.6	-	-	-	16,578.7	-	-	-
121	of which: Mortgage Loans	2,612.5	-	-	-	13,728.9	-	-	-

Notes

2. "Other assets" include loans and advances (including mortgages) and other balance sheet items not listed above including derivative financial assets, property, plant and other fixed assets, intangible assets including goodwill, and deferred tax assets. With the exception of mortgage loans, these assets would not be available for encumbrance in the normal course of business.
3. The Society is not required to provide details of EHQLA and HQLA exposures, as its total assets are less than EUR30bn as per the threshold requirement.
4. EHQLA relates to assets of extremely high liquidity and credit quality.
5. HQLA relates to assets of high liquidity and credit quality.

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

Template A - Encumbered and unencumbered assets		Carrying amount of encumbered assets	of which notionally eligible EHQLA and HQLA	Fair value of encumbered assets	of which notionally eligible EHQLA and HQLA	Carrying amount of unencumbered assets	of which EHQLA and HQLA	Fair value of unencumbered assets	of which EHQLA and HQLA
		£m	£m	£m	£m	£m	£m	£m	£m
		010	030	040	050	060	080	090	100
010	Assets of the reporting institution	2,974.2	-	-	-	15,764.1	-	-	-
030	Equity instruments	-	-	-	-	1.7	-	1.7	-
040	Debt securities	194.0	-	194.0	-	859.4	-	859.4	-
050	of which: covered bonds	-	-	-	-	39.3	-	39.3	-
060	of which: asset-backed securities	-	-	-	-	191.6	-	191.6	-
070	of which: issued by general governments	193.8	-	193.8	-	183.7	-	183.7	-
080	of which: issued by financial corporations	0.2	-	0.2	-	444.8	-	444.8	-
120	Other assets	2,780.2	-	-	-	14,903.0	-	-	-
121	of which: Mortgage Loans	2,471.2	-	-	-	13,254.9	-	-	-

The Society is not required to provide details in the Template B - Collateral received, as the balance is less than EUR 100bn as per the threshold requirement.

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

Template C **As at 31 December 2017**		**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	**1,617.9**	**2,889.2**

Template C As at 31 December 2016		Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
		010	030
Encumbered assets / collateral received and associated liabilities		£m	£m
010	Carrying amount of selected financial liabilities	1,464.2	3,049.6

Template D – Accompanying narrative information
General information on asset encumbrance

The Pillar 3 asset encumbrance disclosure templates have been compiled in accordance with the PRA regulatory reporting requirements. These numbers may differ from the disclosures contained in the Group's Annual Report and Accounts 2017 due to scope and definitional differences with respect to certain assets considered to be encumbered. In accordance with the threshold criteria under the PRA supervisory statement SS11/14, Skipton Building Society is not required to report on the fair value of encumbered and unencumbered collateral received. Furthermore, the statement requires that the data is presented as a median calculation rather than at a specific point in time.

Asset encumbrance generally occurs through the pledging of assets: to secured creditors, as collateral, or to credit enhance financial transactions. Such assets become unavailable for other purposes. The Group uses repurchase agreements/securities lending transactions as an everyday liquidity tool and has a range of counterparties whereby assets may be encumbered in order to raise funding. Assets are solely encumbered at the Society level.

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

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

Mortgage assets are used in long term secured funding transactions such as securitisations, covered bonds and Bank of England schemes. The Society has issued Residential Mortgage Backed Securities through its Darrowby programme and in 2017 it received FCA approval for its regulated Covered Bond programme. Further asset encumbrance occurs through the Society's participation in the Bank of England's Term Funding Scheme. The level of over-collateralisation associated with the Society's secured funding programmes is regularly monitored and they are maintained at levels that are both efficient and prudent. The Group has no sources of encumbrance by any currency other than the reporting currency. Unencumbered other assets include goodwill, deferred tax assets, property, plant and other fixed assets, and derivative assets. The underlying assets and cover pool assets related to any retained securities issued from the Society's secured funding programmes are treated as unencumbered from a regulatory reporting perspective.

Appendix 6 Countercyclical Capital buffer

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

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

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

Breakdown by Country	General credit exposures		Trading book exposure		Securitisation exposure		Own funds requirements					
	Exposure value for SA	Exposure value IRB £m	Sum of long and short position of trading book	Value of trading book exposure for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	**Total**	Own funds requirement weights	Countercyclical capital buffer rate
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**%**	**%**
	010	020	030	040	050	060	070	080	090	100	110	120
United Kingdom	1,094.2	15,833.6	-	-	198.8	-	229.9	-	3.2	233.1	86.8	-
Jersey	952.5	-	-	-	-	-	27.0	-	-	27.0	10.1	-
Guernsey	231.8	0.6	-	-	-	-	6.7	-	-	6.7	2.5	-
Switzerland	23.9	2.1	-	-	-	-	0.4	-	-	0.4	0.1	-
Spain	0.6	2.3	-	-	-	-	0.2	-	-	0.2	0.1	-
Australia	0.2	8.8	-	-	-	-	0.2	-	-	0.2	0.1	-
United States	1.1	9.8	-	-	-	-	0.2	-	-	0.2	0.1	-
Netherlands	10.0	1.3	-	-	-	-	0.2	-	-	0.2	0.1	-
Isle Of Man	1.8	0.3	-	-	-	-	0.1	-	-	0.1	-	-
United Arab Emirates	1.1	3.0	-	-	-	-	0.1	-	-	0.1	-	-
France	0.6	2.4	-	-	-	-	0.1	-	-	0.1	-	-
Denmark	-	0.6	-	-	-	-	0.1	-	-	0.1	-	-
Sweden	-	0.4	-	-	-	-	-	-	-	-	-	2.000
Hong Kong	-	0.5	-	-	-	-	-	-	-	-	-	1.250
Norway	-	0.4	-	-	-	-	-	-	-	-	-	2.000
Other countries	0.5	14.5	-	-	-	-	0.1	-	-	0.1	0.1	-
Total	2,318.3	15,880.6	-	-	198.8	-	265.3	-	3.2	268.5	100.0	-

Amount of institution-specific countercyclical capital buffer	**2017**
Total risk exposure amount £m	**3,864.7**
Institution specific countercyclical buffer rate %	**0.000%**
Institution specific countercyclical buffer requirement £m	**0.004**

Appendix 7 Residential lending exposures by PD scale

The table below sets out the main parameters used for the calculation of the capital requirement for IRB models for the Society, Amber and NYM mortgage portfolios.

PD scale	Original on-balance sheet gross exposure £m	Off-balance sheet exposures pre CCF £m	EAD post CRM and post CCF £m	Average PD %	Number of obligors	Average LGD %	RWAs £m	RWA density %	EL £m	Value adjustments and provisions £m
Society, Amber and NYM exposures - Secured by mortgages on immovable properties										
0.00 to <0.15	9,654.3	214.7	9,922.4	0.06	83,125	20.64	355.0	3.57	1.3	
0.15 to <0.25	1,796.9	229.8	2,012.7	0.20	14,662	25.99	218.8	10.86	1.0	
0.25 to <0.50	1,814.4	332.7	2,120.4	0.35	14,683	28.88	394.4	18.58	2.2	
0.50 to <0.75	685.4	19.6	710.8	0.61	4,942	29.93	201.5	28.33	1.3	
0.75 to <2.50	795.1	0.3	806.3	1.19	5,413	32.70	388.6	48.22	3.2	
2.50 to < 10.00	82.7	-	84.0	4.34	674	32.67	85.7	102.15	1.2	
10.00 to <100.00	71.4	-	72.1	43.22	695	27.16	101.5	140.81	8.6	
100.00 (Default)	63.5	-	63.4	100.00	526	32.52	216.3	340.62	3.5	
Subtotal	14,963.7	797.1	15,792.1	0.82	124,720	23.61	1,961.8	12.42	22.3	7.3

The tables set out on next page for Amber and NYM are specialist lending portfolios and do not have conversion factors as these portfolios are closed to new lending.

Under the IRB Approach these portfolios attract a higher PDs and LGDs resulting in higher risk weights compared to the Society portfolio. This is primarily due to the specialist nature of these mortgage portfolios, whereby loan impairment provisions and arrears are generally higher than those reported in the Society.

The tables below set out a breakdown of IRB residential lending main parameters by Society, Amber and NYM.

PD scale	Original on-balance sheet gross exposure £m	Off-balance sheet exposures pre CCF £m	EAD post CRM and post CCF £m	Average PD %	Number of obligors	Average LGD %	RWAs £m	RWA density %	EL £m	Value adjustments and provisions £m
Society exposures - Secured by mortgages on immovable properties										
0.00 to <0.15	9,558.6	214.7	9,825.0	0.06	82,180	20.58	348.0	3.54	1.3	
0.15 to <0.25	1,680.0	229.8	1,893.5	0.19	13,759	25.51	202.0	10.65	0.9	
0.25 to <0.50	1,634.4	332.7	1,936.8	0.35	13,231	28.36	353.5	18.22	1.9	
0.50 to <0.75	562.7	19.6	585.7	0.61	4,035	28.91	160.0	27.27	1.0	
0.75 to <2.50	568.6	0.3	575.2	1.16	3,750	30.64	256.2	44.46	2.1	
2.50 to < 10.00	35.2	-	35.6	4.38	325	26.13	29.1	81.56	0.4	
10.00 to <100.00	44.2	-	44.6	38.85	483	22.15	54.4	121.69	3.7	
100.00 (Default)	42.6	-	42.5	100.00	388	29.86	135.9	319.01	1.9	
Subtotal	14,126.3	797.1	14,938.9	0.59	118,151	22.97	1,539.1	10.30	13.2	4.5
Amber exposures - Secured by mortgages on immovable properties										
0.00 to <0.15	60.9	-	61.9	0.10	627	27.67	4.5	7.31	0.0	
0.15 to <0.25	74.1	-	75.5	0.20	571	36.10	11.5	15.32	0.1	
0.25 to <0.50	111.8	-	113.9	0.36	894	37.16	27.4	24.14	0.2	
0.50 to <0.75	79.2	-	80.6	0.62	567	37.56	28.9	35.96	0.2	
0.75 to <2.50	153.1	-	156.1	1.25	1,100	40.40	95.5	61.51	0.8	
2.50 to < 10.00	30.8	-	31.4	4.24	235	40.42	39.1	124.87	0.5	
10.00 to <100.00	21.0	-	21.3	52.60	160	36.37	36.8	173.47	4.1	
100.00 (Default)	17.7	-	17.7	100.00	115	39.30	71.0	401.90	1.2	
Subtotal	548.6	-	558.4	5.96	4,269	37.15	314.7	56.35	7.1	2.3
NYM exposures - Secured by mortgages on immovable properties										
0.00 to <0.15	34.8	-	35.5	0.11	318	25.20	2.5	7.03	0.0	
0.15 to <0.25	42.8	-	43.7	0.20	332	29.04	5.3	12.27	0.0	
0.25 to <0.50	68.2	-	69.7	0.36	558	29.86	13.5	19.46	0.1	
0.50 to <0.75	43.5	-	44.5	0.63	340	29.57	12.6	28.51	0.1	
0.75 to <2.50	73.4	-	75.0	1.25	563	32.41	36.9	49.36	0.3	
2.50 to < 10.00	16.7	-	17.0	4.46	114	32.04	17.5	103.23	0.2	
10.00 to <100.00	6.2	-	6.2	42.48	52	31.58	10.3	166.15	0.8	
100.00 (Default)	3.2	-	3.2	100.00	23	30.34	9.4	289.89	0.5	
Subtotal	288.8	-	294.8	2.80	2,300	29.95	108.0	36.64	2.0	0.5

Glossary

Set out below are the definitions of terms used within the Pillar 3 disclosures to assist the reader and to facilitate comparison with other financial institutions:

Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue.
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 III	Basel III sets out details of the 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	The method used to measure the carrying value of a financial asset or a liability measured at amortised cost and to allocate associated interest income or expense over the relevant period.
Fair value	Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction.
Forbearance strategies	Strategies to assist borrowers in financial difficulty, such as arrears capitalisation, a reduction in the monthly payment, a conversion to interest only or a mortgage term extension. Forbearance strategies aim, if possible, to avoid foreclosure or repossession.
Goodwill	Goodwill arises on the acquisition of subsidiary undertakings, joint ventures, associates or other businesses and represents the excess of the fair value of consideration over the fair value of separatelyidentifiable net assets and contingent liabilities acquired at the date of acquisition.
Impaired loans	Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.
Internal Capital Adequacy Assessment Process (ICAAP)	The Group's own assessment, as part of regulatory requirements, of the levels of capital that it needs to hold in respect of the risks it faces under a business as usual scenario and a variety of stress scenarios.
Individual Liquidity Adequacy Assessment Process (ILAAP)	The Group's own assessment that current and projected levels of liquidity are sufficient and appropriate for the Group's plans, under a variety of stress scenarios. It also details the Group's compliance with the PRA's regulatory BIPRU 12 requirements.
Internal ratings-based approach (IRB)	An advanced approach to measuring capital requirements in respect of credit risk under CRD IV. The IRB approach may only be used with permission from the PRA.
International Swaps and Derivatives Association (ISDA) Master Agreement	A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions.
Investment grade	The range of credit ratings, from Aaa to Baa3, as measured by external credit rating agencies.
Leverage ratio	The ratio of Tier 1 capital divided by total exposure, which includes on and off balance sheet assets, after netting derivatives.
Liquid assets	The total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.

Loan-to-value ratio (LTV)	A ratio which expresses the balance of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTVs on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in a house price index).
Loans past due / past due loans	Loans on which payments are overdue including those on which partial payments are being made.
Material Risk Takers (MRTs)	A group of employees to which the FCA's Remuneration Code applies. MRTs consist of Executive Directors, Non-Executive Directors and certain senior managers who could have a material impact on the firm's risk profile.
Member	A person who has a share investment or a mortgage loan with the Society, or is the holder of a Permanent Interest Bearing Share in the Society.
Net Stable Funding Ratio	The Net Stable Funding Ratio (NSFR) is a long term stable funding metric, which measures the stability of our funding sources relative to the assets (mortgage balances) we are required to fund.
Permanent Interest Bearing Shares (PIBS) or subscribed capital	Unsecured, deferred shares that are a form of Tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing members of Skipton Building Society.
Prime	Prime mortgages are those granted to the most credit worthy category of borrower.
Renegotiated loans	Loans are classed as renegotiated, with the customer's consent, when their terms have changed during the year. Loans and advances may be renegotiated whether or not the customer is experiencing financial difficulty in repaying their loan with the Group.
Repo / reverse repo	Short to medium term funding agreements which allow a borrower to sell a financial asset, such as an ABS or government bonds as security for cash. As part of the agreement the borrower agrees to repurchase the security at some later date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo, which can typically be resold or repledged if desired.
Residential loans	Mortgage lending secured against residential property.
Residential mortgage backed securities (RMBS)	A category of ABS that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and / or principal).
Risk appetite	The articulation of the level of risk that the Group is willing to take in order to safeguard the interests of the Society's members whilst achieving business objectives.
Risk weighted asset (RWA)	The value of assets, after adjustment, under CRD IV rules to reflect the degree of risk they represent.
Securitisation	A process by which a group of assets, usually loans, are aggregated into a pool which is used to back the issuance of new securities. A firm transfers these assets to a special purpose vehicle which then issues securities backed by the assets. The Group has established securitisation structures as part of its funding activities. These securitisation structures use retail / residential mortgages as the asset pool.
Subordinated debt / liabilities	A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors and investing members (other than holders of PIBS).
Sub-prime	Loans to borrowers typically having weakened credit histories that include payment delinquencies and in some cases potentially more severe problems such as court judgements and discharged bankruptcies.
Tier 1 capital	A measure of financial strength. Tier 1 capital is divided into Common Equity Tier 1 and other Tier 1 capital. Common Equity Tier 1 capital comprises general reserves from retained profits. The book values of goodwill and other intangible assets are deducted from Common Equity Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as PIBS are included in other Tier 1 capital (i.e. not Common Equity Tier 1).
Tier 2 capital	Tier 2 capital comprises regulated subordinated liabilities and PIBS that have been transitioned out of additional Tier 1 capital – under CRD IV all of the Society's PIBS will be phased out of Tier 1 capital as they fail to satisfy the CRD IV requirements. However £40m of our PIBS will continue to satisfy the criteria for Tier 2 capital and will therefore be phased into Tier 2.
Wholesale funding	Amounts owed to credit institutions, amounts owed to other customers and debt securities in issue excluding balances deposited by offshore customers.

Media Enquiries

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