YORKSHIRE BUILDING SOCIETY ANNUAL REPORT & ACCOUNTS 2015

Helping people enjoy life's choices

YBS GROUP

OUR MEMBERS MAKE US WHO WE ARE

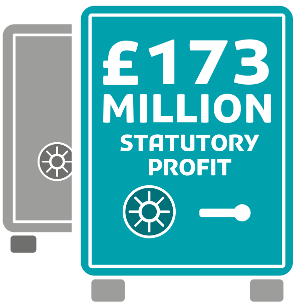
Here to deliver a greater sense of financial security allowing as many people as possible to enjoy life's choices.

Performance at a glance

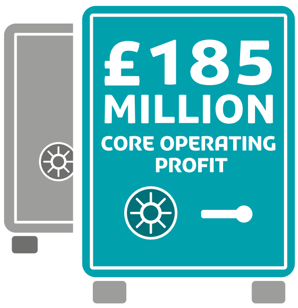
A YEAR OF STRONG FINANCIAL PERFORMANCE

Overall mortgage balances grew by 3.4% to £33.3bn

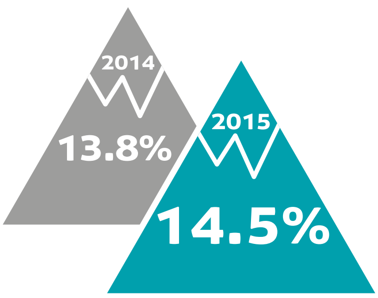
Savings balances grew by 0.5% to £27.9bn despite retail outflow of £0.2bn



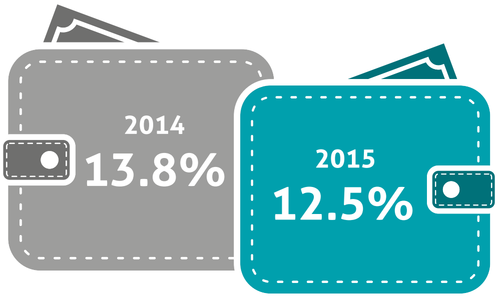
Statutory profit before tax down 8% from £188m in 2014



Core operating profit up 4% from £179m in 2014



Common Equity Tier 1 (CET1) capital ratio was 14.5%, increasing from 13.8% in 2014

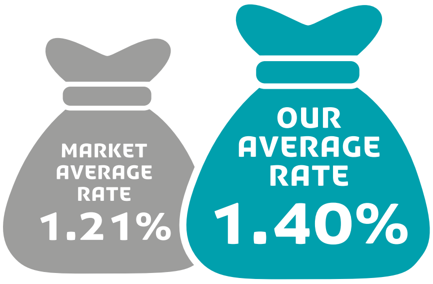


Liquidity ratio down from 13.8% to 12.5%

HEALTHY LEVELS OF LIQUIDITY

Liquid assets ensure we have sufficient cash to run the business and to meet customers' needs.

Our levels are well above those required by regulators.



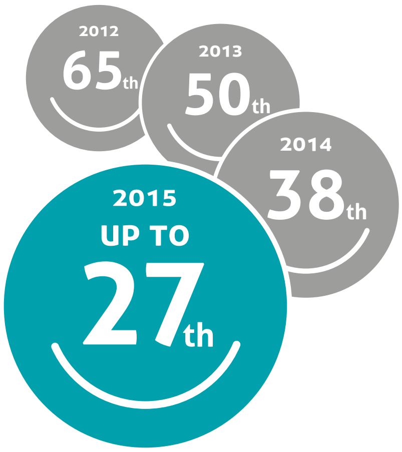
BETTER SAVINGS RATES

Our average savings rate of 1.40% was better than the market average of 1.21%.[1]

Across YBS Group, we are proud to have won 16 industry awards.

EVEN BETTER CUSTOMER EXPERIENCE

We're now 27th for customer experience out of 272 well-known UK brands in the prestigious KPMG Nunwood Customer Experience Excellence study.[2]



Source: [1] Average savings rates based on savings stock from CACI's Current Account and Savings Database (CSDB) currently covering 85% of retail savings market (based on stock value). Data as at 31 October 2015.

Source: [2] Nunwood Consulting – Nunwood Customer Experience Excellence Centre Top 100 UK Brands 2015, 272 companies were subject to the study but only the top 100 is published.

Chairman's Report

STRONG RESULTS AND LONG-TERM VALUE ADDED THROUGH OUR RANGE OF PRODUCTS AND SERVICES

Our Chairman, John Heaps, reports on another strong financial performance, in a year when competition in the mortgage and savings market intensified.

It is with pleasure that in my first annual review I am able to report that the Yorkshire Building Society Group, in what has been a challenging environment, had another successful year; with strong financial results and long-term value delivered to members through our range of products and services.

I am in no doubt that this performance could not have been achieved without our mutual model which puts the interests of our members at the heart of everything we do and allows us to focus on our Group purpose; **"to deliver a greater sense of financial security allowing as many people as possible to enjoy life's choices".**

By focusing on our mutual model we were also able to further strengthen the trust of our members, as demonstrated through our Net Promoter Score®; an industry wide index which tracks what our customers say about us. This index shows we consistently outperform most others in the financial services industry. We were delighted to be ranked in the top three most trusted financial services providers in the UK for most of 2015[3].

Economic and market conditions

It is particularly pleasing to be able to report these results at a time when the economic landscape looks increasingly difficult and the marketplace for our products and services increasingly competitive. While the UK economy is still one of the faster growing G7 countries, with consumers benefiting from record low levels of inflation and falling unemployment, recent signals indicate that growth is slowing while the global markets have been hit by difficulties with emerging markets and concerns about the stability of European banks. These uncertainties mean that interest rates are likely to remain at their record low levels for some time, benefiting our borrowers but continuing to suppress rates paid to savers.

The performance of the housing market was encouraging as it built on the gains of 2014 to record further price increases. Unlike 2014, London was not responsible for the majority of this gain as price growth was spread across the UK. The economic uncertainties I have referred to will have an impact going forward, though as things stand, we expect the housing market to perform positively in 2016.

Strong financial performance

In 2015 we delivered gross mortgage lending of £6.9bn providing home loans to over 29,500 borrowers and opened 166,000 new savings accounts. We continued to see increased competition both from the major banks who have rebuilt their balance sheets and the new challenger banks, resulting in more aggressive pricing across our core markets; a trend we expect to see continue in 2016. Our strong results were achieved after taking the decision to reduce our target lending volumes to avoid competing in over heated parts of the market. Our profit before tax remained strong at £173m. Core operating profit, which measures underlying performance, increased to £185m. Both these profit measures are high against historic levels.

Source: [3] YBS Brand Tracker, conducted by YouGov

Our already strong capital position, as measured by our Common Equity Tier 1 (CET1) ratio improved further to 14.5% and our leverage ratio increased to 5.0%, well above the likely minimum requirement of 3%. Whilst our principal funding remains focused on retail savings, we continued to develop our wholesale funding franchise with three public Treasury trades which reaffirmed market confidence in the Group.

Full detail of our performance is outlined in the Strategic Report, which begins on page 12.

Regulation and legislation

There have been significant senior management changes within our regulatory bodies over the last year, with the appointment of the former deputy governor for Prudential Regulation at the Bank of England, Andrew Bailey, to Chief Executive of the Financial Conduct Authority (FCA). During his time at the Bank, Mr Bailey has always maintained an involvement in the building society sector recognising the value of the mutual business model and the diversity it brings to the financial services market. We therefore welcome this appointment.

Regulation of the financial services industry has continued at pace during the year, with effective and proportionate regulation being key to ensuring economic stability and protection for UK consumers. We are supportive of the UK Government and Regulators' aim to raise standards throughout the sector. The recognition of the building society model and the need to promote diversity demonstrated in the Bank of England and Financial Services Bill is welcome. We are keen that all policy makers recognise that this business model can help create a more resilient financial services sector and should be encouraged through appropriate regulation which avoids taking a one-size fits all approach.

One area where we think this is particularly necessary is the new Bank Surcharge which was introduced in the Summer 2015 Budget to replace the Bank Levy. The legal form of building societies means that the additional tax on profits will have an impact on the growth of our capital reserves which are used to provide financial security and investment in the business. We will therefore continue to urge the Treasury to reconsider the requirement for building societies to be subject to this increased levy.

We are also closely monitoring new regulation that will impact our capital and wholesale funding requirements. Whilst this will make the industry more resilient by requiring institutions to hold either more capital or debt that can be converted to capital, it will also increase costs.

In the year ahead we are preparing for the implementation of the Accountability Regime, which is aimed at increasing individual accountability in financial services. We are supportive of the intentions of these proposals and have fully embedded them through our Trust Code, ensuring it is fully integrated within the Group.

Chairman's Report continued...

Delivering value to our savers

The record low Bank Rate has a continuing impact on the returns we can offer our savers, as we cannot significantly differentiate from the rates available in the market. Our mutual status is, however, an advantage and has enabled us to deliver value to our saving members by providing rates that are 0.19% higher[4] than the industry average.

Our members have also demonstrated to us that they are keen to support their local communities through their savings. Our affinity accounts pay a percentage of the savings balances to a charity or local club, and in 2015 these accounts generated £1.6m in donations. The most successful affinity accounts were Yorkshire Air Ambulance (which received £944,000, their largest ever donation) and Marie Curie, our charity partner, (which received £334,000 from a very successful savings bond that sold out in less than two weeks).

Supporting borrowers to buy their home

The mortgage market in 2015 was the most competitive we have seen since the financial crisis. As noted earlier, we reduced our lending target sensibly as competition intensified. Even so, our healthy financial position enabled us to offer borrowers some of the most competitive rates available with our net new lending in the year representing 3.19%[5] of the mortgage market.

Whilst continuing our prudent approach to new lending, using robust affordability models to ensure long-term protection, we grew our mortgage balances by £1.1bn. Remaining true to our heritage, I am proud that we helped 6,306 people take their first step on the housing ladder, with First Time Buyers accounting for 21% of all our total new mortgage loans. Recognising that one of the main barriers to home ownership is the up-front cost of buying a house, we remain committed to providing mortgages to those with only a 5% deposit.

Serving our members

As a member-owned organisation, communicating with members is a vital part of how the Group operates. Whilst voting at the Annual General Meeting is our biggest member engagement, we also communicate and encourage feedback from members through a variety of activities. This helps us to better understand what matters to members and ensures that we continually improve the services we provide.

In 2012 we embarked on a Strategic Investment Programme aimed at developing a modern business that makes the most of technological advancements, whilst retaining our strong commitment to face-to-face customer service.

As part of this programme, we have recently announced the re-branding of Barnsley Building Society and Chelsea Building Society branches to Yorkshire Building Society. The Chelsea Building Society brand will remain, operating through our online and telephone channels. The changes will result in some branch closures, largely in locations where the Group currently has two branches which will in future operate from just one branch. Barnsley and Chelsea account holders will now be able to access our much larger Yorkshire Building Society branch and agency network.

Whilst these were difficult decisions to make, it is necessary that we continually review the way we operate to ensure we continue to deliver greater efficiencies and secure long-term value to our 3.3 million customers. We are communicating with all customers and colleagues impacted by the changes and are working to minimise the impacts on them.

Providing valuable support to our communities

Working together to support our local communities remains as much a focus for the Group today as it was for our founding members over 150 years ago. Through our Society Matters programme we believe we can help to make a lasting difference and improve the lives of others.

More detail on this activity can be found in the Corporate Responsibility Report on pages 36 - 39.

Valuing our people

Delivering an outstanding customer experience would be impossible without the enthusiasm, commitment and hard work of the Group's 4,593 people. I am consistently impressed by how much colleagues care about each other, the Group and most importantly the customers they serve. Delivering an exceptional people experience, therefore, remains one of the Group's strategic priorities to ensure it continues to attract and retain the best talent. On behalf of the Board I would like to thank all our colleagues for their outstanding performance.

Source: [4] Average rates based on Savings stock from CACI's Current Account and Savings Database (CSDB), currently covering 85% of retail savings market (based on stock value). Data as at 31 October 2015

Source: [5] Bank of England, as at December 2015

£6.9BN
Mortgage lending

29,500 borrowers

£173M
Profit before tax

£188m in 2014

£185M
Core operating profit

£179m in 2014

Changes to your Board

Ed Anderson, your former Chairman, stepped down from the Board in April at the conclusion of the 2015 Annual General Meeting (AGM). Ed had been a Board member for 12 years and had been your Chairman since 2003. During this time he confidently led the Group through the financial crisis and left us as a larger and stronger organisation. On behalf of my colleagues and all our members I would like to thank Ed for his wise counsel and outstanding chairmanship throughout his term of office.

Philip Johnson also retired from the Board after the 2015 AGM. Philip was a non-executive director and Chair of the Audit Committee and his knowledge, experience and commitment during his eight years' service made him a valued member of the Board.

Lynne Charlesworth retired from the Board on 31 October 2015. Lynne's experience and skills in the financial services industry made an immense contribution to the Society during her nine years' service. Lynne had been a non-executive director and held the roles of Vice Chairman and Chair of the Group Risk Committee.

Executive Director and Chief Customer Officer, Ian Bullock, retired on 30 November 2015. Ian had led the Group's customer-facing teams and played a key role in bringing together the retail networks following our merger activity. During his 13 years with the Group, Ian worked tirelessly to ensure both customer experience and customer outcomes remained our key focus and we greatly value all that he contributed to the Group.

I would like to record our great thanks and appreciation to Ed, Philip, Lynne and Ian for their outstanding commitment and contribution to the Group and wish them all well for the future.

There have been two new appointments to your Board during 2015:

Alison Hutchinson joined as a non-executive director on 4 February 2015 and is a member of the Audit and Remuneration Committees. Alison has over 20 years' senior management experience within the financial services and technology sectors and her detailed knowledge will be of great value as we continue to grow our business. She also has a considerable interest in charitable causes which resonates greatly with our own values of supporting local communities and causes that are important to our members.

Gordon Ireland joined as a non-executive director on 1 September 2015 and became a member of the Group Risk Committee on 1 January 2016. Gordon is a chartered accountant and spent most of his career working for PwC and its predecessor firms, acting as audit and review partner for major businesses across the financial services sector. Gordon's audit and financial services background will be of great value and add to the strength of the Board.

In addition, Stephen White was appointed Chief Operating Officer and Executive Director on 24 February 2016. Stephen has a depth of knowledge and experience in leading large-scale operations, IT functions and delivering substantial change, all of which will serve him well in our Group.

More details on all directors is provided on pages 40 - 45 and members will be asked to approve the election of Gordon and Stephen as directors at the 2016 Annual General Meeting as well as being asked to vote on the re-election of all other directors.

The future

We do not expect the external market conditions to get any easier over the coming year. Competition for mortgages and savings, the increasing cost of regulation, the new Bank Surcharge tax and the forthcoming requirement to hold higher levels of remunerated capital will all have an impact on our future profits.

Nevertheless we will continue to implement our customer-led strategy and build on the considerable progress we have made in delivering our investment programme. By doing this we will ensure that we grow and improve the business, helping our current and future customers to save for their futures and become homeowners whilst safeguarding the financial security of the Group.

John Heaps

24 February 2016

Chief Executive's Introduction

WITH OUR MUTUAL HERITAGE WE REALLY DO PUT CUSTOMERS AT OUR HEART

For over 150 years we have been bringing savers and home buyers together for their common benefits. As a committed mutual we are owned by our members, rather than external shareholders, enabling us to keep our members' interests at the centre of everything we do. Whilst we are investing in the organisation, we also carefully balance the need to retain sufficient earnings to ensure the Group's future sustainability for our members, people and local communities.

I'm delighted to introduce the Group's Strategic Report which provides a comprehensive review of our 2015 performance and how this has supported the delivery of our Strategic Priorities.

Progress towards the Group's Vision and Strategic Priorities is closely monitored through a set of Key Performance Indicators (KPIs) reported to the Board monthly via a Balanced Scorecard. The current trading performance is also reported in the Balanced Scorecard.

The table below provides a summary of performance against our top KPIs.

These and other measures are covered in more detail in the Strategic Report.

Scorecard category	KPI	2015 Actual	2015 Target	2014 Actual	Page
Trading Performance	Group net lending Group net retail inflow Retail savings balances	£1.1bn £(0.2)bn £27.9bn	£3.0bn £1.4bn £29.5bn	£2.6bn £0.3bn £27.8bn	16 16 16
People Experience	Colleague engagement	70%	78%	78%	18
Customer Experience	Net Promoter Score®	29%	23%	n/a*	9
Easy & Simple	Customer feedback – simplicity	75%	74%	74%	n/a
Locally Famous	Brand awareness	63%	65%	63%	22
Financial Sustainability	Statutory profit before tax Cost:income ratio Common Equity Tier 1 Capital ratio Liquidity ratio	£173m 63% 14.5% 12.5%	£179m 60% 13.0% **	£188m 59% 13.8% 13.8%	25 28 30 31

Note: * During 2015, the methodology of measuring NPS changed and therefore previous figures cannot be compared on a like for like basis.

** Our liquidity is maintained at all times above our internal stressed and regulatory requirements rather than above a set percentage. This variable target was met at all times during 2015.

As the KPIs show, 2015 has been a challenging year driven by the competitive trading environment and our ongoing investment programme. Both new lending and retail funding positions were impacted by the tough trading conditions. Part way through the year we recognised that product pricing was becoming much harder and at times, aggressive. Consequently we prudently decided to reduce our lending and funding targets to reflect our commitment to long-term financial sustainability. Even with this we are pleased with our achievements in 2015, with:

- 166,000 new savings accounts opened (2014 –200,000)
- Average savings rate of 1.40% against a market average of 1.21%[6] (2014 – 1.60% (YBS) vs 1.34% (market))
- Lent £1.3bn to first time buyers – 21% of our residential lending (37% of all house purchase lending) (2014 – £1.7bn)

The Group's financial position has remained strong, balancing profit levels needed to sustain the business whilst ensuring we give long term value to our members through our products. Across all our brands we received more than 3,300 best buy mentions.

We continue to deliver excellent customer service. We are delighted that we have been ranked 27th for customer experience out of 272 brands in the UK in the prestigious KPMG Nunwood Customer Experience Study[7]. This is an improvement of 38 places since 2012 and really shows that our customers are noticing the continued focus that we have placed on them being at the heart of everything we do.

This is supported by a positive Net Promoter Score®[8] (NPS) of 29% with our highest ever month of 32% in September. We have changed the way we measure NPS in 2015 from a post interaction NPS to a Relationship NPS score which considers the experience of our customers across all brands and product lines, whether they have interacted with us or not.

29%
NET PROMOTER SCORE®

OUR COMMITMENT TO OUR CUSTOMERS IS REINFORCED BY OUR ACHIEVEMENTS THROUGHOUT 2015:

- **166,000 new savings accounts opened (2014 –200,000)**
- **Average savings rate of 1.40% against a market average of 1.21% (2014 – 1.60% (YBS) vs 1.34% (market))**
- **Lent £1.3bn to first time buyers – 21% of our residential lending (37% of all house purchase lending) (2014 – £1.7bn)**

ACROSS ALL OUR BRANDS WE RECEIVED MORE THAN 3,300 BEST BUY MENTIONS.

Source: [6] Average rates based on Savings stock from CACI's Current Account and Savings Database (CSDB), currently covering 85% of retail savings market (based on stock value). Data as at 31 October 2015.

Source: [7] Nunwood Consulting - Nunwood Customer Experience Excellence Centre Top 100 UK Brands 2015; 272 companies were subject to the study but only the top 100 are published.

Source: [8] Nunwood Customer Voice Programme, 12 month score, January to December 2015, based on interviews with 28,329 customers.

Chief Executive's Introduction continued...

Across the Group we are proud to have won the following industry awards:

Award	Accolade	Brand
Moneynet Personal Finance Awards 2015	Best Offset Mortgage Provider	YORKSHIRE BUILDING SOCIETY
Moneynet Personal Finance Awards 2015	Best Debit Card for use abroad	NORWICH & PETERBOROUGH BUILDING SOCIETY
Moneynet Personal Finance Awards 2015	Best Fixed Rate Mortgage Provider	NORWICH & PETERBOROUGH BUILDING SOCIETY
Moneyfacts Awards 2015	Best Short-Term Fixed Rate Mortgage Provider	NORWICH & PETERBOROUGH BUILDING SOCIETY
Moneyfacts Awards 2015	Best Longer Term Fixed Rate Mortgage Provider	YORKSHIRE BUILDING SOCIETY
Moneyfacts Awards 2015	Best Building Society Mortgage Provider	NORWICH & PETERBOROUGH BUILDING SOCIETY
Moneywise Mortgage Awards	Best Lender for Fixed Rates	YORKSHIRE BUILDING SOCIETY
Business Moneyfacts Awards 2015	Best Buy-to-let Mortgage Provider	ACCORD MORTGAGES
Third Sector Business Charity Awards	Challenge Event	YBS GROUP
Community Commitment - Finance & Banking	International CSR Awards 2015	YORKSHIRE BUILDING SOCIETY
International Corporate Social Responsibility Awards 2015	Bronze Award Winner - Community Commitment, Finance & Banking	YORKSHIRE BUILDING SOCIETY
Cyber Security Awards 2015 (EMEA)	Banking/Financial Services Team of The Year	YBS GROUP

Through our Strategic Investment Programme we will continue to improve our core processes to ensure the experience our customers have with us is market leading - whether applying for a mortgage or opening a savings account; whichever of our channels customers opt to use. This will help us to achieve our vision to be **"the most trusted provider of financial services in the UK"**.

Chris Pilling, Chief Executive

24 February 2016

"

We are delighted that we have been ranked 27th for customer experience out of 272 brands in the UK in the prestigious KPMG Nunwood Customer Experience Study[7].

"

1. Our Strategy

DELIVERING A GREATER SENSE OF FINANCIAL SECURITY ALLOWING AS MANY PEOPLE AS POSSIBLE TO ENJOY LIFE'S CHOICES

The Group's current strategy was set and approved by the Board in September 2012. It is constantly monitored and it remains valid today.

Our Vision is "to be the most trusted provider of financial services in the UK".

This is supported by five Strategic Priorities.

- Deliver a market leading **customer experience** built on empathy, simplicity and trust
- Attract and retain the best talent, with a leading **people experience** built on our cultural foundation of 'mutual trust'
- Deliver **sustainable financial performance**, that ensures real financial security for our customers, within our risk appetite
- Deliver products, processes and systems for all our channels and brands that are **easy and simple** to use
- Be **locally famous** and meaningfully engaged in our communities.

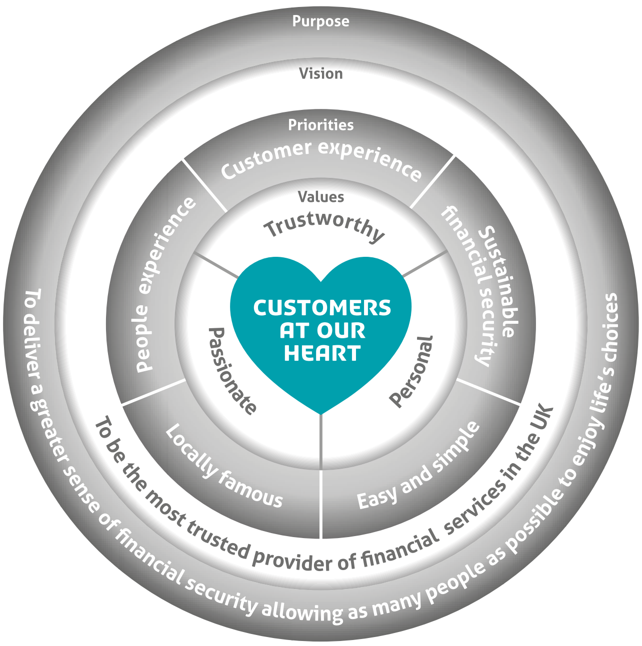
Our Values, developed and adopted by our people, were introduced in 2013. These are:

- **Customers at our heart** – simple but powerful principle that guides everything we do. Achieved by:
- Being **trustworthy** – keeping our promises so people can count on us when it counts most;
- Keeping it **personal** – putting people first with humanity, decency, warmth and care; and
- Being **passionate** – loving what we do today and sharing our ideas to make things better for tomorrow.

During 2015 we began an exercise to develop an over-arching Purpose Statement, which was approved by the Board in September 2015 and is:

"To deliver a greater sense of financial security allowing as many people as possible to enjoy life's choices"

The purpose anchors the Group in a clear long term customer driven goal that guides our Group.



2. Group Business Model

The fundamental Business Model of the Group is based on differentiating itself in the market in the area of 'customer intimacy' – building on the trust agenda. Our mutual strategy is reflected in a business model focused on the provision of financial services in the UK, which can be divided into two core business segments – retail and non-retail.

The **Retail Business** represents the core focus of the Group in terms of customers, resources, and people. Reflecting the traditional building society model, we concentrate on residential mortgages funded through retail savings and, to some extent, wholesale funding. Together the business units in this area offer:

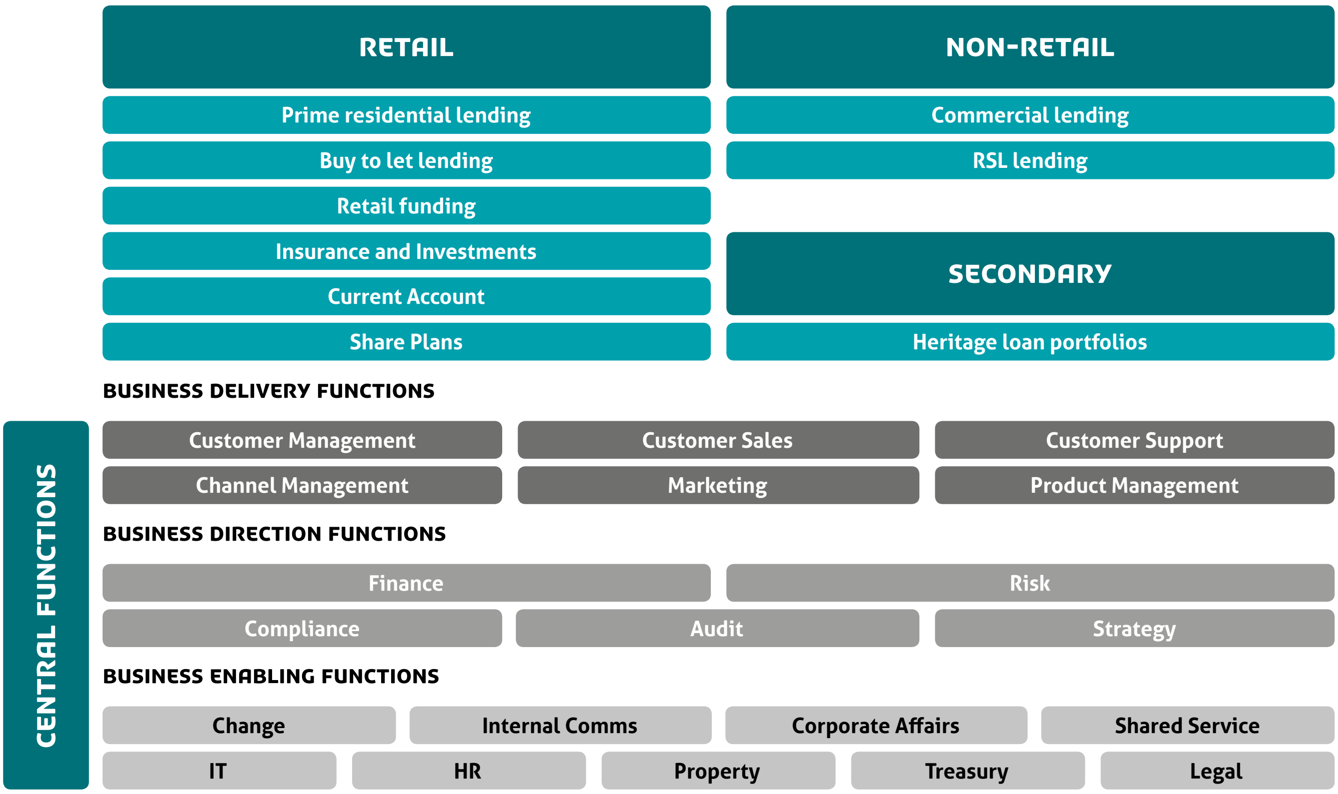
- Retail savings products
- Direct and introduced residential mortgages
- Buy to Let (BTL) mortgages for landlords (offered through our intermediary partners)
- Current accounts
- Employee savings and share schemes for companies (via our SharePlans business) which generates both stable, long-term funding and healthy income streams for the Group
- A range of third party investment and insurance products and services.

The **Non-retail Business** is our commercial lending, including lending to Registered Social Landlords (RSL), who are focused on the provision of low cost social housing for people in need of a home, a profitable and active business which provides loans to small commercial customers and housing associations, supporting the Group's purpose and financial long-term sustainability.

The Group also has a set of **Secondary** businesses which consists of portfolios that are no longer open for new business, and which were either inherited through mergers and acquisitions or are areas in which the Group no longer operates. We are managing down these areas, which include our structured credit portfolio, our credit repair mortgage portfolio and a number of other small loan portfolios.

All our businesses are supported by the **Central functions**, which we categorise into Business Delivery, Business Direction or Business Enabling functions as appropriate.

Our model and business functions can be visualised as:



Our products and services are distributed through a national network of branches, intermediaries and agencies, as well as online and digital channels.

2. Group Business Model continued...

Our merger activity between 2008 and 2010 resulted in us having multiple branches in single locations, a legacy of different products and members being restricted to transacting in the branches of one brand. However, our Strategic Investment Programme has enabled us to modernise our business and therefore we have decided to re-brand both Barnsley Building Society and Chelsea Building Society branches to Yorkshire Building Society. This will give our members of these brands access to a larger network of more than 260 Yorkshire Building Society brand branches and agencies, giving them greater choice and flexibility. The Chelsea brand will remain active through our online and telephony channels.

The changes will result in some branch closures. However, it's our intention to look to retain a branch or agency in every location where we currently have a presence. Where sole branches are closing we are actively pursuing opportunities to open a Yorkshire Building Society agency with local businesses.

Whilst these were difficult decisions to make, it is necessary that we constantly review the way we do business to ensure we continue to deliver long-term value, improved services to our members and help the Group to further develop as a modern mutual.

During 2015 three new risk roles were added to the Group's Senior Leadership Team: Head of Risk (Customer Division), Head of Prudential Risk, and Head of People Risk. These roles were added to enhance the Group's three lines of defence model, which we are embedding as a principle across the organisation as follows:

FIRST LINE OF DEFENCE

Day to day responsibility for running the business

SECOND LINE OF DEFENCE

Accountable for competent risk management across the Group

THIRD LINE OF DEFENCE

Independent assurance through our internal audit function

3. Strategic Investment Programme

In 2012 we launched our Strategic Investment Programme. We are now well into this programme, which is changing and adapting to meet both external needs (including regulatory requirements) and internal capabilities. We've experienced lots of change, and there's more to come as it's vital we keep pace in a fast changing world.

To date we have mostly focused our Strategic Investment Programme on strengthening our risk foundations and other core infrastructure, enhancing our three lines of defence risk model, refreshing our branches and offices and embarking on bringing all of our brands together on a single platform.

Meanwhile, we have invested in new and better systems and processes to improve our customer service and efficiency.

2015 successes in this area include:

- Continued development of our web and mobile channels, offering customers even more choice and better service. In the future customers will have access to a wider range of savings accounts online, allowing them to find the right account for their needs with greater convenience and comfort. This is particularly important as we are seeing greater customer demand for use of our web and telephony channels.
- Continued investment in our branch network with nine additional branches refurbished this year with the new design concept, including the relocation of two branches – Shenfield and Oxford - to more suitable premises.
- Successfully migrated all Barnsley Building Society data to our Single Multi-Brand Platform (SMBP). The migration of data from Chelsea Building Society and Accord Mortgages (our intermediary lending subsidiary) will be completed in 2016. Once the consolidation is completed, all our members of these brands will be able to manage their accounts in over 260 Yorkshire Building Society brand branches and agencies across the UK and will have access to a wider range of products and services. The plans will also enable us to become more efficient and therefore offer better long-term value to our customers.
- A review of our ID and customer verification process, putting ourselves in our customers' shoes, to understand the outcomes of our actions and how they make customers feel.
- An improved bereavement process which now focuses on supporting our customers as much as possible at such a difficult time.

The Strategic Investment Programme also enabled us to enhance our systems and processes to help our colleagues work more efficiently. These improvements are detailed on pages 21 - 22 within the Easy & Simple strategic priority.

4. Review of 2015

4.1 Vision

"Our Vision is to be the most trusted provider of financial services in the UK."

We monitor this monthly through a survey which asks people if they agree that "Yorkshire Building Society is an organisation you can trust". For most of 2015 the survey ranked us in the top three out of 15 financial services organisations measured[9].

4.2 Trading Performance

£6.9BN
Gross lending

£7.6bn in 2014

£1.1BN
Net lending

£2.6bn in 2014

3.1%
Market share of gross lending[10]

3.7% in 2014

The trading environment in 2015 has been challenging with increased competition from banks and building societies. Rates for mortgage customers fell throughout the year with some products in the market being offered below 1%. This level of competition is putting pressure on savings rates across the market and we have sought to maintain a balance between growth of the mortgage book and our ability to maintain savings rates. Whilst we aim to protect savers from the impact of low rates we can only do this within the context of maintaining our financial security and ensuring we do not attract more money than we can safely and sensibly lend. In view of these trading conditions, mid-year we proactively reduced our lending and funding targets, to avoid chasing growth at unsustainable prices.

Providing residential mortgages is at the core of being a building society and we primarily focus our lending on properties within the prime residential mortgage market.

During 2015 we delivered:

- Gross lending of £6.9bn – down from 2014 (£7.6bn) and managed to ensure our lending has sustainable margins and a mix within our risk appetite.
- Net lending of £1.1bn – £2.6bn achieved in 2014.
- Market share of gross lending[10] at 3.1% compared to 2014's level of 3.7%.
- Within the lending figures noted above we achieved an increase in our volume of BTL lending (£0.8bn compared to £0.5bn in 2014). Whilst this is not a primary source of business for us we have seen significant market growth in this sector in recent years. Being active in this market helps us diversify our lending.
- We have also experienced some changes in channel dynamics through the year with more customers transacting through the intermediary market, and some shift towards greater use of the web and telephony channels. We allocate our resources to meet this demand as closely as possible and will continue to reflect customer needs in our customer experience investment programme.

Source: [9] YBS Brand Tracker, conducted by YouGov (regional data is on a 3 month end rolling basis).

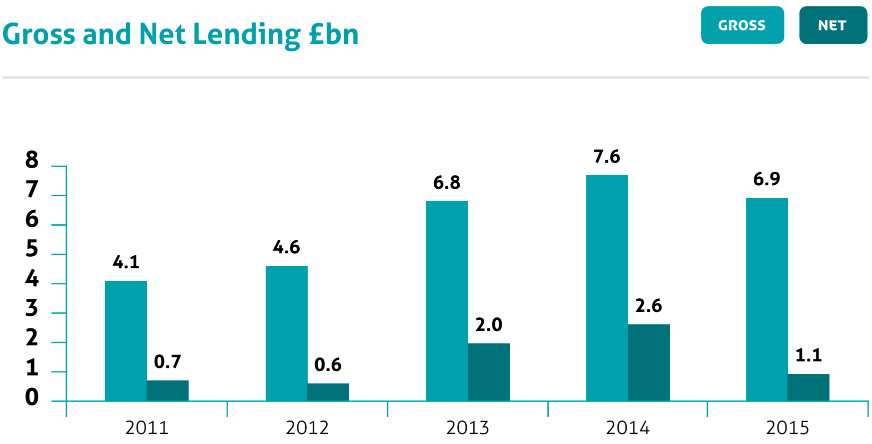
Source: [10] Council of Mortgage Lenders, as at December 2015.

4. Review of 2015 continued...

4.2 Trading Performance continued...

Net lending is a key measure to monitor the Group's lending performance. It represents gross lending less repayments of principal and redemptions. This measures our effectiveness in both new mortgage lending and in retaining borrowers. In 2015, we carried on growing in a balanced way, maintaining growth in each calendar quarter. We experienced an increase in redemptions and repayments (up from £5.0bn in 2014 to £5.8bn) which reflects our balance sheet growth in prior years and increased market activity.

Gross and Net Lending £bn



Our overall mortgage balances grew by 3.4% to £33.3bn.

This mortgage growth has been achieved within the risk limits and appetite set by the Board. The average loan-to-value (LTV) on new lending was 68.91% (2014 – 71.03%). The average indexed LTV for the overall residential portfolio was 49.51% (2014 – 50.89%). Our book remains resilient with 80.35% of customers having an LTV of 75% or less (2014 – 77.03%).

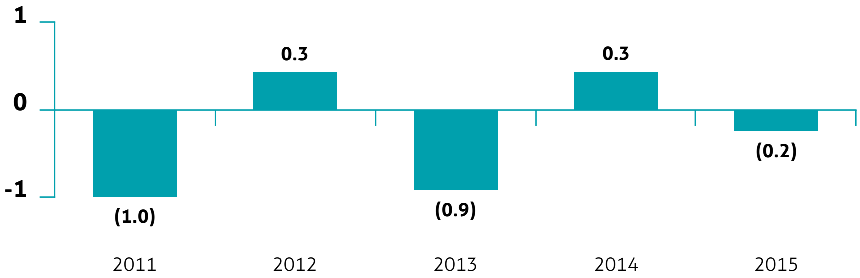
The Board monitors the Group's retail savings performance by tracking the net difference between retail savings deposits and withdrawals in any period. This is referred to as net retail inflow. Our overall savings portfolios had an outflow of £0.2bn in 2015 compared to an inflow of £0.3bn in 2014. This is reflective of the reduced level of mortgage growth experienced in 2015 combined with a small increase on our underlying wholesale funding and slightly lower liquidity at the year end. We continue to offer average rates that are higher than the market average – at the year end our retail savings averaged 1.40% against a market average of 1.21%, a difference of 0.19% (2014 – 0.26%)

We look to optimise our sources of funding to balance:

- The impact on existing customers
- The sustainability of the Group
- Over reliance on one source through using different sources of funding
- The level of liquidity we need to hold to ensure we meet our regulatory requirements and risk appetite
- Our overall funding mix also needs to be balanced against net lending in terms of overall level and term. This means we can properly manage the impact of future rate changes on our business.

At the year end our retail savings averaged 1.40% against a market average of 1.21%.

Retail Inflow/Outflow £bn



Our funding base is predominantly comprised of retail savings but we do have a diversified approach to our funding and have completed issuances of covered bonds and unsecured medium term debt during 2015. At the end of 2015, 90% (2014 – 92%) of mortgages were funded by retail savings and retained profits.

4. Review of 2015 continued...

4.3 Customer Experience

During 2015 we have sought to improve our customer experience across our our channels and brands. This included:

- Improvements to our mortgage application processes which have resulted in faster turnaround of offers, a more consistent customer experience and improved feedback from our broker partners.
- Home and Life insurance quotes now being offered to customers as part of the online mortgage application. This integrated approach ensures that customers are aware of the range of insurance options available to them and have a quick and easy way to take out protection.
- Customers are now able to engage with us via Facebook, Instagram and Twitter, providing real time communication with members.
- An improved bereavement process which now fully supports our customers, aligning five processes into one, and improved customer communications.

For savings members we launched the Savings Pledges in October. The six pledges build on our core value of "customers at our heart" and detail what customers can expect from the Group as a savings provider. The Saving Pledges which have been welcomed by our customers are reviewed and updated regularly. As part of these pledges:

- Customers can simply share their email addresses with us and be one of the first to hear about new savings accounts.
- If a customer sees an available savings account and goes on to book an appointment in a branch or agency to discuss it, then we guarantee the account will be available for the next 14 days, even if it's withdrawn from sale.
- Customers can make the most of their savings with a health check, to make sure they have the right savings account for their savings goal.

OUR ACHIEVEMENTS IN 2015:

- **Improvements to our mortgage application processes which have resulted in faster turnaround of offers**
- **Home and Life insurance quotes now being offered to customers as part of the online mortgage application.**
- **Customers are now able to engage with us via Facebook, Instagram and Twitter**
- **We launched six Savings Pledges building on our core value of "customers at our heart".**

4. Review of 2015 continued...

4.3 Customer Experience continued...

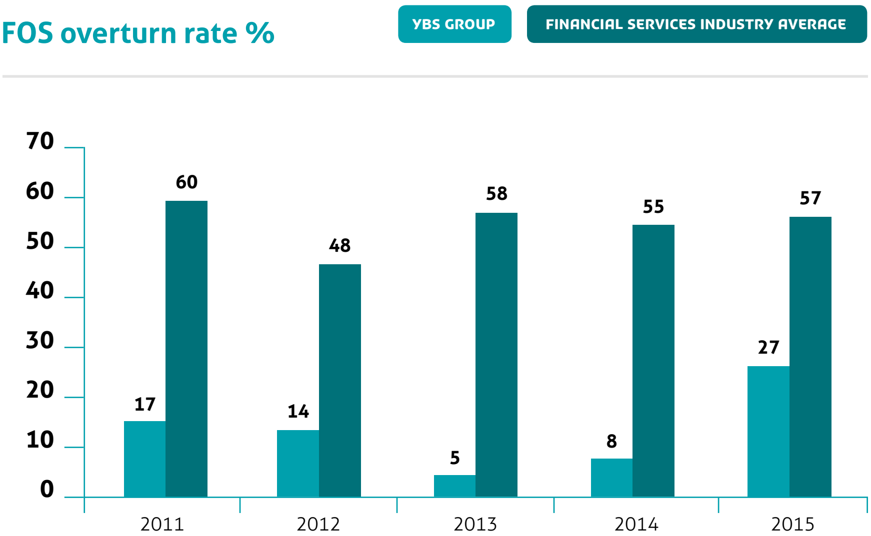
No organisation will get everything right all the time, and to track our own performance we monitor a range of complaints data, as well as looking closely at the cause of complaints to ensure we can learn and adapt. One of the best measures is the Financial Ombudsman Service (FOS) over-turn rate which measures the percentage of cases where FOS decided we had made the wrong decision on complaints referred to them by customers and they therefore made a change in favour of the consumer. In 2015 this rose to 27% but remained well below an industry average of 57%.

The FOS overturn rate increased in H1 2015 27% from the full year for 2014 rate of 8%. This was mainly because of increased volumes and overturn rates on Payment Protection Insurance related complaints. In turn, this was largely driven by a market wide change in approach at the Ombudsman to pre-existing medical conditions.

There is a notable time between a FOS decision and when the complaint was originally handled and therefore the improvements made in 2015 to complaint handling are not reflected in these figures.

Looking at our actual complaints numbers, our number of outstanding complaints fell from a peak of over 2,500 in March 2015 to under 1,000 by the end of the year. This was reflected in the number of complaints per 1,000 customers reducing to 1.08 (2014 - 1.50).

FOS overturn rate %

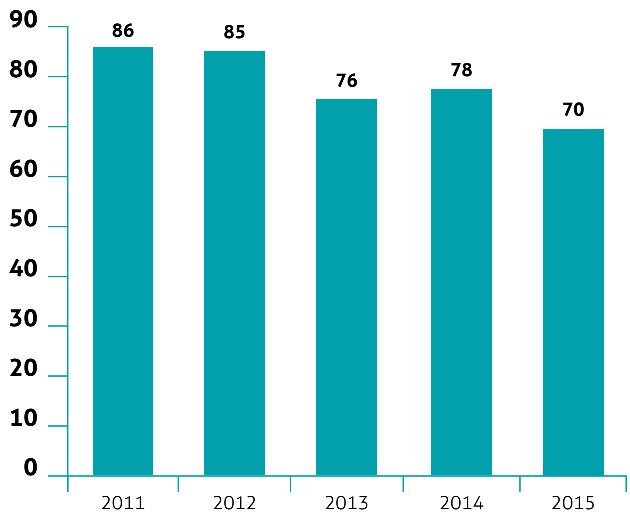


4.4 People Experience

Our people experience strategy is focused on ensuring we create a climate where people are engaged, committed and happy in their workplace. In 2015 our priority was to put the key building blocks in place such as ensuring our pension provision is fit for purpose, developing a career framework and improving our HR technology to equip our managers to lead well. As we make progress in these areas we are increasing the focus on items such as recognition practices, talent and leadership development and in time, will move to a more flexible approach to benefits.

We recognise that we are going through a considerable amount of change and we asked a lot from our colleagues in 2015 as we progressed our ambitious programmes . We therefore anticipated that there would be a negative impact on our Colleague Engagement Score (in particular from changes to the pension provision), which we measure annually through a survey.

Engagement %



Note: In 2013 we introduced a new employee engagement survey managed by an external provider which enabled improved external benchmarking

4. Review of 2015 continued...

“Raising the Roof is our new annual awards event where colleagues can nominate each other across seven categories.”

4. Review of 2015 continued...

4.4 People Experience continued...

Engagement levels[11] have fallen in 2015 partly due to the changes to the Group's Pension Schemes announced during the year as well as the Strategic Investment Programme, which is putting demand on our colleagues. However, with this level of engagement we are still in line with the financial services benchmark and the drop in engagement has not impacted on our absence levels but may have contributed to the increase in resignations.

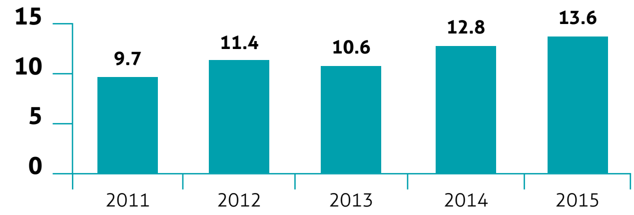
It is important to us that everyone who works for the YBS Group has access to a high quality pension and that all colleagues are supported in their retirement in the same way. This will now happen through a new Retirement Savings Plan, which is a defined contribution (DC) arrangement. This has resulted in the closure of the Defined Benefit Pension Scheme (DB), with around 500 long serving colleagues impacted by this change in benefits. This change has not been implemented as a way to save money at an overall level.

Instead, it will see a more equal distribution of the Group's pension contribution across the total population of pension scheme members. The amount previously invested in the defined benefit scheme has been re-directed to the higher number of colleagues in the defined contribution scheme (including those transferred from the DB scheme), with all active members of the new Retirement Savings Plan receiving a competitive employer pension contribution.

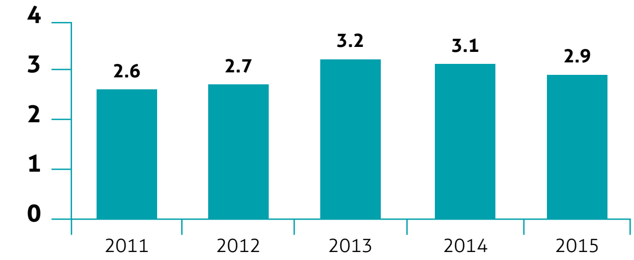
All our people were supported by a wide range of training and development opportunities and in 2015 the equivalent of over 30,000 training days were delivered either online or through attendance on courses.

It is important our colleagues' hard work is recognised and this year we launched two recognition schemes, which attracted over 850 nominations. Raising the Roof is our new annual awards event where colleagues can nominate each other across seven categories. We have also introduced an 'Everyday Thank You' mechanism on the intranet, and thousands have used this to express their appreciation for their colleagues.

Resignation %



Absenteeism %



In 2016 we will continue to develop an apprenticeship programme alongside other developmental opportunities to ensure we are cultivating talent for our future organisation. We will further enhance our approach to recognition as we know this is important to our people, and we will continue to put building blocks in place for a leading people experience.

Source: [11] ORC International

4. Review of 2015 continued...

4.5 Easy and Simple

A core element of the Strategic Investment Programme is to make things easier and simpler both for our customers and our people.

Looking at our investment programme, the following table shows our 2015 progress and 2016 plans for investment:

2015 DELIVERED

- Mortgage processing – further consolidation and redesign of policy and processes to enhance service and efficiency for direct and intermediary based borrowers.
- Further progress on the Single Multi-Brand Platform – successfully managed the Barnsley data migration.
- Group services – moved more activities into a "Shared Services" team for better service and efficiency.
- Continued delivery of web and mobile functionality including:
  - Greater use of social media (launched YBS Facebook, Twitter and Instagram);
  - Personalised website content;
  - Integrated mortgage cross-sales; and
  - Online branch appointment booking.
- Complaints systems – with further improvements to customer service and efficiency.
- Further progressed our Internal Ratings Based capital project, which will allow us to better utilise our available capital.
- New visual identity roll out completed.

2016 IN PROGRESS

- Further improving our mortgage systems, policies and processes – in particular in Accord including simplification of policy and more definitive decisions at agreement in principle (AIP) stage.
- Following completion of the Single Multi-Branded Platform migrating all Accord Mortgages and Chelsea Building Society customer data.
- Re-branding of Barnsley Building Society and Chelsea Building Society branches to Yorkshire Building Society.
- Enhance and expand our agency network.
- Delivering a new market leading arrears management system, meeting regulatory obligations and improving customer service.
- Deliver the ability to fund through securitisation transactions in multi-currencies.
- Continued investment in web and mobile.
- Further improvement of customer experience in a range of areas looking at targeted opportunities to remove effort and delays for customers.
- Review and improvement of the Accord product suite
- Working on data and analytics capability.
- Progress delivery of new HR technology to help all our people managers.
- Develop and grow the Group's social community, engaging with consumers and building greater brand awareness.

4. Review of 2015 continued...

4.5 Easy and Simple continued...

As part of the programme we also made improvements to lower level business processes, such as:

- A new online mortgage appointment booking service which enables customers to see the availability of Mortgage Advisors at their preferred branch location and directly book an appointment in the Advisor's diary. Similarly, customers requiring a telephone based appointment can schedule one at a time convenient to them – including evenings and weekends.
- Using a new system, the Chelsea Building Society and Accord websites can now deliver more relevant content to specific customer groups allowing customers to quickly find the correct information to help them make the right product decisions.
- A portable mortgage 'Approval in Principle', which means customers are now able to switch easily from the online channel into branch or telephone after receiving a quick online lending decision. This benefits those customers who initially need quick confirmation of the ability to borrow but then require advice on which mortgage product is right for them.
- New websites that are optimised for mobile and tablet devices, allowing people to interact with us in a modern way.

4.6 Locally Famous

£392,300 was donated to 1,502 different causes in 2015 by the Yorkshire Building Society Charitable Foundation.

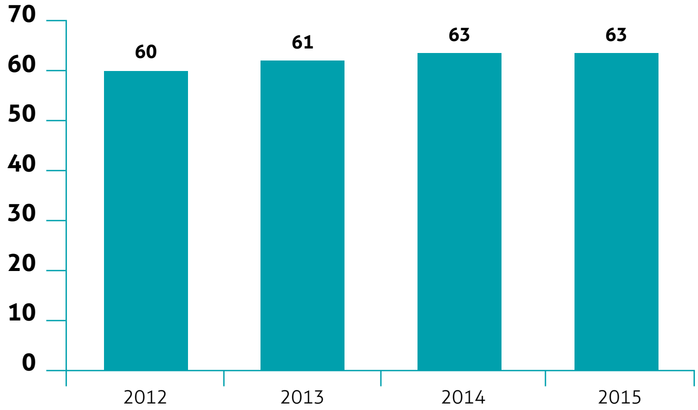
Over £800,000 was raised by colleagues and members for Marie Curie by the end of 2015.

In total, we contributed over 11,000 hours to local communities.

Being locally famous is about how we connect with the communities we serve through activities which are relevant and important to them and the work we do to support the environment.

In 2015 our brand awareness remained similar to the previous year at 63% and shows a slight increase over the last four years.

Brand awareness %



Note: In 2011, the survey was conducted in-house, therefore no comparative data is available.

Source: YouGov brand tracker

4. Review of 2015 continued...

"In 2015 we increased the time we give colleagues to take part in community activities from 14 to 31 hours."

4. Review of 2015 continued...

4.6 Locally Famous continued...

We support the local communities where our members live and work in many ways. Using our three pillar community framework we focus on charitable giving, charitable fundraising and employee volunteering.

Charitable Giving	Fundraising	Employee Volunteering
YBS Charitable Foundation	**Marie Curie 'Hour of Need' campaign**	**Skills-based and hands-on support**
■ Charitable Foundation donations ■ Charity Choices campaigns ■ Small Change Big Difference® scheme ■ Small Change Big Difference® donation month	■ Group-wide Fun Days ■ Group-wide Fundraising challenges ■ Calendar of other fundraising challenges and activities ■ AGM voting donations ■ Payroll giving ■ Affinity Accounts - various charities and clubs	■ Team challenges ■ Financial literacy sessions ■ Employability workshops ■ Workplace insight days ■ Elderly befriending ■ Mentoring ■ Trustee positions ■ Cause collections

Charitable Giving	Fundraising	Employee Volunteering
Through the Yorkshire Building Society Charitable Foundation £392,300 was donated to 1,502 different causes in 2015. The majority of this funding was provided by our members who participate in our Small Change, Big Difference® scheme.	Marie Curie was chosen by colleagues and members as our charity fundraising partner and we set ourselves a target of raising £500,000 between June 2014 and December 2016. The enthusiasm and commitment of our colleagues and members to this cause has been overwhelming and is demonstrated as we report that over £800,000 had been raised by the end of 2015. We have now increased our ambition to achieve £1m by the end of the partnership.	In 2015 we increased the time we give colleagues to take part in community activities from 14 to 31 hours. Over a third of our colleagues got involved, through a wide variety of different skills based and physical activities. In total we contributed over 11,000 hours to local communities and expect to increase this in 2016.

Environment
Throughout 2015 we have increased our focus on environmental management and sustainability programmes. As a result we have reduced our CO_2 emissions by 5%, recycled 100% of our paper waste and reduced our water consumption.

More details on all our community and environmental activities are detailed in the Corporate Responsibility Report on pages 36 - 39.

4. Review of 2015 continued...

4.7 Financial Sustainability

In 2015 the Group recorded another year of strong financial performance, with healthy profit underpinned by continued strong capital and liquidity positions.

The Board monitors the Group's performance on both a statutory profit and core operating profit basis. Statutory profit is defined by accounting regulations and provides a clear comparison between organisations. Core operating profit measures underlying performance by excluding non-core items, both positive and negative, such as timing differences that reverse over time (e.g. fair value adjustments) or items of a one-off nature (e.g. merger related transactions).

Statutory profit before tax for 2015 was £173m, (2014 - £188m). In a competitive market this is a strong performance and is above the level required for the Group to be a sustainable business. Our core operating profit was £185m (2014 - £179m).

Both measures are strong for 2015, continuing the successes of previous years.

£173M
Statutory profit before tax

£188m in 2014

£185M
Core operating profit

£179m in 2014

£m	2011	2012	2013	2014	2015
Net interest income	329	346	532	549	535
Fair value volatility	(10)	(12)	16	(11)	(7)
Net realised gains/(losses)	4	78	(42)	1	2
Other income	53	48	37	26	18
Total income	**376**	**460**	**543**	**565**	**548**
Management expenses	(210)	(250)	(300)	(331)	(346)
	166	**210**	**243**	**234**	**202**
Loan loss provisions	(30)	(39)	(23)	(20)	(13)
Other provisions	(3)	(13)	(21)	(26)	(16)
Statutory profit before tax	**133**	**158**	**199**	**188**	**173**

4. Review of 2015 continued...

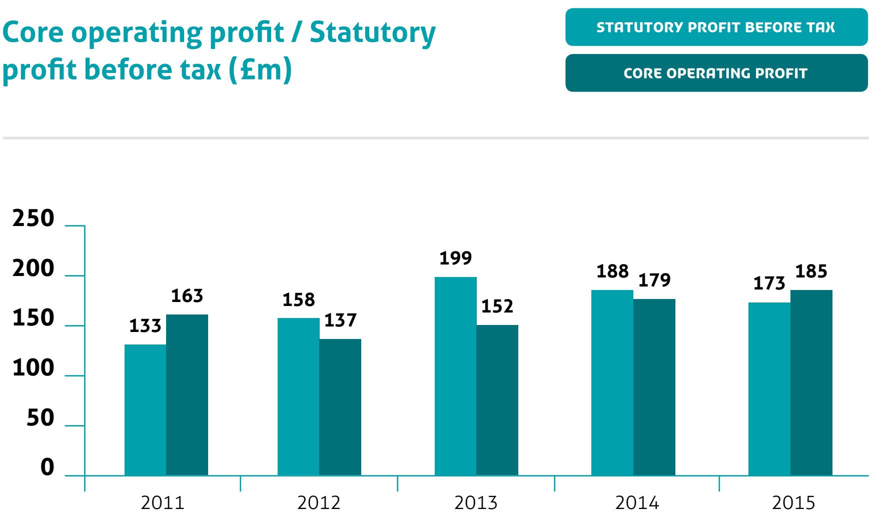
4.7 Financial Sustainability continued...

£m	2011	2012	2013	2014	2015
Statutory profit before tax	**133**	**158**	**199**	**188**	**173**
Add back:					
FSCS levy	3	5	12	12	11
Non-core investments	5	(1)	(14)	(11)	1
Timing differences - fair value volatility	5	13	(2)	22	6
Mergers - adjustments to balances acquired	-	6	(94)	(32)	(4)
Mergers and acquisitions - costs	20	16	2	-	-
Mergers - goodwill	(6)	-	-	-	-
Mortgage book disposal	-	-	13	-	-
Balance sheet structured debt buy back	-	(62)	30	-	-
Other non-core items	3	2	6	-	(2)
Core operating profit	**163**	**137**	**152**	**179**	**185**

The items referenced in the adjustments to show core operating profit include the following:

- Removal of the FSCS levy (£11m) which is our share of the overall cost of funding failed institutions through this scheme.
- Removal of fair value volatility (£6m) which reflects changes in market rates on some of our assets and liabilities. These are mostly timing differences which will reverse in time.
- Fair value adjustments made on merger for customers that had a beneficial rate compared to the prevailing market rate (£4m).

Core operating profit / Statutory profit before tax (£m)



4. Review of 2015 continued...

4.7 Financial Sustainability continued...

The key movements and trends within the Income Statement were as follows:

- Net interest income was £535m (2014 - £549m). At 1.41% (2014 - 1.52%) this income as a percentage of mean assets (Net Interest Margin) was down but this was expected and remained in line with our plan. This is a key measure used by the Board - in essence it reflects how an institution manages the income from its assets and the interest paid for its funding. The main factors impacting this through the year include:
  - The continued availability of relatively low-cost retail funding as savings rates have been impacted by a number of factors, including the record low Bank of England Bank Rate (unchanged since March 2009) and the continued impact of the Government's Funding for Lending Scheme (FLS).
  - Through 2015 we have maintained our savings rates and we are now paying an average of 0.19% more than the average in the market[12] (2014 – 0.26%). Whilst we aim to protect savers from the impact of low rates we must ensure we do not attract more money than we can safely and sensibly lend. Any surplus liquidity is held at the Bank of England at a rate much lower than the rates we pay our savers and so we need to manage our liquidity carefully.
  - The cost of raising funds in the wholesale markets remained low due to the continued availability of low cost, government-backed funding in both the UK and the Eurozone. As the availability of these schemes reduces then this may impact on broader wholesale funding costs in the market.
  - Some reduction in the margin on mortgages was experienced through a combination of factors;
    - The relatively low margins currently being experienced on new business due to the competitive environment.
    - A number of product maturities from historic products earning higher margins than current products earn.
    - Increased transfer / redemption activity from SVR customers as rates on new products in the market have become increasingly attractive.
  - Net new lending was £1.1bn for the whole of 2015 (2014 - £2.6bn), representing a net market share of 3.19%[13].
- Fair value volatility represents adjustments to the value of some of our assets and liabilities to reflect changes in underlying market rates. These are almost entirely timing differences which will reverse in future years as the assets and liabilities themselves mature. As such this figure could move materially year on year, and we aim to minimise its impact. In 2015 it was broadly stable reflecting a loss of £6m compared to an £11m loss in 2014. Both these results are within our range of expectations.
- Net realised gains were £2m in 2015, compared to 2014 which saw a net realised gain of £1m.
- Other income declined by £8m to £18m reflecting the ongoing fees payable under the FLS combined with lower underlying income from the sale of investment and insurance products which fell from £17.9m to £14.4m. In part, this fall was driven by the shift in business towards intermediary channels where we do not receive the benefit of any additional product sales.
- Management expenses increased by £15m (4.5%), driven by a combination of:
  - General inflationary pressures and growth in the size of the business.
  - The ongoing impact of increased and changing regulation..
  - Continued investment in our change programme. Whilst the Group made the same total investments as in 2014 (£65m in both years) a greater proportion of this was charged to the Income Statement in 2015 (£54m against £46m).

The investment programme is aimed at further enhancing our service and product delivery and we continue to believe that the level of investment in systems, networks, people and products is right for the Group and will deliver sustainable benefits for our customers and our people.

Source: [12] Average rates based on Savings stock from CACI's Current Account and Savings Database (CSDB), currently covering 85% of retail savings market (based on stock value). Data as at 31 October 2015.

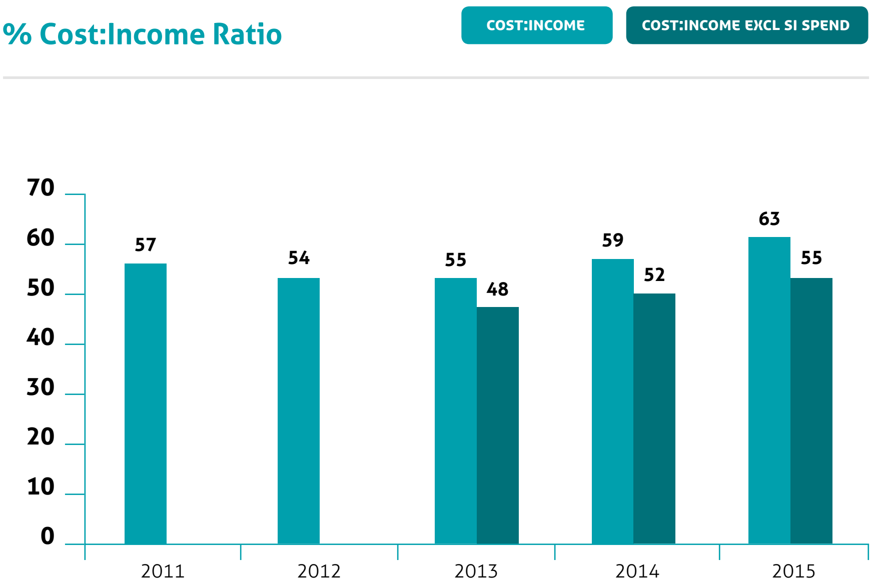
Source: [13] Bank of England, as at December 2015.

4. Review of 2015 continued...

4.7 Financial Sustainability continued...

A key measure used by the Group to manage its overall cost position is the cost:income ratio which looks at the relationship between income generation and our costs. The lower the ratio, the less an institution is spending to generate every pound of income. We have seen an increase in our cost:income ratio in line with our expectations and reflecting the Strategic Investment Programme. We are strongly focused on this area of our business. As we progress through our investment programme we expect to realise efficiencies which, when combined with ongoing cost management across the business, will result in an improving cost:income ratio. Excluding our strategic investment costs the cost:income ratio was 55% (2014 – 52%).

% Cost:Income Ratio



SI spend: the cost of implementing our Strategic Investment Programme

The charge made for impairment on our mortgage portfolios fell by £7m to £13m compared to £20m in 2014. This reflects our continued efforts to manage the quality of our loan portfolios and the improved economic and housing market conditions during the year. Charges for other provisions of £16m represent two main items:

- Provisions for customer redress / repossessed property reinstatement, which at £4m is at a lower level than 2014 (£11m). The 2015 charge mainly relates to:
  - The ongoing provision for claims against payment protection insurance
  - The provision for a potential remediation of a repossessed property whose grounds had, unknown to us, been used for waste disposal without a licence.
- The cost of the Financial Services Compensation Scheme whereby we, and other retail savings institutions, fund the wind down of a number of failed institutions. This charge remained stable at £11m in 2015 (2014 - £12m).

Overall we believe that these results represent a strong performance, especially as we are investing heavily in the future of the business.

4. Review of 2015 continued...

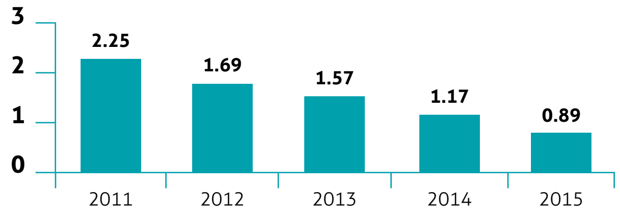
4.7 Financial Sustainability continued...

Group Balance Sheet

£bn	2011	2012	2013	2014	2015
Liquid Assets	4.9	5.2	4.4	4.8	4.4
Mortgage and other loans	27.0	27.6	29.5	32.2	33.3
Other Assets	0.7	0.7	0.6	0.6	0.5
Total assets	**32.6**	**33.5**	**34.5**	**37.6**	**38.2**
Retail Savings	26.0	26.8	26.3	27.2	27.4
Wholesale Funding	3.9	4.2	5.9	7.5	7.9
Other liabilities	0.7	0.8	0.4	0.6	0.5
	30.6	**31.8**	**32.6**	**35.3**	**35.8**
Remunerated Capital	0.4	0.1	0.1	0.3	0.3
Reserves	1.6	1.6	1.8	2.0	2.1
Total Liabilities	**32.6**	**33.5**	**34.5**	**37.6**	**38.2**

The quality of our mortgage portfolio is monitored by management and the Board on a monthly basis using a number of indicators. The most important indicator is the percentage of our outstanding retail mortgage balances in arrears by three months or more (including possessions). The proportion of loans (by value) in arrears by three months or more (including possessions) reduced from 1.17% in 2014 to 0.89% as at 31 December 2015.

3 Months Arrears %



The industry average for mortgage arrears is measured as the number of accounts more than three months in arrears (including possessions) – and at 0.96%, (2014 - 1.21%) our performance remains below the CML industry average of 1.20%[14] (2014 - 1.39%).

We have continued to participate in the wholesale funding markets in 2015, with a €750m seven year unsecured debt issuance, a €500m five year public issue and a €500m seven year issue.

Source: [14] Council of Mortgage Lenders, as at December 2015.

4. Review of 2015 continued...

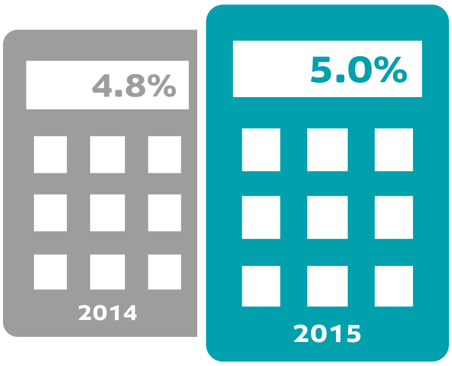
4.7 Financial Sustainability continued...

Sustainability

Whilst delivering further balance sheet growth we have improved the Group's already strong capital position. One key measure that the Board monitors on a monthly basis is the Common Equity Tier 1 (CET1) ratio which represents the strongest form of capital. For us it mainly reflects our accumulated profits built up over time. The ratio compares this to the Group's assets, weighted by the level of risk they carry.

As at 31 December 2015:

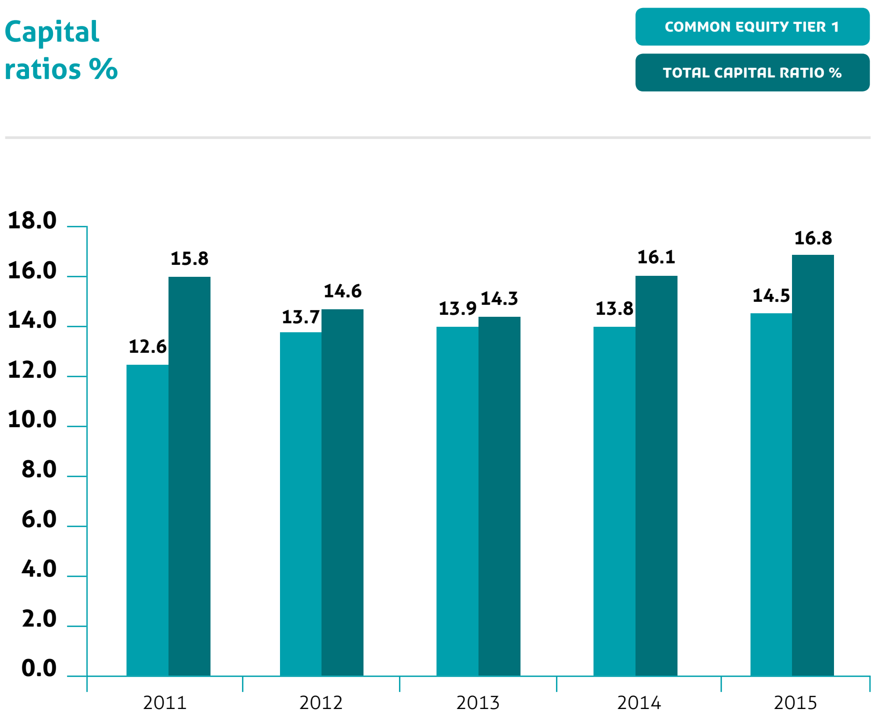
- Our Common Equity Tier 1 capital ratio was 14.5%, increasing from 13.8% at the end of 2014.
- Our Total Capital Ratio increased from 16.1% in 2014 to 16.8% in 2015.



LEVERAGE RATIO IS UP

At the end of 2015 our leverage ratio has increased to 5.0% (2014 - 4.8%).

Capital ratios %



Another measure of capital strength is the leverage ratio. Whilst this measure removes the risk weighting used in the CET1 ratio, it also adds in a measure of off-balance sheet exposures to the asset side of the equation, requiring capital to be held against features such as mortgage offers that have yet to complete.

At the end of 2015 our leverage ratio has increased to 5.0% (2014 – 4.8%). This does not become a mandatory measure for the Group until 2018 but we are already well above the likely minimum requirement of 3% and our leverage ratio compares favourably with most of our key competitors.

The views around financial performance of the Group were maintained by external rating agencies during 2015.

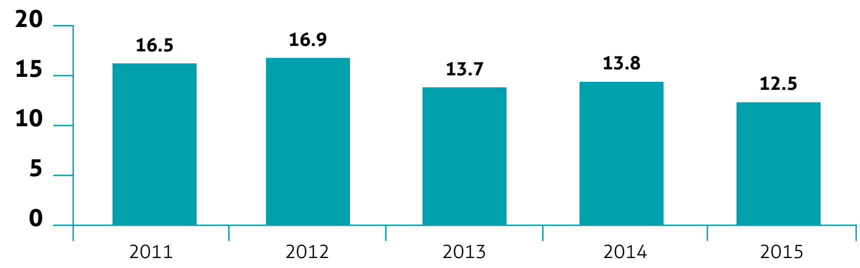
4. Review of 2015 continued...

4.7 Financial Sustainability continued...

One of the key measures that we are required to report to the Prudential Regulation Authority (PRA) is the liquidity ratio. This expresses the total cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets as a percentage of our shares and borrowings. It is inefficient to hold significantly more liquidity than is required as excess liquidity earns less than it costs to raise. For this reason the Group has managed its liquidity levels down in recent years (to optimise the cost of holding it) whilst continuing to maintain prudent levels of liquidity.

Throughout the year we remained comfortably above the liquidity thresholds set by the PRA (and by our own stress testing models) without holding excessive, expensive levels.

Liquidity %



5. Risks

The principal risks and uncertainties faced by the Group can be classified into three categories; macroeconomic risks, business model risks and risks relating to our investment programme. The Group has constructed its systems of monitoring and control around the risks identified below.

Details of our risk management infrastructure are included in the Risk Management Report on pages 61 - 62.

5.1 Macro-economic Risks

At the end of 2015 and the beginning of 2016, the principal macro-economic risk and uncertainties faced by the Group can be summarised as follows:

- UK economic growth has been broadly as expected in 2015, though there are signs of a modest slowdown in the second half of the year and more recent metrics following the end of the year are indicating that there are a range of broader economic concerns starting to appear. A slowdown in emerging markets is currently seen as the greatest risk to the UK economy. Disinflation has spread through economies around the world with many experiencing brief periods of negative inflation, including in the UK. As a result, central banks continue to push back the likely time for the monetary policy tightening cycle to begin. Current financial market pricing suggests that the first rate rise in the UK may not happen until 2017 or beyond.
- Continued international uncertainty, driven by the conflicts in Iraq, Syria and Ukraine, market volatility in Asian markets, falling oil prices, continuing difficulties in the European economy and the possibility of Britain leaving the EU.
- Whilst the Government's 2015 Autumn Statement suggested they would not aim to reduce the public sector deficit as fast as previously indicated, it still indicates a considerable squeeze on public spending. When coupled with the continued low interest rate environment, the future ability and appetite of customers to save poses a risk to the Group's funding strategy.
- The housing market has continued to post positive price movements due in part to initiatives to help first time buyers. BTL lending has increased strongly in 2015; however there is the potential for it to amplify a housing boom and bust. This has drawn close scrutiny from the Financial Policy Committee, and the Chancellor has announced a 3% stamp duty surcharge on BTL properties from April 2016, as well as changes to the tax rules on BTL mortgages. While this could pose a risk to the Group's plan for BTL lending it might, at the margin, improve access to the housing market for first time buyers.

5. Risks continued...

5.2 Business Model Risks

The principal risks inherent within the Group are:

Credit Risk	Market Risk	Conduct Risk
The risk that a borrower or counterparty fails to pay interest or to repay principal on a loan or other financial instrument (e.g. a bond) on time.	The risk that the value of, or the income derived from, the Group's assets and liabilities changes unfavourably due to movements in interest rates and foreign currency rates.	The risk that the Group fails to design and implement operational arrangements, products, systems and controls such that it can maintain legal and regulatory compliance, deliver fair customer outcomes and achieve a positive experience for customers.

Financial Risk	Operational Risk
The risk of the Group having inadequate earnings, cash flow or capital to meet current or future requirements and expectations. It includes loss or damage to the earnings capacity, market value or liquidity of the Group arising from mismatches between the Group's assets, funding and other commitments, which may be exposed by changes in market rates, market conditions or the Group's own credit profile.	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events such as cyber-attacks. Cyber risk is high on the Group's agenda and we have taken further precautions in the year to protect the Group and members from the threat of cyber-crime.

The Group's approach to managing and reporting risk is covered in the Risk Management Report on pages 60 - 62.

5.3 Investment Programme Risks

Following a full review of the investment programme we are confident in our ability to achieve our Plan – albeit this is taking longer than the original ambitious five year timescale set in 2012. In addition, the demand for IT and change resource within the financial services industry is intense, making availability of resources increasingly difficult.

The Board recognises that the successful management of risks and uncertainties in the delivery of this programme is key.

6. Viability and going concern statements

Provision C.2.2. of the Financial Reporting Council's *The UK Corporate Governance Code* requires the directors to explain how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.

The Group assesses the viability of its Corporate Plan by ensuring that the financial forecasts meet risk appetite limits in respect of capital generation, liquidity and other key metrics. An integral part of the planning process is to assess the Group's resilience to a range of adverse scenarios that may materialise and ensuring the Plan addresses any resulting vulnerabilities.

The Board has determined that a three year period of assessment is an appropriate period over which to provide its viability statement. This is the longest period over which the Board considers that it can form a reasonably firm view over the possible macroeconomic environment and associated key drivers of business performance.

The Board has carried out a robust assessment of the principal risks and uncertainties that would threaten the business model, future performance, solvency or liquidity of the Group. These risks are described in section 5 of this Strategic Report. The Group's risk management framework and governance structure are described in the Risk Management Report.

As part of the annual Group ICAAP (Internal Capital Adequacy Assessment Process) and ILAA (Internal Liquidity Adequacy Assessment), the Group stresses its capital and liquidity plans, respectively under "severe but plausible" stress test scenarios, in line with PRA requirements.

The ICAAP test ensures that the plan projections for capital requirements and capital generation are resilient to stresses should the environment deteriorate beyond the levels currently envisaged. The resulting potential erosion in the capital excess is held on the balance sheet as a capital planning buffer to ensure that the Group can continue to meet its minimum capital requirements at all times.

The ILAA test ensures that the Group holds adequate liquid assets in terms of the quality and quantity to meet both its business as usual liquidity needs, as well as any increased requirement that could occur as a result of the Group entering into a period of stress. Planned liquidity levels meet the Group's two key risk appetite measures over a period of three years.

Having assessed the Group's current capital and liquidity positions, and principal risks, the Board has a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the next three years.

As set out on page 84, the directors are required to consider whether it is appropriate to adopt the going concern basis in preparing these financial statements and identify any material uncertainties to the ability of the Group to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

In accordance with best practice, the Board undertakes regular rigorous assessments of whether the Group is a going concern in the light of current economic and market conditions. The metrics considered in the latest review, performed in February 2016, included:

- Sustainability – review of business performance against specific exposure limits and key risk indicators.
- Liquidity & Funding – review of projected future surplus liquidity against both regulatory and internal thresholds.
- Capital & Profitability – stress testing of the Group's capital plans.
- Enterprise Risk Management – review of the risk map identifying future events/conditions that could impact achievement of the Group's objectives.

As a result of this review the Board concluded that the Group has sufficient resources for at least the foreseeable future and that there are no material uncertainties that challenge the assessment that the Group's financial statements should be prepared on the going concern basis.

7. Outlook

LOOKING FORWARD TO 2016

Concerns over UK and global political instability continue to grow. In particular, the Prime Minister has announced that a referendum on the UK's membership of the EU will take place on 23 June 2016. There are many arguments for and against 'Brexit' and how it would impact on financial services. It is a major factor affecting the wider UK financial services industry with significant implications for regulation. The impact on large banks that base their European or international headquarters in the City will be greater than the impact on the Group; however, any resulting financial shocks from the process of negotiating any trade and wider arrangements with the EU could have a significant impact on the wider economy and affect confidence in the UK housing market. There is also a potential implication regarding the availability or cost of wholesale funding that could have a further impact on the financial sector over the period of uncertainty. All of these uncertainties continue to impact on financial markets, including those in which the Group raises wholesale funding.

The building society sector will be negatively impacted by the new banking surcharge announced in July and we firmly believe it will not assist in creating greater diversity in UK financial services. Reducing profit through the surcharge means that building societies cannot build their capital as quickly as other lenders. Unlike the Banks, retained profits are our primary source of capital. Ultimately this could impact our mortgage lending and future investment in the Group.

Changes in the rules around mortgages and the introduction of the new pension freedoms mean that more people than ever before are looking for, or are in need of, financial advice. The Financial Conduct Authority (FCA) and HM Treasury have launched a Financial Advice Market Review which will examine how financial advice could work better for consumers. The review is an opportunity to look at how the advice market is working and has the potential to radically change the landscape to the benefit of both financial services providers and customers.

Another possible change under review at EU level is to remuneration rules, which currently affects lower risk institutions as severely as those which pay more significant bonuses. This review is welcomed by the Group as the existing proposals result in significant deferral of bonuses as well as increased risk of future clawback and we believe this could result in lower availability of talent in the market and may also result in some individuals choosing to leave the financial services sector in time.

The changes to the regulatory requirements for capital are also likely to have an impact in the medium term. In particular there are two aspects that will have a broader impact on the Group:

- The latest Basel committee proposals for the revised standardised approaches and the extent to which lenders can benefit from internal models are likely to increase risk weighted assets for lenders. This will lead to a requirement to hold higher levels of capital. Whilst we are well placed in this regard it will put additional requirements in place.
- The European Banking Authority consultation on the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) will also likely have an impact in the medium term on capital and wholesale funding requirements across the industry. The requirement to hold either more capital or have access to debt that can be converted to capital will make the industry more resilient, but it will increase costs of funding and capital as a result.

As political and regulatory changes continue and the competition for mortgages and savings intensifies, we do not see trading conditions improving in the medium-term. In particular a continuation of aggressive pricing for mortgages, combined with further increases in product transfers and redemptions, is likely to put some downward pressure on savings rates and income levels. Our growth ambitions have been moderated to take into account these market dynamics and to allow the Group to concentrate on delivery of the investment programme.

Overall, the Board believes that 2015 was a good year of progress and performance for the Group. We believe that 2016 will be a more difficult year and will present new challenges, but also new opportunities, and that the Group is well positioned for both.

Robin Churchouse, Finance Director

24 February 2016

Corporate Responsibility Report

SOCIETY MATTERS

At YBS Group we're committed to helping create a better society, supporting the issues that are important to our members and people.

Our new Corporate Responsibility programme, which was launched at the end of 2015, is called Society Matters and focuses on four key areas;

- **Yorkshire Building Society Charitable Foundation**
- **Charity Fundraising for Marie Curie**
- **Employee volunteering and supporting local communities**
- **Supporting the environment**

Through these activities the Group contributed the equivalent of £2,430,000 to society, with the Charitable Foundation donating a further £392,300.

We won three awards for our community work in 2015, including the Third Sector Business Charity Awards – Challenge Event and Yorkshire Business Masters Awards – Pride/CSR.

Yorkshire Building Society Charitable Foundation

Yorkshire Building Society Charitable Foundation is a registered charity and is independent of the Group. It focuses on making small financial donations to many different causes with an average donation of £261 in 2015. Since the Foundation was set up in 1999 it has donated over £6m.

In 2015, Charitable Foundation gave £392,300 in 1,502 separate donations to charities and community groups.

YORKSHIRE BUILDING SOCIETY CHARITABLE FOUNDATION

Funding the Charitable Foundation

The Group makes a significant financial contribution to the Charitable Foundation each year, as well as providing administrative support.

However the majority of the Charitable Foundation's funding is from the 756,010 accounts which are part of the Small Change, Big Difference® (SCBD)* scheme. These members donate the pence from the interest on their mortgage and savings accounts directly to the Charitable Foundation.

756,010 members' accounts are part of the SCBD scheme which generated £346,500 for charities and good causes in 2015.

As it's our members who largely fund the Charitable Foundation, the Trustees give priority to causes that they care about. In 2015, 9 out of 10 donations were given to charities and good causes recommended by our members and colleagues.

89% of Charitable Foundation donations were to causes nominated by the Group's members and colleagues.

Following severe flooding in December 2015, the Charitable Foundation made a £25,000 donation to the Community Flood Appeals in Bradford, Calderdale, Cumbria, Leeds and York[15].

Fundraising for Marie Curie

In June 2014 we launched our Hour of Need campaign with this fantastic charity, with the aim of raising £500,000 by December 2016. This would equate to funding an hour of care by Marie Curie nurses for every hour of our fundraising campaign, helping more people with terminal illness spend their final days in the comfort of their home.

Since then colleagues, members and the general public have completely overwhelmed us with their support and we are delighted to have already exceeded this target, a year early.

Raised £824,000 for Marie Curie (£613,000 during 2015), which will provide 41,200 hours of additional nursing care in local communities.

This was achieved through a variety of activities across the Group, with every one of our branches and head office teams contributing to this fundraising success, and a hugely popular Marie Curie Savings Bond which was launched in November 2015 and sold out in less than two weeks.

Colleagues contributed over 2,909 hours of volunteering time to support Marie Curie.

[15] 80% of flood donations were paid in January 2016.

* Small Change Big Difference® is a registered trademark of Yorkshire Building Society.

Corporate Responsibility Report continued...

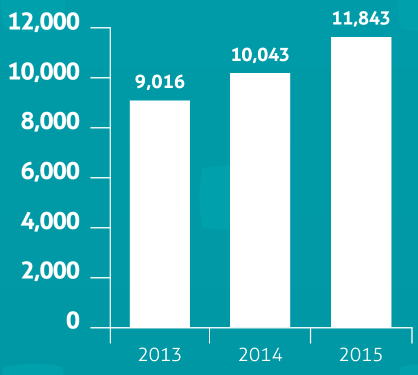
Supporting communities by volunteering our time and skills

We know that time can be just as valuable as money to charities and community groups. That's why our volunteering scheme gives our employees the time to support projects and charities in their local community.

Every employee has 31 hours paid leave to take part in voluntary or charitable activities each year.

From student mentoring to redecorating community centres, we encourage our colleagues to donate their time and skills to activities that they care about within their local community. In 2015 we launched a number of new volunteering programmes with key partners, including Silver Line, Be a Trustee and SGOSS (Governors for Schools), to provide new volunteering opportunities for our people. We were delighted that over 11,000 hours were donated to communities across the UK, our highest ever volunteering hours.

Volunteering hours



Our volunteering not only benefits the local communities, it also helps to support our People Experience ambitions. After carrying out volunteering activities, 85% of colleagues felt their teamwork skills had improved and over 60% said their communication skills had been enhanced and that they felt greater pride in working for the Group.

Over 35% of colleagues volunteered their time and skills in their community last year.

Initiatives to support the environment

We remain committed to delivering initiatives that help to mitigate our environmental impact and help us to reduce our waste and energy usage.

Throughout 2015 we continued to strengthen our environmental management and sustainability programmes and reviewed our energy and environmental policies to ensure we reduce energy consumption and environmental impacts.

Our investment in branch refurbishments enabled us to make significant positive environmental changes. We have been installing energy efficient heating, ventilation and air conditioning systems, LED lighting, low water use fittings and advanced control systems which ensure we don't use energy when our branches are unoccupied.

20% reduction in water usage across our branch network as a result of the refurbishment programme.

Our energy efficiency programme led to a 5% drop in $CO2$ emissions associated with our electricity and gas consumption.

In 2014 we installed more than 1300 solar panels to our offices in Bradford and Peterborough; these have already generated 300,000 kWh of electricity, and reduced our overall energy consumption by around 2%.

Received almost £30,000 in payment for the energy we have generated from our solar panels.

Waste

Mindful that reducing waste not only helps the environment, but also our costs, we have introduced a number of initiatives aimed at reducing the resources we use as well as providing more opportunities to recycle. In our office sites we increased waste recovery and recycling by 55% and in our branches almost 90% of our general waste is recovered or recycled.

100% of all paper waste is recycled across the Group.

Sustainable Travel Choices

Whilst colleague travel is necessary for our business, we actively encourage and support our people to consider responsible travel choices.

Over 650 colleagues participate in our Liftshare and Cycle to Work schemes and we have negotiated a discount on local public transport in our West Yorkshire heartland where we employ the greatest number of people.

We have also considerably reduced business travel by investing in video and teleconferencing services, with colleagues in over 4,000 meetings joining video conferences during 2015.

Non-Executive Directors

John Heaps, LLB
Chairman

John Heaps was appointed Chairman of the Society on 21 April 2015 having joined the Board in November 2014 as a non-executive director and Chairman Designate. He also chairs the Board Governance and Nominations Committee.

John is a lawyer by training and the former chairman of corporate law firm Eversheds, from where he retired in April 2015, having served on its Board since 2008 and before that its Senior Management Team since 1999. During his time as chairman of Eversheds he was ultimately responsible for the firm's compliance with the legal sector's regulatory regime. John contributed significantly to the development of the firm's long-term strategy and helped drive considerable change as it grew from a group of affiliated UK offices into a major international law firm.

John is a member of the Business and Oversight Board of the Law Society, serves on the Risk and Audit and Constitutional Committees of the International Bar Association and is a Trustee of the Garden Bridge Trust, a project to build a new Thames crossing between Blackfriars and Waterloo.

Dame Kate Barker, DBE, CBE
Independent Non-executive Director

Dame Kate Barker joined the Board in November 2010 and is a member of the Group Risk Committee, the Remuneration Committee and the Board Governance and Nominations Committee. She is also a Trustee of the Society's pension scheme.

Kate was previously on the Board of the Society and stepped down when she became a member of the Bank of England's Monetary Policy Committee (MPC) in 2001 until May 2010. Prior to her appointment to the MPC she was Chief Economic Adviser to the CBI.

Kate also has a background in housing and is the author of major government policy reviews on housing supply and planning. In 2006 she was awarded a CBE for services to social housing and was appointed a Dame in June 2014 for services to the economy. She is a non-executive director of Electra Private Equity Plc and Taylor Wimpey plc and Chair of the British Coal Staff Superannuation Scheme.

Non-Executive Directors

Alison Hutchinson, BSc
Independent Non-executive Director

Alison Hutchinson joined the Board on 4 February 2015 and is a member of the Audit Committee and Remuneration Committee.

Alison has a strong background in both the IT and financial services sector having started her career at IBM where she became Global Director of Online Financial Services. In 2000 she joined Barclays Bank where she held a number of senior management positions including head of its B2B online business and Marketing Director of Barclaycard. Her retail financial services experience was further extended in 2004 when she moved to the specialist mortgage provider, Kensington Group where she was Managing Director and then Group Chief Executive, leading the successful sale to Investec in 2008.

Alison is currently the CEO of the charity, The Pennies Foundation. She is also a Trustee of the Charities Aid Foundation and a non-executive director of Aviva Life Holdings Ltd.

Gordon Ireland, BSc, FCA
Independent Non-executive Director

Gordon Ireland joined the Board on 1 September 2015 and is a member of the Group Risk Committee.

Gordon is a chartered accountant and spent 36 years working for PwC and its predecessor firms, including 24 years as partner. At PwC he specialised in the financial services sector, auditing many of the UK's leading insurance companies, as well as acting as an audit and review partner for major businesses across the sector.

He was elected as a member of PwC's UK supervisory board on which he served for more than nine years, including three as vice chairman. He also served as chairman for three years on PwC's partner admissions panel and its senior management remuneration committee. Gordon also represented PwC on a number of external technical advisory groups at UK and European level. Following his retirement from PwC in 2010 until June 2015 he was Chief Executive of a professional indemnity captive insurer of PwC's network.

Gordon is a non-executive director of Aspen Insurance Holdings Ltd where he is Chairman of the Audit Committee and a member of the Risk Committee and is a non-executive director of Iccaria Insurance ICC Ltd.

Non-Executive Directors

David Paige, BSc, FCA
Independent Non-executive Director

David Paige joined the Board in 2006 and is Chair of the Group Risk Committee and a member of the Audit Committee. He is also Chairman of the Society's pension scheme.

David is a chartered accountant and has considerable experience within the financial services industry on the risk, financial and audit sides. He was a partner at Coopers & Lybrand in their financial services division before moving into senior executive positions with NatWest Bank Plc, Zurich Financial Services, Aviva Plc and Royal & Sun Alliance Insurance Group Plc where he was Executive Director (Risk).

David is a non-executive director of Willis Ltd and the IFG Group Plc.

Guy Parsons, BA
Independent Non-executive Director

Guy Parsons joined the Board in May 2013 and is Chair of the Remuneration Committee. Guy has more than 25 years' experience of director-level roles in the leisure and hospitality industry. This includes director of Accor UK, a subsidiary of Accor SA, where he was responsible for Sales, Marketing and Operations for Novotel UK and director positions at Whitbread Plc where he was Marketing Director for Travel Inn, Sales & Marketing Director of the Whitbread Hotel Company and Managing Director for TGI Fridays. In 2004 he joined Travelodge where he eventually became Chief Executive in 2010, leading the successful growth of the business to over 500 hotels in the UK, Ireland and Spain. Guy has held a number of non-executive positions and is currently Chief Executive of easyHotel Plc.

Mark Pain, BSc, FCA
Independent Non-executive Director & Vice Chairman

Mark Pain joined the Board in August 2013 and was appointed Vice Chairman and Senior Independent Director of the Society on 1 November 2015. He is also Chair of the Audit Committee and a member of the Group Risk Committee and the Board Governance and Nominations Committee.

Mark has 18 years' experience at director-level roles within FTSE 100 companies across the financial services and residential properties sectors. He spent 16 years with the Abbey National Group, including seven years as Group Finance Director, Chief Executive of Abbey National Treasury Services, and Customer Sales Director. In 2006 he was then appointed Group Finance Director at Barratt Developments Plc where he worked until 2009.

Mark holds a number of other directorships; he is a non-executive director of Aviva Insurance Ltd and Ladbrokes Plc, the Senior Independent Director at Johnston Press Plc and Chairman of London Square Developments Ltd.

Executive Directors

Chris Pilling, MA
Chief Executive

Chris Pilling joined the Society on 31 December 2011. He has a wealth of experience in delivering exceptional customer service both within the financial services sector and elsewhere. Prior to joining the Society, Chris was with HSBC Bank Plc for six years, most recently as Head of Branch Network. His previous roles with HSBC also included Chief Executive of First Direct, which is its telephone and internet-based retail bank. Prior to HSBC, Chris held a variety of senior roles in various sectors including Marketing and Customer Services Director at ASDA.

Chris is also a non-executive director of The Department of Health and Vice Chairman of the Building Societies Association.

Andy Caton, BA
Chief Corporate Affairs & Treasury Officer & Executive Director

Andy Caton joined the Society in 1991 as an economist and was appointed to the Executive Management team in 1998. In 2004 he was appointed Corporate Development Director and is responsible for the Treasury, Corporate Affairs and Asset and Liability functions.

Andy is a trustee of Yorkshire Building Society Charitable Foundation. He is President of the Bradford Chamber of Commerce and a director of West & North Yorkshire Chambers of Commerce and Industry.

Executive Directors

Robin Churchouse, MA, ACA
Finance Director

Robin Churchouse joined the Society in 2004 as Head of Finance. He was promoted to the Executive Management team in June 2006 and was appointed Finance Director in June 2010. In January 2014 he took on additional responsibility for the Property and Shared Services function, and in late 2015, he also took over from a retired director of the customer service, and collections and arrears functions until their functions were transferred to the new role of Chief Operating Officer & Executive Director in February 2016. Robin has responsibility for the Corporate Strategy and Planning, Finance, and Capital Management functions.

Before joining the Society, Robin gained a wide range of experience across a number of financial services organisations, including roles in finance, planning and strategy, management consultancy, corporate finance, risk management and prudential regulation.

Mike Regnier, MEng, MBA
Chief Customer Officer & Executive Director

Mike Regnier joined the Society on 3 June 2014. Previously, he was with Lloyds Banking Group where he held a number of senior positions, including Personal Current Accounts & Credit Cards Director and most recently as the Products and Marketing Director for TSB where he was responsible for the re-launch of the TSB brand on the UK high street in 2013. Prior to Lloyds Banking Group, he held management positions at ASDA and the Boston Consulting Group.

Mike is responsible for the Group's branch network, product development, marketing, customer experience and the customer relations functions. He is also a director of Accord Mortgages Ltd, the Society's intermediary lending subsidiary.

Stephen White, BComm
Chief Operating Officer & Executive Director

Stephen White joined the Society on 24 February 2016 as Chief Operating Officer and has responsibility for the Group's Operations functions including lending and customer services, arrears and collections, property and procurement. On the retirement of the Chief Information & Change Officer in May 2016 he will also have responsibility for the Group's IT, Information Security and Change Management functions.

Stephen has 20 years' experience in financial services, most recently as Group Chief Operating Officer at Allied Irish Bank. His previous roles have included Executive General Manager at National Australia Bank and management roles at Ernst &Young, Royal Bank of Scotland and Abbey National where he started his career as a branch manager.

Other Chief Officers

Jane Hanson, BA, MBA, MCIPD
Chief People Officer

Jane Hanson joined the Society in March 2013 to lead the Human Resources (HR) and Internal Communications functions. Jane has extensive experience within HR and financial services, having worked with Alliance & Leicester, HSBC and First Direct - who regularly featured in the Sunday Times 'Top 100 Employers' list under her tenure as Head of HR.

Richard Wells, FCIB
Chief Risk Officer

Richard Wells joined the Society in 2010 originally as General Manager, Risk. He is responsible for ensuring that appropriate procedures and capability exists within the Group for the management of all of the risks that it has planned to take or that it encounters. Richard has extensive experience of risk management within the financial services industry including senior risk management roles at a number of the UK's major banks and building societies. He is also responsible for the legal and secretarial function.

David Henderson, BSc
Chief Information & Change Officer

David Henderson joined the Society in 2007 as Chief Information Officer and now has responsibility for the Group's IT, Information Security and Change Management functions. David is leading our business transformation programmes as part of our strategic plans to invest substantially in improved business processes and technology. David started his career in the building society sector, and prior to joining the Society held a range of senior IT positions within a major UK banking group. David is due to retire in May 2016.

Directors' Report

The directors have pleasure in presenting their Annual Report, together with the Group Accounts and Annual Business Statement, for the year ended 31 December 2015.

Business objectives and activities

The Group's vision is 'to be the most trusted provider of financial services in the UK'.

Further information on the Group's vision and strategy is given in the Strategic Report on pages 12 to 35.

Principal risks, uncertainties and going concern

The principal risks and uncertainties faced by the Group are set out in the Strategic Report on pages 31 to 32 and our approach to managing them is set out in the Risk Management Report on pages 60 to 62.

As set out on page 84, the directors are required to consider whether it is appropriate to adopt the going concern basis in preparing these financial statements and identify any material uncertainties to the ability of the Group to continue to do so over a period of at least 12 months from the date of approval of the financial statements. A summary of this assessment is set out in the Strategic Report on page 33.

One key tool for mitigating risk is the requirement for all institutions to hold minimum levels of capital. In this regard, the Group uses the standardised approach under the Capital Requirements Directive (CRD IV) and holds well in excess of its regulatory requirement. The Pillar 3 disclosures required under CRD IV are published on the Society's website.

Another key tool is the requirement to hold a sufficient level of high quality liquid assets to meet cash flow demand under potential stress scenarios. The Group holds such liquidity in line with our risk appetite which ensures we are consistently well above the regulatory requirement.

Disclosure requirements under CRD IV country-by-country reporting

In compliance with the Regulations of Article 89 of the Capital Requirements Directive IV (CRD IV) country-by-country reporting (CBCR) we disclose the following information:

a) Name, nature of activities and geographical location

Yorkshire Building Society is the parent company and a list of the subsidiaries can be found in Note 10 of these accounts. The principal activities of the Group can be found in the Strategic Report and in Note 12.

All Group companies operate in the United Kingdom only.

b) Average number of employees

The average number of employees is disclosed in Note 7.

c) Annual Turnover

Net operating income is set out in the Group Income Statement.

d) Pre-tax profit or loss

Pre-tax profit is set out in the Group Income Statement.

e) Corporation tax paid

Corporation tax paid is set out in the Group Statement of Cash Flows.

f) Public subsidies received

No public subsidies were received in 2015.

Business review and future developments

Key developments and the future outlook are reviewed by the Chairman on pages 4 to 7 and in the Strategic Report on pages 34 to 35. The Strategic Report identifies and explains the Group's Key Performance Indicators and sets out how the Group has performed against each during 2015.

Profit and capital

Profit before tax for the year was £173.3m (2014 – £188.2m) and after tax the amount transferred to Group general reserves was £138.5m (2014 – £147.4m).

Total Group reserves at 31 December 2015 were £2,104.9m (2014 – £1,960.3m). Details of reserves movements are given in the Statements of Changes in Members' Interest on page 93.

Gross capital at 31 December 2015 was £2,397.7m (2014 – £2,266.7m) including £286.1m (2014 – £299.5m) of subordinated liabilities and £6.7m (2014 – £6.9m) of subscribed capital. Expressed as a ratio of shares and deposits gross capital was 6.78% (2014 – 6.52%) and free capital was 6.33% (2014 – 6.05%). These ratios are explained on page 165.

Further information about the Group's capital strength is outlined in the Strategic Report on pages 30 to 31.

Directors' Report continued...

Mortgage arrears

Details of the Group's mortgage accounts which were 12 months or more in arrears at 31 December 2015 are as follows:

	2015	2014	**2015** % of mortgage accounts/balances	2014
Number of accounts	**259**	395	**0.10**	0.15
Balances outstanding on accounts	**£37.1m**	£56.8m	**0.11**	0.18
Amount of arrears included in balances	**£4.9m**	£6.7m	**0.01**	0.02

Further details of the Group's arrears position and the various provisions made against potential losses are set out in the Strategic Report on pages 28 to 29.

Note 39 on page 155 describes the various forbearance measures offered by the Group to borrowers experiencing difficulties in meeting their repayments.

Colleagues

Our colleagues are key to our vision of building trust, and they bring this to life every day through their interactions with our customers. We place significant emphasis on our colleagues' experience and we are working hard to develop a great working environment and culture that allows people to be at their best.

The organisation is changing as we modernise and ensure we are able to deliver a sustainable future for YBS Group and our customers, and this has presented a challenge to the day to day experience for our people. We have seen our colleague engagement score reduce to 70% (from 78% in 2014) which, whilst still in line with the financial services industry benchmark, is not as strong as we want it to be.

We are actively developing our people policies and practices, ensuring colleagues feel valued and recognised, are able to grow and develop and have a voice that is listened to. All diverse perspectives through our colleagues and applicants to YBS Group are valued, as detailed in our equal opportunities policy.

Directors

The names of the directors of the Society who served during the year and their roles and membership of Board committees are described in the Corporate Governance Report on page 56.

At the 2016 Annual General Meeting (AGM), Gordon Ireland, Non-executive Director, and Stephen White, Chief Operating Office and Executive Director, will be put forward for election by members. At the same meeting all other existing directors will be put forward for re-election. Biographical details of all directors are set out on pages 40 to 45.

None of the directors had an interest in, or share of, any associated body of the Society at any time during the financial year.

The directors in office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Group's auditor is unaware.

Auditor

The reappointment of Deloitte LLP as auditor is to be proposed at the AGM.

On behalf of the Board

John Heaps
Chairman
24 February 2016

Corporate Governance Report

CHAIRMAN'S STATEMENT

Dear Member,

This is my first Corporate Governance Report to you since my appointment as Chairman of your Board on 21 April 2015 following the retirement of Ed Anderson.
As your Chairman, one of my responsibilities is to ensure that the Society maintains high standards of corporate governance. Good corporate governance, which provides a framework for the way in which the Board (and the rest of Yorkshire Building Society) operates, is also vital in providing effective leadership and in assisting the Society to continue as a successful organisation run for the benefit of its current and future members in a legal, ethical and transparent manner.

As stated in previous Corporate Governance Reports, the Board's approach to corporate governance is influenced by the following considerations:

- That the Board is accountable to the Society's members for the conduct and performance of the business.
- That the interests of members are at the heart of the Board's decision making.
- That the interests of other parties, including all our customers, colleagues and the communities in which we operate, are also taken into account.
- That the Society should be managed in a prudent and effective manner with effective decision making and robust management of the risks that the Society may face.
- That the effectiveness of the Board is vital to the financial strength and future success of the Group.

This approach is based on the principles and provisions of the UK Corporate Governance Code published by the Financial Reporting Council (the FRC) in September 2014 (the Code) to the extent that they are relevant to a building society. A copy of the Code is available at www.frc.org.uk. In the interest of transparency, the Financial Conduct Authority (the FCA) and the Prudential Regulatory Authority (the PRA) also encourage each building society to explain in its Annual Report and Accounts whether, and to what extent, it adheres to the Code.

Governance has also been the focus of our Regulators and, in particular, the accountability of senior managers within the banking and building society sectors. This has resulted in a new Accountability Regime which takes effect on 7 March 2016. This new regime comprises of three components: the Senior Managers' Regime which includes the allocation of functions and responsibilities to executive and certain non-executive directors and other senior management, the introduction of a new Certified Regime for relevant colleagues (requiring us to certify them as 'fit and proper') and the introduction of revised Conduct Rules. A substantial amount of work has been undertaken to ensure that we are prepared for the implementation of this regime in March. This includes making it more personal to the Group by positioning it as 'our Trust Code' which complements our vision to be the most trusted provider of financial services in the UK. This new regime does pose some challenges for the Board and our colleagues within the Group in its implementation, though we welcome the greater clarity that it brings around individual accountability and ensuring that the customer remains at the heart of everything that we do.

During 2015 the Society complied with the Building Societies Association guidance on the Code. This Report sets out below how the Board has operated in 2015 and applied the Code provisions using the Code section headings.

John Heaps
Chairman
24 February 2016

Corporate Governance Report continued...

THE UK CORPORATE GOVERNANCE CODE

Section A of the code: Leadership

The role of the Board

The Group is headed by the Board which is accountable to the members of the Society and whose principal role is to:

- Be collectively responsible for the success, including the long-term success, of the Group and for acting in the best interest of the Society and its members as a whole (both current and future). The Board may also consider the interests of other customers, colleagues, suppliers and the wider community.
- Have responsibility for the overall management of the Group within a framework of risk management which supports and directs financial security, fair outcomes and a Group built on trust.
- Establish a sustainable business model and set the strategy of the Group consistent with that model.
- Develop the culture of the Group and set a 'tone from the top' to ensure that the desired values and behaviours are Board-led.
- Have oversight of the Group's operations ensuring the following are in place:
  - Competent and prudent management
  - Sound planning and risk management
  - Adequate systems of internal control
  - Adequate accounting and other records
  - Compliance with statutory and regulatory obligations
  - Adequate financial resources
  - The fair treatment of all customers
  - Appropriate risk aligned remuneration systems.
- Review performance of the Group in the light of the strategy and Corporate Plan and ensures that any necessary corrective action is taken. An essential part of this is the review of the Board management information.
- Retain specific matters for approval.

Reserved matters to the Board

As referred to above, the Board maintains a schedule of reserved matters (which is reviewed at least annually) in order to ensure that it exercises control over the business of the Group. These include the approval of:

- The Annual Report & Accounts and the Interim Financial Results.
- The strategic aims of the Group, including mergers and other acquisitions and disposals.
- The Corporate Plan.
- Certain policies (including the Commercial and Retail Lending Policy and Vulnerable Customer Policy).
- The Group's risk appetite.
- Other matters which must be approved by the Board under legislation and the Society's Rules.
- The appointment of Directors and Chief Officers.

The Board delegates implementation of the strategy and the 'day to day' management of the Group to the senior executive team which is led by the Chief Executive. It delegates certain other responsibilities to Board committees which are documented in the committees' terms of reference.

A copy of the Board's terms of reference and schedule of reserved matters is available on request from the Group Secretary or can be found on the Society's website at www.ybs.co.uk/board.

Board committees

As referred to above, certain matters are referred to Board committees in order that they can be considered in more detail by those directors with the most relevant skills and expertise. The committees are:

- Audit Committee – details are contained in the Audit Committee Report on pages 57 to 59.
- Board Governance and Nominations Committee – details are contained under the heading of Section B of this report.
- Group Risk Committee – details are contained in the Risk Management Report on pages 61 to 62.
- Remuneration Committee – details are contained in the Directors' Remuneration Report on pages 82 to 83.

In addition to the above committees, there is a Chairman's Committee which is made up of the Chairman, Vice Chairman and the Chief Executive. Other directors may be co-opted onto the committee, as agreed by the Board, to consider specific matters. The committee's main function is to consider any matter which the Board has specifically delegated to it.

Members of these committees are set out in the table on page 56. Changes to the membership of the Audit, Group Risk and Remuneration committees during 2015 are set out in the reports referred to above. The terms of reference of the committees are available on

Corporate Governance Report continued...

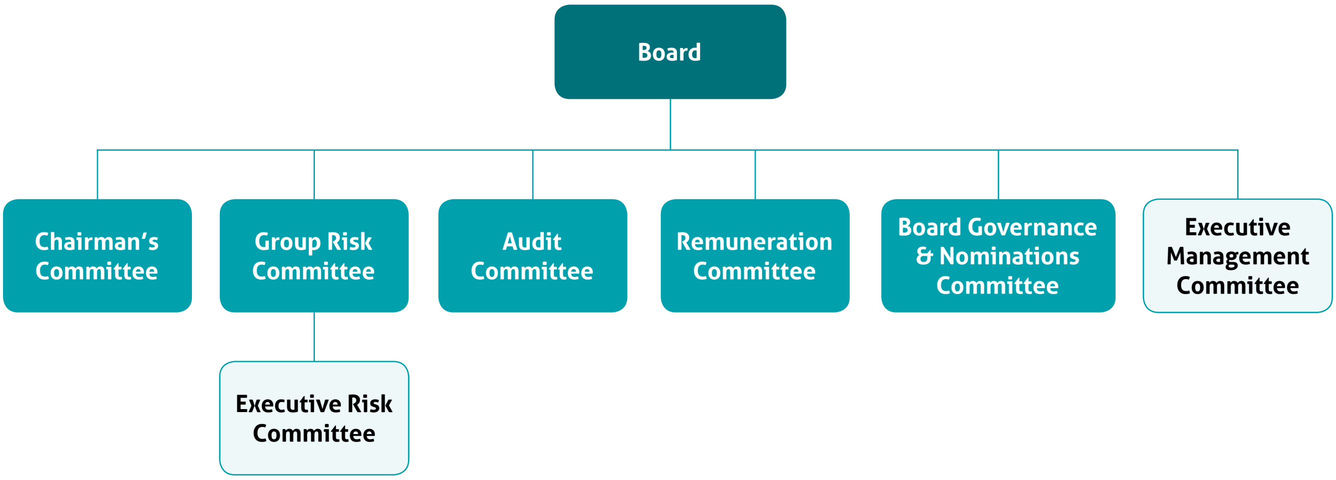
The UK Corporate Governance Code continued...

request from the Group Secretary or on the Society's website at www.ybs.co.uk/committees. The chair of each committee reports to the subsequent Board meeting on the matters discussed at each committee meeting. The minutes of each committee meeting are circulated to all directors.

The Board and executive committee structure is set out below.

In addition there is a suite of sub-committees that report into the Executive Management and Executive Risk Committees.

Board and Executive committees



Key:

- Board and Board sub-committees
- Executive committees

Board meetings

The Board held 10 meetings in 2015. The attendance record of each director at these meetings and at relevant Board committee meetings is set out on page 56. To provide focus on the development of strategy, twice a year (in June and September) the Board has specific strategy sessions outside of the usual Board meetings. The Board generally meets in West Yorkshire but at least one meeting each year is held in a location outside of West Yorkshire where the Group has an administrative centre. In October 2015 the meeting was held at the administrative office in Peterborough.

Board agenda items

At each Board meeting, the Board receives a comprehensive management information pack covering financial and non-financial information (including customer service and people metrics) with risk being an integral part of each reporting item. It also covers the external and competitive environment. Where appropriate the relevant executive director or chief officer provides an oral update to the Board on the performance of particular aspects of the business targets and highlights any emerging issues. In addition, the agenda includes the following:

- Minutes of Board committee meetings held since the previous Board meeting and oral updates from the chairs of Board committees on the main issues discussed and matters agreed. This ensures that all Board members are aware of the key discussions and decisions made by the committees.
- A report from the Chief Executive which highlights the current trading and financial performance and any other relevant matters including the 'highs' and the 'lows' of the preceding month.
- Items for decision and key matters which need to be debated. For example, in 2015 the matters that the Board considered included the following:
  - Progress of the Group's Strategic Initiatives

Corporate Governance Report continued...

The UK Corporate Governance Code continued...

- Approval of the 2014 Annual Report & Accounts and the 2015 Interim Financial Statement
- The distribution strategy including a review of the Group's brands
- Interest rates and the approach to be taken when the Bank Rate changes
- The management of conduct and prudential risk including regulatory dialogue and correspondence
- Results of the colleague 'ViewPoint' survey
- A revised Corporate Plan covering the next five years
- The Corporate Responsibility Strategy
- Changes to the senior leadership team
- Review and updates on the new Accountability Regime and our Trust Code
- Changes to the Group's pension schemes
- Management of cyber security
- Approach to liquidity transfer pricing and impact on return on capital.

- Minutes of the meetings of the monthly Executive Management Committee meeting.

If a major item requires further detailed consideration then the Board may delegate this to an appropriate Board committee.

As referred to above, the Board holds two separate strategy sessions each year. In 2015 these sessions included detailed reviews of a number of matters including Customer Experience, Distribution, Product and People strategies and approval of the investment plan including investment in branch refurbishments, enhancing web and mobile capability and upgrading the Group's infrastructure.

Non-executive directors

In addition to playing their part on the Board as a whole, the non-executive directors are responsible for bringing independent judgement to Board debate and decisions using their own experience and skills, and for constructively challenging the executive team.

The non-executive directors meet without the executive directors present at least four times a year to discuss relevant matters. In 2015 such discussions included Board agenda topics, the content and format of management information received by the Board, succession planning and the overall performance of the executive team.

The Vice Chairman, who is also the Society's Senior Independent Director, deputises for the Chairman when appropriate and provides support and guidance to him. He would also act, if required, as an intermediary for the other directors. As Senior Independent Director, the Vice Chairman is also the main point of contact for members should the normal channels of communication with the Chairman, Chief Executive or other executive directors fail or be inappropriate.

The roles of the Chairman and the Chief Executive

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose.

The Chairman is responsible for leadership of the Board and for ensuring that the Board acts effectively, promoting high standards of corporate governance. He is also responsible for leading the development of the Group's culture by the Board and thus setting the 'tone from the top'.

The Chief Executive has overall responsibility for managing the Society and its subsidiaries and for implementing the strategies and policies agreed by the Board, supported by the executive team and through a suite of management and risk committees.

Section B of the code: Effectiveness

Composition of the Board and Succession Planning

As at the date of this report, the total number of directors was 12 consisting of five executive directors and seven non-executive directors. The size and composition of the Board and the Board committees are kept under constant review by the Chairman and are reviewed at least annually by the Board Governance and Nominations Committee (which is made up of John Heaps, the Chairman, Mark Pain, the Vice Chairman and Kate Barker, Non-executive Director). This is to ensure that there is adequate and orderly succession planning for executive and non-executive directors and that there is the optimum mix of skills and experience on the Board for the direction of the Group's activities and to populate and chair the Board committees. The Board accepts that there needs to be flexibility in the number of directors (particularly in the number of non-executive directors), to take into account any future skills or experience gaps, either due to changes in the Group's business activities or as part of succession planning and recruitment.

Non-executive director succession planning:

The Board Governance & Nominations Committee reviews a skills matrix of the non-executive directors each year; this consists of a schedule of desired skills within the non-executive population and a self-evaluation of the level of experience against each skill gained outside of the Group. The Committee also reviews at each meeting the anticipated retirement date of each non-executive director

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and the impact on Board committee membership. These processes assist in the forward recruitment planning including the skills and experience required of the successful candidate. In 2015 it was agreed that there needed to be non-executive recruitment in 2016 to further strengthen the risk and retail banking experience and also to give regard to greater diversity on the Board. It is anticipated that further announcements on this recruitment will be made later in the year.

Executive director and senior management succession planning

An annual review is undertaken by the non-executive directors of the succession plan status for roles within the executive team (i.e. the executive directors and other chief officers). During 2015 the senior leader development planning has been aligned to this succession plan. As a result, a senior leader development programme is due to commence in March 2016 which will further enhance the development of our people in addition to a number of external senior appointments that have been made to the organisation in recent years.

On 30 November 2015 Ian Bullock, Chief Customer Officer & Executive Director, retired. David Henderson, Chief Information and Change Officer announced in 2015 that he will be retiring in spring 2016. During 2015 the structure of the executive team has been reviewed to ensure it meets the future business needs. As a result, a new Chief Operating Officer role was created which has been filled by the appointment of Stephen White in February 2016.

Succession plans are also reviewed by each chief officer for their division on an annual basis to ensure plans are considered for critical roles and to ensure development opportunities are put in place.

Details of all the Society's directors are set out on pages 40 to 44.

Changes to the Board

Retirement of Directors

During 2015 there were four Directors who retired; namely:

- Ed Anderson, Chairman, who retired immediately following the AGM on 21 April 2015 after 12 years on the Board. He was succeeded by John Heaps who had been appointed Chairman Designate on 20 November 2014.
- Philip Johnson, Non-executive Director and Chair of Audit Committee, also retired on 21 April 2015 after nearly eight years on the Board. He was succeeded as Chair of Audit Committee by Mark Pain who was an existing non-executive director.
- Lynne Charlesworth, Vice Chairman/Senior Independent Director ('SID') and Chair of Group Risk Committee, who retired on 31 October 2015 after nearly 9 years on the Board. She was succeeded as Vice Chairman/SID by Mark Pain. She was succeeded as Chair of the Group Risk Committee by David Paige, an existing non-executive director.
- Ian Bullock, Chief Customer Officer & Executive Director, who retired on 30 November 2015. Mr Bullock's executive responsibilities have been split between the Chief Customer Officer & Executive Director role held by Mike Regnier and, as referred to above, a new position of Chief Operating Officer & Executive Director held by Stephen White.

Appointment of new Directors

Non-executive Director

The appointment of new directors is initially considered by the Board Governance and Nominations Committee. As mentioned above, the committee is responsible for considering matters relating to the composition of the Board, including nominating candidates for the position of director, taking into account the balance of skills, knowledge and experience of directors, and making recommendations to the Board as appropriate.

As referred to in the 2014 Corporate Governance Report, in October 2014 the Board appointed Korn Ferry to assist in the search for non-executive directors with risk experience as part of the ongoing non-executive director succession planning process. Korn Ferry has no other connection with the Society.

The search process was led internally by a selection panel made up of three non-executive directors, as agreed by the Board Governance and Nominations Committee, which was led by the former Vice Chairman, Lynne Charlesworth. A role specification was drawn up with a 'long list' of candidates considered by the selection panel who then conducted interviews with the selected short list of candidates. The Chief Executive also met with each candidate. Following this process and on the recommendation of the selection panel, the Board approved the appointment of Gordon Ireland as a non-executive director with effect from 1 September 2015. He was also appointed a member of the Group Risk Committee with effect from 1 January 2016. Details of Mr Ireland can be found on page 41.

In February 2015 Alison Hutchinson also joined the Board as a non-executive director. The recruitment process was undertaken in 2014 and was set out in the 2014 Corporate Governance Report.

Executive Director

The Board has appointed Stephen White as Chief Operating Officer & Executive Director with effect from 24 February 2016. This appointment was made following a search undertaken by Egon Zhender which has no other connection with the Society. As with the non-executive

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appointment referred to above, a role specification was drawn up with a 'long list' of candidates considered by the Chief Executive. This was reduced to a short list of four candidates who were all interviewed by the Chief Executive and subsequently reduced to two candidates. These two candidates were then interviewed by a number of the Chief Officers including the Finance Director & Chief Operating Officer and the Chief Customer Officer & Executive Director. The preferred candidate, Stephen White, was then interviewed by the Chairman and Vice Chairman prior to his formal appointment by the Board.

The appointments of Gordon Ireland and Stephen White are subject to election by members at the AGM to be held on 26 April 2016. They have both received approval from the Society's regulators, the FCA and the PRA, as Approved Persons to fulfil their controlled function as a director of the Society. In addition, once again, the Board has adopted the Code provision that all other directors should be subject to annual re-election by members at the AGM to ensure that members have the opportunity to vote on all their directors.

Diversity

The Board gives consideration to all aspects of diversity, including gender, on the Board although it continues to adopt the principle that all appointments should be based on merit and the skills and experience that the individual can bring and take into account the composite make-up, skills and experience on the Board. In November 2013 the Board approved a recommendation of the Board Governance and Nominations Committee that there should be an aspirational target to have 25% female directors by the end of 2015. The percentage of females on the Society's Board at 31 December 2015 was 18.2% (2014 – 15.4%). This aspirational target was met during part of 2015 and, as stated in the 2014 Corporate Governance Report, the figure is expected to fluctuate during the ongoing recruitment phase referred to above.

By way of further information and in keeping with the Society's focus on diversity, as at 31 December 2015 there were the following percentages of female colleagues in the Group:

- 33% of the executive team (excluding executive directors). This reduces to 14% if executive directors are included
- 25% of the next level senior managers (i.e. the senior leadership team)
- 66% of all colleagues (including executive directors)

The Group is committed to creating a leading People Experience for its colleagues through ensuring equality, diversity and inclusion for all. It takes into account diversity at all levels of recruitment and supports colleagues through various initiatives, including taking on voluntary roles such as trusteeship and non-executive roles in local voluntary organisations, to enable colleagues to gain experience of Board roles.

Performance evaluation

Board evaluation

The Board undertakes an annual evaluation of the performance and effectiveness of itself together with an annual review of the performance of individual directors.

As referred to in the 2014 Corporate Governance Report, in the latter part of 2014 an external Board effectiveness review was carried out by Praesta Partners LLP with the results presented by Praesta at the Board meeting in January 2015.

The review confirmed that the Society has an effective Board that has worked well in demanding times with an open culture that encourages constructive challenge. Following discussion by the Board, there were a number of matters that were to be considered for further improvement. These included a further review of the presentation and content of Board papers and management information to the Board and a review of more routine matters that could be delegated to an appropriate Board committee to provide more capacity for the Board to consider key items. In addition, following Mr Heaps' appointment as Chairman in April 2015 he has focused on Board effectiveness and has engaged in detailed conversations with all directors, both individually and collectively, on a number of occasions to improve how the Board operates both from an interactive as well as administrative perspective. As a result an action plan has been drawn up for various areas to be considered during the course of 2016 including:

- Review of the Board agenda to ensure that it is balanced and has more input from the non-executive directors
- Continuation of the review of the Board Management Information pack
- Further consideration of the impact of the Senior Managers' Regime
- Consideration of greater gender diversity on the Board in the next recruitment process.

The formal internal Board evaluation questionnaire was not conducted in the last quarter of 2015, as would be the usual process, given that a review of how the Board operates is currently an ongoing (as opposed to a one off) process. However the Board agreed that such a questionnaire would be undertaken later in 2016 once these actions have been concluded.

In 2015 internal performance evaluations of the Audit, Group Risk, Remuneration and Board Governance and Nominations Committees were carried out through the means of a questionnaire completed by all relevant committee

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members. The results were reviewed by the relevant committees and any appropriate improvements were identified for action.

Individual director evaluation

In the latter part of 2015 individual evaluation of directors was undertaken through the completion of internal questionnaires which concluded that all directors continued to perform effectively. Each non-executive director was reviewed by all other directors and chief officers. The written results of the questionnaire were given to each such director by the Chairman in appraisal meetings held in January 2016. The Vice Chairman conducted the appraisal meeting with the Chairman.

The non-executive directors reviewed the performance of each executive director (and also other members of the executive team) through the completion of an internal questionnaire. This was used as part of the year end performance appraisal meetings with the Chief Executive. The Chief Executive's appraisal meeting was conducted by the Chairman.

Conflicts of interest

One of the criteria which the Board takes into consideration when recruiting a non-executive director is his/her ability to have sufficient time to take on the position. In addition, during the term of their directorship with the Society any other positions that a director takes up have to first be referred to the Board so that the time commitment and any potential conflict of interest can be considered. The Board has a Conflicts of Interest policy which sets out procedures for regularly reviewing, through the Board Governance and Nominations Committee, and if appropriate, authorising any potential conflicts as they arise. This applies to executive as well as non-executive directors.

The letters of appointment of non-executive directors give an indication of the time commitment required although this will change depending on whether he/she is chair and/or member of any Board committee(s). The commitment will also increase, inevitably, when a potential merger or other major development is being considered.

Copies of the letters of appointment of each of the non-executive directors are available for inspection on request from the Group Secretary.

The Board is satisfied that all of the non-executive directors are independent based upon the guidance set out in the Code, including the Chairman on appointment. By the 2016 AGM David Paige will have served nine years as a non-executive director since his first election by members. However, the Board is of the view that the independence of his judgement will not be prejudiced by his continuation as a director.

Induction and development

The Chairman ensures that, on appointment, non-executive directors receive a comprehensive tailored induction programme on the Group's business and regulatory environment which is monitored by the Board Governance and Nominations Committee. All non-executive directors update their skills, knowledge and familiarity with the Group through internal presentations by senior managers, relevant external and internal presentations and training and through branch visits and attendance at member events which are referred to below and on page 55. In November 2015, for example, Deloitte LLP presented their annual update on accounting, regulatory and other topical issues to the Board which was forward looking. The Board also had a number of training sessions on capital management and the non-executive directors received a presentation on the new Regulatory Senior Managers Regime in addition to updates at Board meetings on this topic. Individual training requirements for non-executive directors are discussed as part of the performance evaluation process. A training record for each non-executive director is maintained by the Group Secretary.

Non-executive directors are encouraged to contact individual members of the executive team to discuss any queries that they may have and to undertake branch and department visits on an ad hoc basis in order to deepen their understanding of the business.

All directors have access to independent professional advice if required and have the benefit of appropriate liability insurance cover at the Society's expense. In addition, they have access to the advice and services of the Group Secretary who is responsible for ensuring that Board procedures are complied with and for advising the Board, through the Chairman, on governance matters.

Section C of the code: Accountability

The Board is responsible for the system of internal control. The Audit Committee Report on pages 57 to 59 sets out the internal control framework which is designed to safeguard member and Group assets and to facilitate the effectiveness and efficiency of operations which helps to ensure the reliability of internal and external reporting and assists in compliance with applicable laws and regulations.

The Board is also responsible for setting the risk appetite of the Group and ensuring that there is a robust system for risk management in place to ensure the security of members' funds. The Group's risk management framework is set out in the Risk Management Report on page 61.

The Board has delegated to the Audit Committee oversight of the relationship with the external auditor to ensure that they remain independent and objective.

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Further details can be found in the Audit Committee Report page 59.

Section D of the code: Remuneration

The Board has delegated to the Remuneration Committee the policy on remuneration for the Chairman, the executive directors and other members of the executive team and the senior leadership team. A review of its activities and the remuneration policy is set out in the Directors' Remuneration Report on pages 76 to 83.

Section E of the code: Relations with members

Member engagement

The Society's owners are its individual members who are made up of its savers and borrowers (subject to a small number of exceptions). This is different to the shareholders of a listed company, whose owners may include institutional shareholders. The vast majority of the Society's customers are, therefore, its members and the Society encourages feedback from them on any aspect of the Society's activities.

This feedback takes various forms, including member 'Question Time' meetings which give members the opportunity to meet and ask questions of the Chief Executive, the senior management team and local branch colleagues. The non-executive directors are encouraged to attend at least one member event during the year to engage with members and understand any concerns that they may have. In 2016 we are looking to extend the reach of our Question Time programme through online and social media channels, ensuring members can engage with us through their channel of choice.

The Society also operates My Voice, our online research community. My Voice gives customers the opportunity to feedback on a variety of topics that really matter through regular collaborative forums and mini polls. It enables the Society to have a two way dialogue with our customers about what they want, what we could do better and what they want us to keep doing and to help shape the future of Yorkshire Building Society. Since its launch in November 2014 there are now 2,400 active members on My Voice.

In addition, a monthly customer perception tracker with over 2,500 customers across all Group brands is undertaken to monitor the strength of the relationship customers have with the Group. The results provide a key performance indicator of customer advocacy (called the Net Promoter Score®) which is monitored by the Board on a monthly basis. We also contact approximately 30,000 members every year through our customer experience and brand tracker surveys to understand how they perceive the organisation and how we can improve our products and services.

The Society's member engagement process is under review to ensure that it remains relevant and to make it as easy as possible for the Board and the executive team to listen to our members and better meet their needs.

The AGM

At the AGM, the Chairman, Chief Executive and Finance Director give presentations on the previous year's financial performance and on future plans. At the 2015 AGM, the Chair of the Remuneration Committee also gave a presentation on the directors' remuneration. The meeting also provides an opportunity for members to question the Chairman, Chief Executive and other directors on the resolutions to be proposed at the meeting and on any other aspect of the Society's business. All directors attend the AGM (unless their absence is unavoidable) including the chairs of all of the Board committees.

All members who are eligible to vote at the AGM receive a proxy voting form, which includes a 'vote withheld' option, and a pre-paid reply envelope (unless they have opted to receive the AGM pack by email) to encourage them to exercise their vote through the appointment of a proxy if the member cannot attend and vote at the meeting. Members are also able to appoint a proxy online.

At the AGM, the Chairman calls for a poll on all resolutions so that all proxy votes are recorded. The results of the proxy votes, and the votes cast at the AGM, are published on the Society's website and in branches. A separate resolution is proposed on each issue, including a resolution on the Annual Report and Accounts.

Relations with other investors

The Society also places great importance on maintaining a frequent dialogue with its providers of external capital and funding. As part of the annual results publication process, the Society usually conducts a series of investor meetings to provide a detailed briefing on its financial performance. These briefings are held with a wide range of institutional investors and analysts and are not restricted to existing providers of wholesale funds or capital. The presentation materials are available throughout the year on the Society's website. In addition, representatives of the Society's Treasury team conduct regular face-to-face meetings with external stakeholders throughout the year in order to provide updates on the Society's performance and respond to market queries.

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Board and committee attendance record 2015

Set out below are details of the directors during 2015 and their attendance record at Board meetings and relevant Board committee meetings in the year. The figure in brackets indicates the number of meetings that the director was eligible to attend during 2015.

Director	Board Meetings	Board Committees				
		Audit	Chairman's	Nominations	Remuneration	Risk
Ed Anderson						
Chairman (retired 21.04.2015)	4(4)	–	1(1)	1(1)	–	–
Dame Kate Barker						
Non-executive Director	10(10)	–	–	3(3)	6(6)	5(5)
Ian Bullock						
Chief Customer Officer & Executive Director (retired 30.11.2015)	9(9)	–	–	–	–	–
Andy Caton						
Chief Corporate Affairs Officer & Treasury Officer & Executive Director	10(10)	–	–	–	–	–
Lynne Charlesworth						
Vice Chairman/SID (retired 31.10.2015)	8(8)	–	1(1)	3(3)	–	4(4)
Robin Churchouse						
Finance Director	9(10)	–	–	–	–	–
John Heaps						
Chairman	10(10)	–	0(0)	2(2)	–	–
Alison Hutchinson						
Non-executive Director (appointed 04.02.2015)	8(9)	6(9)	–	–	2(2)	–
Gordon Ireland						
Non-executive Director (appointed 01.09.2015)	4(4)	–	–	–	–	–
Philip Johnson						
Non-executive Director (retired 21.04.2015)	4(4)	3(3)	–	–	–	–
David Paige						
Non-executive Director	10(10)	9(9)	–	–	4(4)	5(5)
Mark Pain						
Vice Chairman/SID	9(10)	9(9)	0(0)	0(0)	–	5(5)
Guy Parsons						
Non-executive Director	10(10)	–	–	–	6(6)	–
Chris Pilling						
Chief Executive	10(10)	–	1(1)	–	–	–
Mike Regnier						
Chief Commercial Officer & Executive Director	10(10)	–	–	–	–	–

Notes:
In addition, the written resolution procedure under the Society's Rules was used on seven occasions by the Board and on one occasion by each of the Group Risk Committee and the Chairman's Committee to conduct business.

On behalf of the Board

John Heaps
Chairman
24 February 2016

Audit Committee Report

I took over the role of Chair of the Audit Committee in April 2015, following the retirement of Philip Johnson. I would like to take the opportunity to thank Philip for the role he has played in chairing the committee since the financial crisis.

Membership and attendees

The Audit Committee is appointed by the Board and is made up of three non-executive directors. Membership and attendance at meetings during 2015 is shown on page 56. David Paige and I have recent, relevant financial experience. We meet this statement through either current or previous roles, other current non-executive directorships and our relevant qualifications. More information on the skills and experience of the members can be found in the Directors' Biographies on pages 40 and 44.

During the year, Philip Johnson retired as Chair of the committee. Alison Hutchinson was appointed to the committee in February 2015.

In the second half of the year most meetings began with a private session between executive management and the committee. Each of these meetings concluded with a private session between the committee and both the internal and external auditors.

The committee invites the presence of senior management when it is felt that this would help them discharge their duties.

Roles and responsibilities

The roles and responsibilities of the committee are set out in its terms of reference which are reviewed and approved by the Board each year. They can be found in the Corporate Governance section of our website www.ybs.co.uk/committees

Financial reporting issues and judgements

Our role in monitoring financial reporting issues is key to ensuring that all our stakeholders maintain their trust in our activities and reporting. We utilise our external auditor, Deloitte LLP (Deloitte), to help ensure that suitable accounting policies have been implemented and appropriate judgements have been made by management.

We considered the following main issues during 2015:

- Revenue recognition. The Group recognises income in relation to the provision of mortgages on an effective interest rate basis. Fees and commissions are spread over the expected behavioural life of the mortgage. The committee agreed with the assumptions used and concluded that revenue was fairly stated.
- Strategic initiatives. The Group has invested significantly in the strategic initiative programme. The committee have reviewed the cost allocation and ensured that the capitalisation of costs associated with the initiative is appropriate.
- Loan loss provisions. Management have reviewed the outputs of these models and subjected the results to additional provisioning overlays where they believed that the underlying credit risk facing the Group wasn't being reflected fully. The committee reviewed the approaches used, assumptions adopted and the overlays applied by management and agreed with the overall level of provisions held.
- Run-off of fair values associated with acquired books. The Group has mortgage books which were acquired following the mergers with the Chelsea and Norwich & Peterborough where the life time fair value of these books on acquisition was estimated by management. As these acquired assets run off over time, any adjustments to their fair values are recognised in the Income Statement. The committee reviewed all the judgements made in this regard and discussed these at length with management and the external auditors. As a consequence, we are comfortable that a cautious but appropriate approach has continued to be taken.
- Hedge accounting. The Group holds derivative financial instruments in order to mitigate various risks as set out in Note 34 on pages 137 to 139. Where the requirements of hedge accounting are met, the changes in the value of these instruments, recognised in the Income Statement, may be offset by the corresponding changes in the value of the hedged items. The committee has overseen management's control activities in this area and is confident that amounts recognised in the Income Statement are fairly stated and that appropriate disclosures have been made.
- Viability and going concern. When preparing the Group's Annual Report and Accounts the directors are required to confirm in the Directors' Responsibilities Statement on page 84 that the Group is a going concern, unless it is inappropriate to presume

Audit Committee Report continued...

that the Group will continue in business. In addition, the directors are also required to confirm the longer-term viability of the Group as set out in the Strategic Report on pages 33 to 35. The committee reviewed and challenged comprehensive papers prepared by management and was in a position to recommend to the directors that the Annual Accounts should be prepared on a going concern basis and that there is a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the next three years.

The Group's Annual Report and Accounts are required to be fair, balanced and understandable as well as providing the necessary information for members to assess the Group's performance, business model and strategy. The process to draft and review the Annual Report and Accounts is undertaken alongside the external audit undertaken by Deloitte.

The committee is satisfied that, taken as a whole, the Annual Report is fair, balanced and understandable.

Internal controls

The Board recognises the importance of sound systems of internal control in the achievement of its objectives and the safeguarding of member and Group assets. Internal control also facilitates the effectiveness and efficiency of operations, helps to ensure the reliability of internal and external reporting and assists in compliance with applicable laws and regulations.

The Group operates in a dynamic business environment and, as a result, the risks it faces are continually changing. The internal control framework has been designed to ensure thorough and regular evaluation of the nature and extent of risk and the Group's ability to react accordingly. It is the Board's responsibility to develop policies on risk and control. All colleagues have responsibility for internal control as part of their accountability for achieving objectives. Colleague training and induction is designed to ensure that they are clear on their accountabilities in this area and are competent to operate and monitor the internal control framework.

An effective control framework is vital to manage risk and to maintain the trust of all our stakeholders particularly as the Group looks to deliver a significant strategic change programme. We review this framework through regular reporting from management, Internal Audit and our external auditors who set out the views of management as well as their own independent opinions. We work closely with the Group Risk Committee as some areas, such as compliance monitoring, provide formal reports to that committee.

Further details of actual risk management practices are provided in the Risk Management Report on pages 60 to 65.

The main internal control areas considered and reviewed in detail during 2015 were:

- Internal audit reports. The committee approved the Internal Audit plan for the year and the resources needed to support it. It received reports on the outcomes from the delivery of the plan. The committee considered an annual report giving an overall assessment of the effectiveness of internal control.
- Our external auditors provide us with internal control reports in respect of key financial reporting processes and systems arising from the external audit review. During the year, Deloitte did not highlight any material control weaknesses.
- We track the status of issues raised in control reports, both from our internal and external auditors. The volume and age profile of control issues has remained within our risk appetite.

The committee has received more frequent reports on the use of the confidential reporting channels in the Group to enable effective oversight of any concerns raised by colleagues and stakeholders. The information received and considered by the committee provided reasonable assurance that during 2015 there were no material breaches of control or regulatory standards and that, overall, the Society maintained an adequate internal control framework that met the principles of the Code.

Oversight of Internal Audit

The committee receives regular reports from Internal Audit setting out the results of their assurance activity including their performance against a range of measures included in their balanced scorecard. The function reports annually on the skills and resources necessary to discharge its role.

The Internal Audit function is governed by a Charter which is approved annually by the committee and can be found on the Group's internet site www.ybs.co.uk/committees. In 2015, a concise version of the Charter was approved to help communicate the important role of Internal Audit in the Group.

The Internal Audit function has deployed an internal quality assurance programme that meets the requirements of the Chartered Institute of Internal Auditors' Guidance for internal audit in the financial sector. The committee received the outputs from these reviews to assist in its ongoing assessment of the effectiveness of the Group's Internal Audit approach. In 2015, a rolling programme of annual externally sourced oversight commenced.

Audit Committee Report continued...

Oversight of external audit and the external audit process

Each year the committee approves the proposed audit plan presented by the external auditor including a discussion of key risk areas to ensure that there is agreement on the focus of work and materiality measures.

The external auditor provides regular reports to the committee on their work on the Interim Financial Statements and the Annual Report and Accounts prior to the committee recommending approval.

The committee carries out a formal assessment of the effectiveness of the external audit process each year.

The committee takes into account the performance of the external auditor when considering their reappointment as well as their length of tenure and the date of rotation of the audit partner. Deloitte were appointed in July 2009 following a competitive tender process and the external audit partner rotated off the audit following the 2013 year end.

During 2015, the committee considered the need for a competitive tender and concluded this was not necessary given the performance of Deloitte throughout the year and the level of change within the Group. The committee recommended that they be reappointed at the 2016 AGM for the current year.

Corporate governance code requirements mean that the audit contract should be put out to tender at least every ten years. Under the transitional arrangements, this means that the contract will need to be re-tendered no later than 2019.

External auditor objectivity and independence

The Group has a policy on the use of the external auditor for non-audit work which is overseen by the committee. The purpose of this policy is to ensure the continued independence and objectivity of the external auditor. The policy sets out examples of services which the external auditor can and cannot perform. Fees for individual assignments which exceed pre-defined limits require prior notification to the Audit Committee Chairman who then considers whether formal committee approval is required. The level of fees incurred is regularly monitored.

Details of the fees paid for non-audit services during the year can be found in Note 7 on page 104.

Audit Committee effectiveness

The effectiveness of the committee is assessed annually. A self-assessment exercise, co-ordinated by Internal Audit, is performed and the results are reported to the Board. The 2015 review concluded that the committee operated effectively during the year.

Committee members are expected to undertake relevant training as part of their ongoing development as an individual Board member. Each year, as well as undertaking individual training as members consider appropriate, the committee as a whole receives training on current topics. In 2015, this comprised updates on: IFRS 9 'Financial Instruments', cyber security, and regulatory themes.

On behalf of the Board

Mark Pain
Chair of the Audit Committee
24 February 2016

Risk Management Report

I took over the role of Chair of the Group Risk Committee in November 2015, following the retirement of Lynne Charlesworth.

Introduction

The Group's risk management framework and governance structure provides a mechanism for proactively identifying and addressing the key risks to the achievement of the Group's objectives. It delivers comprehensive identification, monitoring, control and ongoing management of the risks to which the Group is exposed, so as to ensure the security of its members' funds. The Group's ability to properly identify, measure, monitor and report risk is critical to its sustainable financial security and its ability to provide value and fair outcomes to its membership and customers.

Risk governance

The Board is ultimately responsible for every aspect of the Group's activities. In particular, its role is to focus on the Group's strategy and ensure that the necessary resources are in place to meet its objectives and to ensure that robust financial controls and systems of risk management are in place. To assist the Board, a Group Risk Committee, made up of non-executive directors and attended by senior executives, considers all risk matters relating to the Group, including credit risk, operational risk, market risk, liquidity risk, funding risk, business risk, and regulatory risk (including prudential and conduct) requirements. As chairman of the committee I provide regular updates to the Board on matters considered by the committee.

The Group's overall statement of risk appetite is as follows:

'The organisation will not take, or retain, risk positions that threaten its ability to remain a sustainable and independent mutual organisation, thereby ensuring the sustainability of YBS Group and that no stakeholder suffers a loss.'

The Group maintains an independent second line risk management function (Group Risk) that is responsible for ensuring that appropriate risk management techniques and measures are deployed that remain commensurate with the Group's strategic aims, its appetite for risk and the actual risks it faces at any time. The Group Risk function provides periodic independent reports on risk positions and risk management activities for consideration by the Group Risk Committee, its sub-committees and the Board. The Group's Chief Risk Officer provides a formal update to each Board meeting covering all areas of risk management, including both routine reporting and ad hoc issues.

Risk vision and strategy

Risk in various forms arises naturally from the Group's provision of various financial services to customers. The Group's Risk Vision promotes advanced risk management to support and direct financial security, fair customer outcomes, and a Group built on trust. The Group's Risk Management Strategy that results from that vision gives high-level strategic direction on matters of risk taking and risk management to ensure that the Group:

- Delivers good outcomes, including fair conduct outcomes for customers.
- Makes prudentially sound risk decisions.
- Assists the Group's regulators in delivering their objectives.
- Employs competent risk management practices.
- Takes action when it is appropriate to take fewer or greater risks in achieving the Group's objectives and plans.
- Has direction on the most critical risk management tool – risk appetite.
- Monitors emerging risks and where appropriate takes action to mitigate them.

The Group has a framework of consistently articulated risk appetites for all risk categories and a regularly updated Group Risk Map by which it aims to identify the major sources of risk to its strategic objectives, its assets and operations. The Group then deploys appropriate measures to control and monitor those risks. The key risks are plotted on the Group Risk Map with their position determined by the assessment of net impact and likelihood of occurrence, together with an assessment of how each risk sits against the Group's risk management capability. Supporting each risk assessment is a risk dashboard that integrates all the relevant information about the risk, including key risk indicators, control assessments, audit and compliance points, emerging issues, and actions being taken. The risk map is updated and reviewed monthly and the Group's risk sub-committees monitor the dashboards relevant to their activities. The dashboards are refreshed in detail on a quarterly basis by the Group's Chief Officers. In addition, the Group Risk Committee reviews the dashboards relating to the most significant risks on a quarterly basis.

Risk Management Report continued...

Risk framework and culture

The risk framework of appetite statements, risk map and dashboards, risk management information, the risk committee structure and the Group's Trust Code testify to a robust and embedded risk culture that continues to mature. The Group continues to evolve and embed a "Three Lines of Defence" model for risk management as follows:

1st Line of Defence (Responsible):

- Day to day responsibility for running the business.
- Develop a clear risk and control framework including responsibility for initiating risk appetite, policy, controls and outcome testing with the capability to identify, assess, control, mitigate and report risk.

2nd Line of Defence (Accountable):

- Accountability for ensuring competent risk management across the Group within risk appetite and the reporting of risks to the Board.
- Support, coach, facilitate, independently monitor, challenge, report and if necessary give direct instruction.
- Manage regulatory relationships and brief the Board.
- Oversee the effectiveness of the Three Lines of Defence model.

3rd Line of Defence (Internal Audit):

- Help the Board and Executive Management to protect the assets, reputation and sustainability of the organisation by independently assessing whether all significant risks are identified and appropriately reported by management and the Risk function to the Board and Executive Management; independently assessing whether they are adequately controlled; and by challenging Executive Management to improve the effectiveness of governance, risk management and internal controls.

Stress testing

Stress and scenario testing are widely used throughout the Group and involve a large number of colleagues. Such testing ranges from stress testing the Group's capital and liquidity requirements to ensure sustainability in reasonable stressed scenarios, stress testing required to support regulatory submissions (the Internal Capital Adequacy Assessment Process, the "ICAAP"; and the Individual Liquidity Adequacy Assessment, the "ILAA") together with the annual reverse stress tests which attempt to produce illustrative scenarios that might cause the Group to fail, regular scenario analysis, and the daily stress testing of liquidity and market risk.

Group Risk Committee (GRC)

The Group Risk Committee oversees the Group's risk governance framework and provides an entity-wide perspective on all risk matters. It normally meets four times a year but will meet more frequently when the need arises. Its membership comprises four non-executive directors: David Paige (Committee Chair), Dame Kate Barker, Mark Pain and Gordon Ireland (appointed January 2016); and it is also attended by senior executives including the Chief Executive Officer, Chief Operating Officer and Finance Director, and the Chief Risk Officer. Details of attendance are set out on page 56. The committee's terms of reference are available from the Corporate Governance section of our website: (www.ybs.co.uk/committees).

During 2015 a self-assessment of the effectiveness of the committee was undertaken. It concluded in April 2015 that reporting lines for the committee and Group Risk were appropriate and that the members felt their skills and experience make a contribution. The committee wanted more training on relevant issues and for the improvement in the quality of papers to continue. Both points have been addressed during 2015.

The committee has delegated responsibility for the detailed oversight of the Group's risk strategy, risk appetite, risk monitoring, liquidity management and capital management. During 2015 the committee met five times and the matters considered included:

Approval of:

- The risk management strategy.
- The Group's risk appetite ahead of approval by the Board.
- The Group's updated risk register.
- The regulatory capital submission (ICAAP) ahead of approval by the Board.
- The regulatory liquidity submission (ILAA) ahead of approval by the Board.
- Reverse stress tests.
- The regulatory Recovery and Resolution Plans.
- Second Line of Defence Oversight Plans for Compliance and Conduct, Credit Risk and Prudential Risk.
- Risk Overlay Process for Material Risk Takers' Bonus.
- Money Laundering Reporting Officer's annual report.
- Delegation of mandates and sub-committees.

Monitoring of:

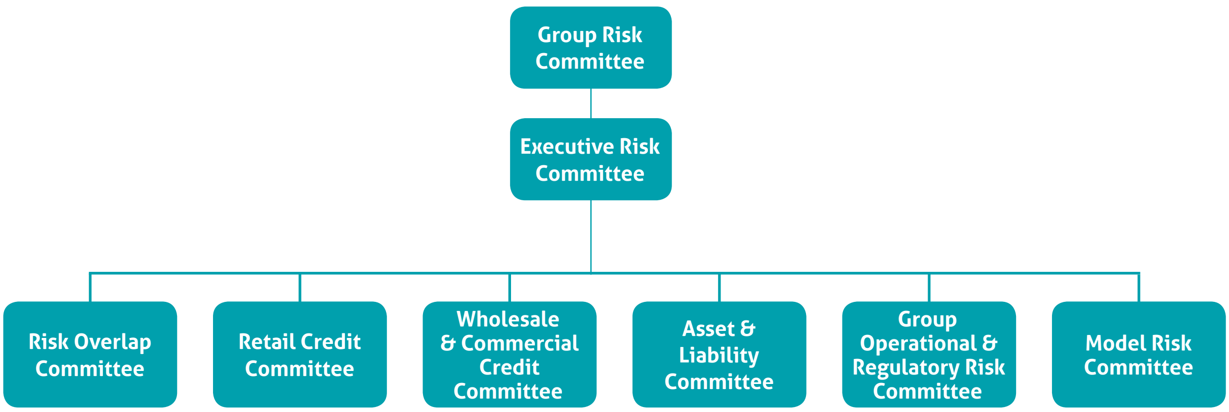
- Economic, political and market risks and their potential impact on risk appetite.
- Risk horizon including the Group Risk Map.
- Risk appetite adherence.
- Second LoD Monitoring of Compliance and Conduct and Credit Risk.
- The project to implement Internal Ratings Based (IRB) approach to capital requirements for retail credit risk.

Risk Management Report continued...

- Effectiveness of the Three Lines of Defence Model.
- Cyber Risk.
- Periodic investigative deep dives into ad hoc areas including credit risk and the compliance operating model.

The Executive Risk Committee (ERC), which is a sub-committee of the Group Risk Committee, acts as an umbrella for six sub-committees. ERC meets once a month and runs for an entire day: the sub-committees meet in sequence on that day (with the exception of Model Risk Committee), making risk management oversight a focus of attention for the Group. The component committees of ERC and their areas of coverage are summarised below.

Board committee, executive committee and executive sub-committees in 2015



Risk Overlap Committee (ROC)

This committee covers issues that cut across the responsibilities of more than one committee, or that are more enterprise-wide in their nature, such as capital, the group risk profile, or the risk management strategy. The committee is chaired by Richard Wells, Chief Risk Officer and the chairs of the other risk sub-committees form part of the membership.

Asset and Liability Committee (ALCO)

This committee is responsible, under delegated authority of the Board, for managing the Group's liquidity, market risk and currency risk. It has been chaired by the Head of Treasury, but from January 2016 it is chaired by Robin Churchouse, Finance Director. Its membership is drawn from Risk, Finance, Treasury, Products and Internal Audit.

a) Liquidity risk

The Board recognises that a structural maturity mismatch inevitably exists within the Group's Statement of Financial Position, caused by the fundamental purpose of the Group's business, that is, providing its members with long-term mortgage advances funded primarily by shorter term retail savings accounts.

The Group's liquidity policy is to maintain sufficient liquid resources to cover a potential highly stressed outflow. This is achieved through maintaining a prudent level of appropriate high-quality liquid assets, wholesale funding facilities, and through the management of the growth of the business.

The Group maintains and monitors a liquidity and funding risk appetite comprising qualitative statements and specific metrics. The Group holds sufficient liquidity to continue trading and protect members even under highly stressed conditions. On an annual basis, a range of liquidity stress scenarios are developed covering, in the last iteration, a total of 11 scenarios assessed over two timeframes. The worst-case three month scenario forms the basis of our overall liquidity adequacy assessment. The Group's liquidity and funding risk appetite triggers a warning whenever liquidity falls to within 15% of our internal or regulatory liquidity requirements.

During 2015, the UK regulatory approach to liquidity adequacy was superseded by the European Capital Requirements Directive IV (CRD IV) approach, with the Liquidity Coverage Ratio (LCR) replacing Individual Liquidity Guidance (ILG) as the binding regulatory liquidity metric from 1 October. As such, daily monitoring has been updated to reflect the revisions in the regulatory environment, with LCR reporting being included and ILG reporting removed.

Internal and external metrics to ensure liquidity levels are adequate

Risk Management Report continued...

and within risk appetite are run, reviewed and reported daily to relevant parties within the Group. The additional weekly ALCO meeting reviews an extended projection of funding and liquidity against a longer-term forecast for the measures outlined above, with appropriate actions taken where required. All views of liquidity adequacy are reported monthly to ALCO and to the Board, with quarterly reporting to GRC.

The Group's liquidity and funding risk appetite also seeks to ensure that a stable and diverse funding base is maintained to support balance sheet lending activities and to meet operational requirements. This appetite is supported by a range of limits and key risk indicators which are monitored daily and monthly. For wholesale funding, the appetite is for funding which is diversified in terms of investor profile, currency, geography, instrument type and maturity spectrum; for retail funding it is diversified in terms of product and distribution type.

Detail of actual exposures at the year-end is contained in Note 35.

b) Market risk

Market risk is the risk to earnings and capital arising from changes in interest rates, foreign currency exchange rates, structural mismatches within the Statement of Financial Position (basis risk), and the price of financial instruments. The Group has a formal structure for managing its market risks including established risk limits, reporting lines, mandates and other control procedures. The market risk position is monitored daily and reviewed by ALCO at least monthly. The Board receives monthly summaries of risk positions.

Market risk arises primarily from the activities within the Group's retail business units and the Group's Treasury function. The Group's Asset and Liability Management (ALM) process will ensure that risks connected with these areas of activity are identified and that suitable measures and risk management practices are applied. Mitigating this risk through a hedging strategy and within the agreed risk appetite is the responsibility of Group Treasury. Group ALM also monitors the suitability of and compliance with the operating limits set for the activities of the Group's Treasury function by the Board, and it reports and recommends accordingly.

The Group's principal source of market risk is interest rate risk. This is monitored via four main measures:

- Value at Risk provides a measure of the maximum likely loss that could be sustained over a specified time period at a stated level of confidence.
- Basis point value sensitivity provides a measure of the sensitivity of the present value of the Statement of Financial Position to a one basis point (0.01%) parallel shift in interest rates.
- Statement of Financial Position structural analysis monitors the composition of the Statement of Financial Position in terms of the different interest rate bases of assets and liabilities.
- Re-pricing gap analysis is used primarily for the identification of instrument re-pricing concentrations.

More details of these risk management measures can be found in Note 36.

The Board recognises that these key measures for managing interest rate risk cannot be individually optimised in a simultaneous fashion. For instance, attempts to reduce the volatility of net interest income are likely to result in an increase in the volatility of the market value of the Statement of Financial Position. The Board therefore advocates the use of a wide variety of complementary risk indicators and measures and is disinclined to adopt a narrow definition or 'one figure' measure. An important factor in the risk measures is the degree of internal consistency between them. To facilitate this approach, the key measures are supplemented by other techniques including:

- Stress testing which is used to monitor the sensitivity of net interest income to extreme market conditions.
- Scenario analysis which measures variability in net interest income using a number of possible interest rate scenarios.

c) Currency risk

The Group has certain instruments denominated in currencies other than Sterling. Its policy is to eliminate currency risk, other than a small operational mismatch, through the use of cross-currency interest rate swaps and foreign exchange contracts.

Details of actual exposures are contained in Note 37.

d) Other market risks

Other market risks are minimised by the use of derivative instruments which are used exclusively for this purpose and not for trading activities.

e) Credit ratings

The Group monitors its own Credit Ratings on a regular basis and actively engages with the rating agencies as appropriate. The impact of the rating agencies' assessment of the Group is taken into account during the development of the financial plans for the Group as well as in determining the appropriate level of risk appetite.

Retail Credit Committee

This committee is responsible, under delegated authority of the Board, for managing the Group's retail credit risk. It is chaired by the Head

Risk Management Report continued...

of Credit Risk and its membership is drawn from Finance, Customer, Products and Treasury.

Credit risk

Credit risk is the potential risk of financial loss arising from the failure of a customer or other counterparty to settle their financial and contractual obligations as they fall due. The Group has in place a comprehensive set of controls and limits to monitor and govern the amount of such risk accepted.

Credit risk is the most significant risk that the Group is exposed to. It relates to its core business of providing loans secured on residential property. The Group provides Retail prime residential and BTL mortgage lending to households and landlords across the UK and does not consider there to be any undue concentration of its credit risk in any particular part of the UK. In addition, the Group has unsecured credit risk exposures to current accounts with overdraft facilities and a closed unsecured personal loan portfolio.

The Group ensures the credit risk of its lending portfolios is appropriately managed, in line with the Board approved risk appetite, via its lending criteria, its pricing, and its monitoring and management processes and techniques. Retail credit exposures are managed in accordance with the Statement of Lending Policy and through the use of credit scoring, affordability assessments and credit policy that factor in the profile of the borrower, the nature of the loan, environmental conditions and the collateral that may be provided as security for the loan. Actual and forecast retail exposures are monitored and managed against risk appetite limits by the Retail Credit Risk Committee. In particular the committee monitors arrears, loan-to-value ratios, possessions, expected losses and affordability. Retail Credit Risk Committee has four sub-committees that oversee lending policy and criteria, lending quality, interest-only mortgage exposure and collections and recoveries.

Retail credit risk management information is reported monthly to Retail Credit Committee and the Board with quarterly reports to Group Risk Committee.

Detail of actual retail credit risk exposures is contained in Note 39.

Wholesale and Commercial Credit Committee

This committee is responsible, under delegated authority of the Board, for managing the Group's wholesale credit risk. It is chaired by the Head of Asset and Liability Risk and its membership is drawn from Treasury, Finance, Customer, Commercial Lending and Risk.

The Group's wholesale credit risk arises principally from assets held for liquidity purposes. The risk is that counterparties with whom the Group invests liquid assets fail to repay those investments when they fall due.

The Wholesale and Commercial Credit Committee takes primary responsibility for the task of assessing and monitoring wholesale counterparty creditworthiness and conducting credit research and analysis. It does this by reviewing the Group's exposures and through setting limits to individual counterparties based on analysis presented to the committee. Limits are also set against the aggregate exposure to equally-rated institutions and to all institutions based in any one country. The Group continuously monitors the lines to other institutions and makes adjustments to these lines when required. Additionally, all new derivative transactions are covered by an International Swaps and Derivatives Association (ISDA) master agreement and a credit support annex that mitigates our exposure.

The committee also maintains oversight of the Group's commercial lending activities. Wholesale and commercial credit risk management information is reported to Wholesale and Commercial Credit Committee and the Board on a monthly basis, and quarterly to Group Risk Committee.

Details of actual exposures are contained in Note 38.

Model Risk Committee

The Model Risk Committee is responsible for providing oversight of the performance of risk models, as well as approval of new risk models which are deemed to be highly material to the Group. It has been chaired by the Head of Credit Risk, but from January 2016 it is chaired by Richard Wells, Chief Risk Officer. Its membership is drawn from Credit Risk, Finance, Treasury, Asset and Liability Risk, and Strategy and Insight.

Model risk

Model Risk is the potential risk of adverse consequences arising from decisions based on incorrect or misused model outputs. The Group has a range of models in place which are used in the control and assessment of various risks. The Model Risk Committee was introduced to centralise the approval and ongoing review of the Group's models.

The Group is currently undertaking a project to deliver the Advanced IRB approach to capital management of credit risk. The Model Risk Committee acts as the Group's Designated Committee for IRB purposes, which will involve the approval and oversight of all material aspects of the Group's IRB Rating System.

Risk Management Report continued...

Group Operational and Regulatory Risk Committee

This committee is responsible, under delegated authority of the Board, for managing the Group's Operational and Regulatory risk. It is chaired by the Head of Risk (Customer and Commercial) and its membership is drawn from Risk, Information and Change, Customer, People, Information Security and Risk, Finance and Shared Services.

Operational and regulatory risk

Operational risk is defined as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems, and from external events. To minimise operational risk, the Group maintains a system of internal controls commensurate with the characteristics of the business, the markets in which it operates, leading practice principles and regulatory considerations.

Regulatory risk (including prudential and conduct) is the risk of non-compliance with the rules, regulations and expectations of the regulatory authorities.

Group Operational and Regulatory Risk Committee oversees the functioning of the operational risk framework and compliance with regulatory requirements. It has a number of sub-committees which oversee areas of risk such as data governance, financial crime, cyber security, and supplier management to a greater level of detail. It also receives information from three additional committees relating to change, people experience, and reward.

The Group's operational risk management framework sets out the group-wide strategy for identifying, assessing and managing operational risk. The framework is not static and is updated periodically in line with changes in the business profile, product developments, internal management environment and external developments. The operational risk management programme is embedded in all business operations and provides management and their teams with a structure for managing risk and control issues and to assist management in decision making.

The Group measures its operational risks based on both numerical and qualitative assessments of the risks it faces. These measures help to determine the level of control required to manage such risk within the overall risk appetite of the organisation. Operational and Regulatory risk management information is reported to Group Operational & Regulatory Risk Committee and to the Board monthly, and quarterly to the Group Risk Committee.

The Group aims to maintain a sound system of internal control that provides reasonable, but not absolute, assurance that it will not be hindered in achieving its business objectives, nor in the orderly and legitimate conduct of its business, by circumstances that may be reasonably foreseen. The focus is adapted to current conditions. For example, recent years have seen the development of more refined conduct risk strategies and controls in response to increasing expectations of regulatory authorities.

The Group's regulatory risk framework sets out to ensure that the Group delivers fair customer outcomes and meets prudential requirements. The Group continued this focus on conduct risk management during 2015 to ensure that fair outcomes for customers are paramount – a focus that aligns perfectly with the Group's strategic vision. The conduct risk strategic framework is embedded and supported by a continually refined risk appetite approved by the Board.

Outcome testing and monitoring of the five core pillars (customer treatment, product governance, sales suitability, complaints & redress, and reward) of conduct behaviour are also in place. This continues to be an area of significant focus for the Group.

Future developments

The committee framework is continuously evolving. An improvement identified for 2016 is the introduction of a Prudential Risk Committee to be chaired by the Head of Prudential Risk. Its core responsibilities will be the oversight of Prudential Risk Appetite, forecast Prudential Risk exposures and scenario/stress analyses, and regulatory developments where they impact Prudential Risk.

On behalf of the Board

David Paige
Chair of the Group Risk Committee
24 February 2016

Directors' Remuneration Report

LETTER FROM THE CHAIRMAN OF THE REMUNERATION COMMITTEE

Dear Member,

The purpose of the Directors' Remuneration Report is to detail the remuneration arrangements of our Board throughout 2015, to outline the rationale for pay decisions taken, and to confirm the bonus outturn for the year. Decisions made by the Remuneration Committee (the committee) are guided by the Group's Remuneration Policy.

At the 2016 AGM, members will be asked to vote upon both the Remuneration Report and the Remuneration Policy; the latter has been amended to reflect planned changes from 2016 to how we reward our executive directors for their efforts on behalf of the Group.

Remuneration in the context of 2015 performance

The industry continues to experience significant change, resulting in a challenging trading environment. The Group has adapted to both respond to these changes and work towards meeting our goal of being the most trusted provider of financial services in the UK. Within this context, the Group's 2015 financial performance remains strong.

Base Salary – The basic salary of the Chief Executive Officer (CEO) was increased by 4.2% and the other executive directors increased by between 1.3% and 3.4% on 1 May 2015. These increases were in line with those of the wider colleague group which ranged from 1.3% to 5.0%. Base pay adjustments are determined by a combination of both personal performance and relative position to the market, informed by the YBS Group's Career Framework, a grading structure that helps us to clearly understand the size and scale of roles in the organisation. Salaries are set in a manner that aids the retention of talent in a challenging environment.

Following Ian Bullock's retirement from the Board, Mike Regnier has assumed the role of Chief Customer Officer, whilst retaining responsibilities previously held in his role of Chief Commercial Officer. As a result of the increase in his responsibilities, Mike's salary was increased from £322,608 to £354,870 from 1 December 2015.

Board Changes

Ian Bullock – As announced in the Chairman's report (page 7), Ian Bullock retired as Chief Customer Officer on 30 November 2015. Until this date, Ian continued to receive a salary of £330,702 along with the relevant benefits outlined on page 68 of the Remuneration Report. In line with the Group's policy on retirement arrangements and loss of office on page 81, Ian will continue to be eligible to receive a bonus in respect of 2015 performance, pro-rated to reflect the time spent in role. His outstanding deferred bonus awards earned in previous years will be paid subject to committee discretion.

Chairman and Non-executive Director Changes – Ed Anderson retired from his role as Chairman of the Group after the 2015 AGM on 21 April. Philip Johnson also retired after the 2015 AGM and Lynne Charlesworth retired as Vice-Chair of the Group on 31 October 2015. The fees paid to each non-executive director, as outlined on page 73 reflect the time spent in role during 2015.

On behalf of the committee, I extend our best wishes to Ian, Ed, Philip and Lynne in retirement and thank them for their contribution to the Group.

Following Lynne Charlesworth's retirement, Mark Pain assumed the role of Vice-Chair and that of Senior Independent Director. At the same time, David Paige commenced the role of Chairman of the Risk Committee, also vacated by Lynne. Mark Pain assumed the role of Chairman of the Audit Committee following Philip Johnson's retirement and all fees were pro-rated to reflect the time spent in role.

John Heaps' fee for the year was £141,967 which includes a fee paid at Chairman Designate level and an increase in fee following his appointment to Chairman. The fee, with effect from 1 December, is £180,000 to reflect comparable market data and nearest peer comparisons.

Alison Hutchinson and Gordon Ireland also joined the Group in 2015 as non-executive directors and the fees paid to them reflect the time spent in role during the year.

Directors' Remuneration Report continued...

Letter from the Chairman of the Remuneration Committee continued...

Annual Bonus – As a result of performance in 2015, the committee has approved in principle, a bonus payment of £176,990 (31.01%) of base salary for the CEO, along with payments of between 18.37% and 31.01% of base salary for the Group's executive directors. These bonus awards reflect the performance of the Group; individual performance is the differentiator in terms of the percentage awarded to each executive director.

Pension – The Group's Defined Benefit pension scheme sections were closed to future accrual on 31 December 2015, with active members transferring to the Group's new Retirement Savings Plan (a Defined Contribution arrangement) from 1 January 2016. The Society had previously supported a number of pension arrangements as a result of historical changes and mergers – this move formed part of a wider change, to ensure that all colleagues have access to the same pension provision going forward. From an executive director perspective, this change impacts Andy Caton who will no longer participate in the Defined Benefit pension scheme; rather, he will receive a pension cash allowance in lieu of pension contributions.

As part of the pension changes made in 2015, it was agreed that existing members of the Defined Contribution scheme will receive an increased contribution of 0.25% per annum on joining the new pension arrangement. To reflect the scheme's revised charging structure, this increase will apply through to 31 December 2017 and in line with the arrangements made for all colleagues, participating in a Society pension arrangement at the end of 2015.

Directors' Remuneration Policy – proposed changes from 2016

The Directors' Remuneration Policy was approved by members at the 2014 AGM; it is subject to a vote every three years unless changes are made in the interim.

The Directors' Remuneration Policy will be subject to an advisory vote at the 2016 AGM as a result of planned changes to the Group's bonus arrangements. The changes are planned to take effect from 2016. The main focus of these changes relates to the composition of the Group's bonus schemes and the committee's desire to better align the Group's variable pay arrangements to its strategic delivery.

2016 Bonus – Currently, the Group employs a number of bonus schemes with varying structures and metrics that recognise (in different ways) colleagues' contribution to the organisation's success. It is intended that from 2016, the Group will employ a single bonus scheme, the structure of which will be consistent in terms of measures (Financial and Customer), and individual contribution, ensuring the Group's remuneration practices:

- support the Group's short and long-term business objectives (Financial Sustainability)
- are aligned with the Group's culture and values (Customer Experience)
- recognise individual performance (personal objectives).

The key features of the scheme are:

- The development of a bonus pool determined by reference to the Group's financial performance.
- The bonus pool is moderated up or down as a result of the Customer Experience received by our members and customers.
- Individual awards are determined by an executive director's performance against his or her annual objectives.
- The payment of bonus will remain subject to the Group's risk overlay process and requirements of the PRA's Remuneration Code.
- The bonus opportunity for the executive directors in 2016 is unchanged from 2015: target performance will yield a payment of 30% of base salary, and maximum bonus opportunity of 50%.
- Bonus deferral will apply as detailed in the Remuneration Policy on page 71 and in line with the Remuneration Code.

In addition, subject to committee discretion and the Group's risk overlay process, from 2016, executive directors who resign from the Group will be eligible to receive deferred bonus payments earned in previous years. Under these circumstances, the Share Equivalent Instrument (SEI) value will remain at the original allocated amount.

It is these changes that members are being asked to make an advisory vote upon at the 2016 AGM.

This report discloses information in line with the Building Societies (Accounts and Related Provisions) Regulations 1998; and the Pillar 3 disclosure requirements relevant to a Proportionality level 2 firm (relating to the European Banking Authority's CRD IV requirements). The Society also voluntarily complies, where possible, with disclosure requirements of the Large and Medium-sized Companies (Accounts and Reports) Regulations 2008.

I trust that our members will agree that the performance of the Group and its leaders in 2015 warrants their continued approval of the Annual Report on Remuneration. In addition, I trust that the proposals outlined in relation to the Group's forward looking Directors' Remuneration Policy will also receive your endorsement.

Guy Parsons
Chair of the Remuneration Committee
24 February 2016

Directors' Remuneration Report continued...

Annual Report on Remuneration

This section sets out the implementation of the Group's Remuneration Policy (as agreed at the 2014 AGM) in 2015. The Directors' Remuneration Policy on page 76 details the Group's remuneration policy, to be applied from January 2016.

Executive Directors' Remuneration

The table below shows the remuneration of the executive directors of the Group for the years ended 31 December 2015 and 2014. This is audited information.

	Salary £000[1]	Variable pay £000[2]	Deferred Variable pay from previous years £000	Taxable benefits £000[5]	Increase in accrued pension £000[6]	Pension contribution/cash allowance £000[7]	Total £000[9]
Year ended 31 December 2015							
Executive Director							
Ian Bullock[9]	301	42	91[11]	10	–	48	492
Andy Caton	306	28	58[3,11]	12	4	–	408
Robin Churchouse	331	45	69[11]	11	–	53	509
Chris Pilling	571	71[3]	169[3,11]	15	–	92	918
Mike Regnier	319	49	163[3,4]	11	–	51	593
Total	1,828	235	550	59	4	244	2,920
Year ended 31 December 2014							
Ian Bullock	321	57	79[10,11]	9	–	51	517
Andy Caton	303	43[3]	60[6,10,11]	11	9	–	426
Robin Churchouse	325	19	87[10,11]	11	–	52	494
Chris Pilling	548	97[3]	175[3,4,11]	15	–	88	923
Mike Regnier[8]	180	36	140[3,4]	6	–	29	391
Total	1,677	252	541	52	9	220	2,751

Directors' Remuneration Report continued...

Notes on individual elements of remuneration

1. Salary

Defined as basic pay paid over the course of the calendar year. In 2014, pension cash allowances paid to executive directors were included under the salary heading. For clarity, these are now included in the column headed "Pension contribution / cash allowance" and the 2014 table is updated to reflect this change.

The amount shown for Ian Bullock in the 2015 table reflects the amount paid to him prior to his retirement on 30 November 2015.

Executive directors are eligible to receive a salary increase each May at the annual Pay Review. The 2015 increases were in line with those of the wider colleague group which ranged from 1.3% to 5.0% based on performance, relative position to market, affordability, and with the aim of retaining talent in a challenging environment.

The executive director base salaries from 1 May 2015 are as set out below:

	£	Increase %
Ian Bullock	330,702	1.60
Andy Caton	307,860	1.60
Robin Churchouse	332,634	1.30
Chris Pilling	578,523	4.20
Mike Regnier[1]	322,608	3.40

Change in CEO pay

The table below sets out the percentage change in salary from the prior year at pay review for the CEO compared to the wider colleague population. This includes all colleagues, as well as other executive directors.

Pay Review Percentage Change 2015	2015 Pay Review Salary Increase
CEO	4.20%
Colleague average (including executive directors)	2.67%
Overall change in CEO pay (including salary, bonus, benefits and pension) in 2015	-4.42%

This change is based on overall pay awarded in 2014 vs. 2015 rather than what is received in this timeframe, as reported in the Single Figure Tables on page 68.

2. Variable pay in 2015

This consists of bonus payments due to each executive director to be paid in April 2016 (undeferred element, reflective of 2015 performance).

Any bonus awarded reflects the performance of the Group and the individual performance of each executive director, and the bonus measures are based on profit before tax, cost, customer service scores and personal objectives.

Bonus targets and 2015 annual bonus outturn (where individual performance is assumed as 'met')

Performance Condition	2015 Target as a % of base salary	Payout calculated as a % of base salary
Pre-tax profit (adjusted)	15.00%	15.69%
Cost	7.50%	2.37%
Customer service (NPS)	7.50%	9.50%
Total	30.00%*	27.56%

* Bonus is capped at 50% of base salary for all executive directors.

The overall pre-tax profit result, as mentioned on page 8, was below target; however the pre-tax profit measure used in the annual bonus scheme excludes all Day 1 Fair Value release, resulting in a higher performance against target.

Bonus awards are delivered after the end of the performance period (2015) and are subject to deferral. The amount that is deferred is in cash as outlined on page 71 "Bonus deferral – 2015".

The bonus due to Ian Bullock in respect of 2015 performance has been pro-rated to reflect his time in role up to his retirement from the Group on 30 November 2015.

3. SEI (Share Equivalent Instrument)

Where applicable, 50% of variable pay awards are delivered via a SEI. For the purposes of calculating Total Remuneration to determine whether Andy Caton has reached the 'de-minimis'* threshold we have used the employer contributions to the Defined Benefit pension scheme meaning 50% of his bonus in 2014 is delivered in the form of a Share Equivalent Instrument.

[1] Mike Regnier's salary was increased by 10% to £354,870 from 1 December 2015 to reflect the additional responsibilities he assumed upon appointment as Chief Customer Officer.

* **De Minimis:** in 2015, where a colleague's total remuneration is greater than £500,000 per annum and/or where variable remuneration totals more than 33% of their total remuneration, bonus is paid over four years, 40% is paid following the end of the performance period and 20% is paid in years two, three and four respectively and 50% of the total bonus must be delivered in shares or via a share equivalent instrument.

Directors’ Remuneration Report continued...

4. Deferred variable pay from previous years

These deferred variable pay awards include payment to compensate for lost earnings incurred by Chris Pilling (included in the 2014 table) and Mike Regnier (2014 and 2015 respectively) on leaving their previous employer.

5. Taxable benefits

The executive directors received benefits in 2015 that comprised a company car (or equivalent allowance), private medical insurance and permanent health insurance. Ian Bullock’s benefits ceased upon retirement from the Group on 30 November 2015. No significant changes to the construct of the executive directors’ benefits entitlement are envisaged for 2016.

In addition, in common with all other colleagues, the executive directors can participate in a concessionary mortgage scheme which is subject to a maximum concessionary amount of £160,000, although none do so.

6 & 7 Pension arrangements

Up to the end of 2015, the executive directors were either eligible to participate in the contributory defined benefit section (on a career average revalued earnings basis) or the defined contribution section of the Group’s pension scheme. The pension schemes also provide for dependents’ pensions and a lump sum of four times basic salary on death in service.

6. Increase in accrued pension – relates to Andy Caton’s membership of the Group’s Defined Benefit Pension Scheme. The increase in accrued pension relates to the change in the annual pension to which Andy Caton is entitled as a result of changes in pensionable earnings (excluding inflation) and increases in pensionable service during the year. The value of this defined benefit pension includes those arising from unfunded arrangements:

7. Pension contribution/cash allowance – a contribution of up to 16% of base salary is paid directly into the defined contribution pension scheme for the executive directors (excluding Andy Caton). Where prevailing tax restrictions limit pension contributions, the remainder is paid as a cash allowance.

Employee contributions for both the defined contribution section and the defined benefit section of the YBS pension scheme are paid by salary sacrifice. The employer contributions do not include these additional employee contributions as they are effectively included in the pre-sacrifice salary figures.

8. Executive director appointment

Mike Regnier was appointed as an executive director on 3 June 2014. The 2014 single figure table therefore outlines his remuneration from that date.

9. Executive director retirement

Ian Bullock retired from the Society on 30 November 2015. The 2015 single figure table therefore outlines his remuneration until that date. In line with the Group’s policy on retirement arrangements and loss of office on page 81, Ian will continue to be eligible to receive a bonus in respect of 2015 performance, pro-rated to reflect the time spent in role. His outstanding deferred bonus awards earned in previous years will be paid subject to committee discretion.

	Contributions from director £000	Increase in accrued pension £000	Accrued pension at 31 Dec 2015 £000	Transfer value of accrued benefits at 31 Dec 2014 £000	Transfer value of accrued benefits at 31 Dec 2015 £000	Movement in transfer value less directors’ contributions £000
Andy Caton	–	4	152	2,599	3,363	764

Directors' Remuneration Report continued...

10. Malus

The 2011 bonus awards for three executive directors were subject to malus reductions of between 5% and 10% (pro-rated due to time in role) in response to enforcement action linked to the structured deposit promotional material. The reduction was confirmed in the 2014 Annual Report and Accounts and applied to the final 2011 deferred element that was paid in 2015.

11. Malus

Deferred bonus elements in respect of the 2012 performance period for some executive directors were subject to a 5% reduction due to the arrears issues as detailed in the 2013 Annual Report and Accounts.

Neither Malus adjustments affect remuneration awarded in 2015.

Bonus Deferral – 2015

All executive director bonus awards in 2015 comply with the PRA's Remuneration Code and are subject to deferral. Deferred elements are in turn subject to future performance conditions, and may be reduced or forfeited as appropriate. If the first deferred element is not paid, this does not impact on the later deferred elements, which stand alone and are subject to the relevant performance condition for that year.

Executive directors, Chief Officers and Material Risk Takers (MRTs) below the "de-minimis" threshold

Percentage of Bonus Deferred	Bonus Delivery	Payment of Deferred Bonus
50% of any bonus earned is paid following the end of the performance period and 25% is paid in each of the following two years.	Cash	Payments will be reduced or forfeited if the sustainable level of capital required to support the Group's growth rate is not generated each year. This is done via a scale adjustment measured against a minimum level of Return On Mean Assets (ROMA) for each year based upon the growth achieved. In addition, a 'risk overlay' process considers the management of specific business risk appetite measures and payment can be amended where material breaches are identified.

2015 Bonus	Delivery	2016	2017	2018
Undeferred April	Cash			
Deferred year 1 April	Cash			
Deferred year 2 April	Cash			

Key:

bonus deferral period

Directors' Remuneration Report continued...

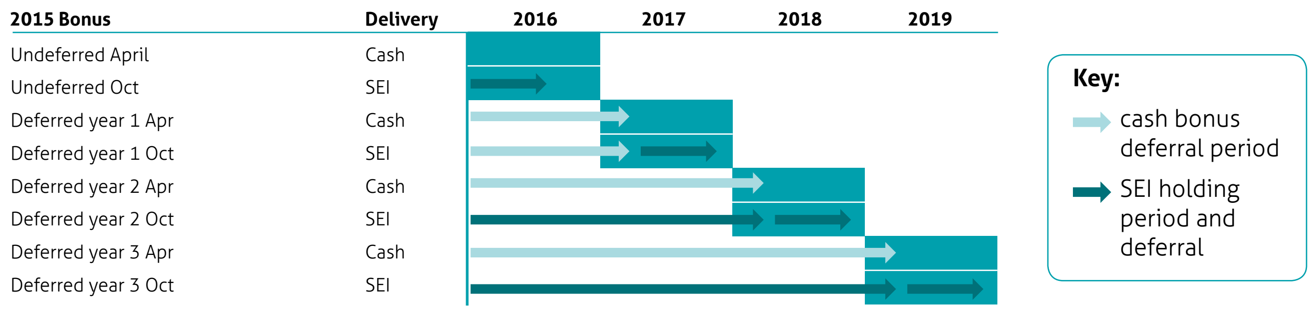
CEO and executive directors above the "de-minimis" threshold

Colleagues above the "de-minimis" threshold receive their bonus via a mixture of cash and SEI. The SEI is an award of units that act like a share, £1 equals 1 unit and the number of units initially awarded is determined by a colleague's bonus achievement.

Each year the units are valued based on a Return on Mean Asset (ROMA) multiplier prior to payment, with the value being assessed based on the Group's full year results published in March. The award of units is then held for a further six month period where they are re-valued for a final time based on half year results before being converted into a cash payment.

Percentage of Bonus Deferred	Bonus Delivery	Share Equivalent Instrument (SEI)
40% of any bonus earned is paid following the end of the performance period and 20% is paid in years two, three and four respectively.	**Undeferred element** 50% paid as cash, 50% subject to a six month retention requirement and delivered via share equivalent instrument. **Deferred elements** 50% of each deferred element paid as cash and 50% subject to a six month retention requirement and delivered via a share equivalent instrument.	The Performance Measures are the same as for executive directors that are below the "de-minimis" threshold. The ROMA multiplier is the ratio of the actual ROMA for the relevant financial year divided by the target ROMA for the year. The number of units awarded in 2015 is the element of bonus earned in 2015 which is to be delivered via the share equivalent instrument divided by the deemed initial unit value of £1. The SEI is subject to a cap on unit value of £1.25 per unit.

Length of time variable pay is at risk



Directors' Remuneration Report continued...

Non-executive directors' remuneration

Fees

Consideration of external market data, the responsibilities of each non-executive director, and the skills and time commitment required to discharge their duties is taken into account in determining non-executive director fees. The committee has no input into the setting of non-executive director fees; however, the Chairman of the committee recommends the Chairman's fee.

The non-executive directors' basic and committee fees for 2015 are outlined below. Note that the Group's non-executive directors do not receive any benefits. Non-executive directors are reimbursed for any expenses incurred, such as travel and subsistence. Any tax due is the responsibility of individual non-executive directors.

Non-executive director remuneration – year ended 31 December 2015

Non-executive director	Basic Fees £000	Committee Fees[1] £000	Total £000
Ed Anderson (Chairman, retired 21 April 2015)	47	–	47
John Heaps (Chairman from 21 April 2015[2])	142	–	142
Dame Kate Barker[3]	47	19	66
Lynne Charlesworth (retired 31 October 2015)	57	16	73
Alison Hutchinson (appointed 4 February 2015)	42	10	52
Gordon Ireland (appointed 1 September 2015)	16	–	16
Philip Johnson (retired 21 April 2015)	14	6	20
David Paige[3]	47	43	90
Mark Pain (Vice Chairman from 1 November 2015)	50	24	74
Guy Parsons	47	14	61
Total	509	132	641

[1] Details of non-executive director committee membership and role-holders are set out in the table on page 56.

[2] John Heaps joined the Group as Chairman Designate on 20 November 2014, and was appointed Chairman on 21 April 2015.

[3] The Committee fees for David Paige and Dame Kate Barker include £22,015 and £5,474 respectively for their duties as Chairman and Trustee of the Yorkshire Building Society Pension Scheme in 2015.

Directors' Remuneration Report continued...

Changes to non-executive director fees

In 2015, the fees for the Chairman increased by 5.0% and the other non-executive directors by 2.7% at the July fee review, reflecting the principles outlined above and in line with the general pay award for colleagues. Committee membership fees increased slightly ahead of this figure, and the fee of the Remuneration Committee Chair was increased to £16,000 to bring it closer to the fees of the Chairs of the Audit Committee and Group Risk Committee, reflecting the level of responsibility associated with the position.

From 1 December 2015, the Chairman's fee was increased to £180,000 to reflect comparable data available and nearest peer comparisons. The changes are reflected below:

Non-executive director fees (annual equivalents)	Overall Fees 2014 £	Overall Fees 2015 £
Chairman's basic fees	150,400	158,013
Vice-Chair basic fees	66,365	68,206
Non-executive Director basic fees	45,360	46,616
Additional fee for:		
Audit Committee – Chair	18,765	19,340
Audit Committee – Member	7,770	7,997
Remuneration Committee – Chair	12,510	14,374
Remuneration Committee – Member	5,175	5,321
Group Risk Committee – Chair	18,765	19,340
Group Risk Committee – Member	7,770	7,997

Directors' Remuneration Report continued...

Aggregate remuneration data

In accordance with the Capital Requirements Regulation as part of CRD IV, which requires the disclosure of the aggregate remuneration data for senior managers and MRTs, the Group's data is set out as follows:

	Senior Management[1] £000	Other MRTs £000	Total £000
Aggregate remuneration data			
Fixed Pay	9,165	752	9,917
2015 Variable Pay (undeferred)	949	62	1,011
2015 Variable pay (deferred)	828	–	828
2015 Variable Pay due via SEI	140	–	140
Deferred variable pay to be paid 2016	1,187	–	1,187
Outstanding deferred variable pay from previous years	1,862	–	1,862
Total	14,131	814	14,945
Aggregate bonus buyout and severance payments			
Bonus Buyout Payments – 2015	492	–	492
Severance Payments – 2015	404	–	404
Total	896	–	896

	Senior Management	Other MRT	Total
Number of MRT colleagues	47	8	55
Number of Bonus Buyout Recipients	7	0	7

Ratios between fixed and variable pay

YBS Group's fixed:variable pay ratio is not affected by the CRD IV cap on variable pay as the variable component of total remuneration to the fixed component does not exceed 1:1. The split between fixed and variable remuneration for executive directors in 2015 is set out below:

	Proportion (On Target Achievement)		Proportion (Max Achievement)		Actual 2015 Ratio	
	Fixed Element	Variable Element	Fixed Element	Variable Element	Fixed Element	Variable Element
All executive directors	80.25%	19.75%	70.93%	29.07%	81.80%	18.20%

[1] Senior managers and colleagues whose actions have a material impact on the risk profile (including executive and non-executive directors). Non-executive directors' fees are included under fixed pay. No variable pay was awarded to non-executive directors.

Directors' Remuneration Report continued...

Individuals remunerated €1 million or more

Number of colleagues	Total Remuneration Band
1	€1m – €1.5m

Payments to past directors

There were no payments made to past directors during the financial year ended 31 December 2015.

Payments for loss of office

There were no payments made for directors' loss of office during the financial year ended 31 December 2015.

Remuneration Policy

The Group's directors' remuneration policy aligns to our five strategic priorities; to deliver a leading customer experience, to attract and retain the best talent with a leading people experience, to deliver products and processes that are easy and simple, to deliver sustainable financial performance and to be locally famous. The Remuneration Policy supports these priorities by allowing the Group to recruit and retain talent, to focus on our customers and by being compliant from a regulatory perspective.

The Group's approach to remuneration recognises its executive directors for their contribution to the organisation's success. No executive director, Chief Officer or MRT colleague is involved in deciding his or her own remuneration.

A key principle in developing the Group's remuneration policy is to focus the executive directors and non-executive directors on the delivery of key business and customer outcomes together. The Group's Remuneration Policy and how it intends to manage remuneration in 2016 is outlined below:

Remuneration Element	Purpose and link to strategy	Operation	Opportunity
Salary	Reflects the ongoing value of executive directors in their role as defined by the combination of: ▪ Skills, knowledge and experience; ▪ Performance; ▪ Demonstrating the Group's behaviours and values.	Base salaries are typically reviewed annually (or more frequently if required) in line with the range of increases for all colleagues, and determined with reference to: ▪ Role, experience and individual performance; ▪ Affordability – the economic environment and overall financial state of the Group; ▪ External market factors established with reference to the YBS Group's Career Framework grading structure.	There is no 'maximum' salary opportunity; however, pay decisions are operated within a framework where: ▪ A change to executive director responsibilities has occurred; ▪ Higher increases may be awarded where there is a strong commercial rationale to do so.
Bonus	Rewards the achievement of Group performance criteria, anchored to the core business objectives of financial performance, customer experience and risk.	Both the Group Risk Committee and the Audit Committee input into a Risk Overlay process that provides objective business risk and sustainability assessments.	'On-target' achievement of Group performance criteria results in a bonus of 30% of base salary for the executive directors. The maximum bonus available to executive directors is 50% of base salary.

Directors' Remuneration Report continued...

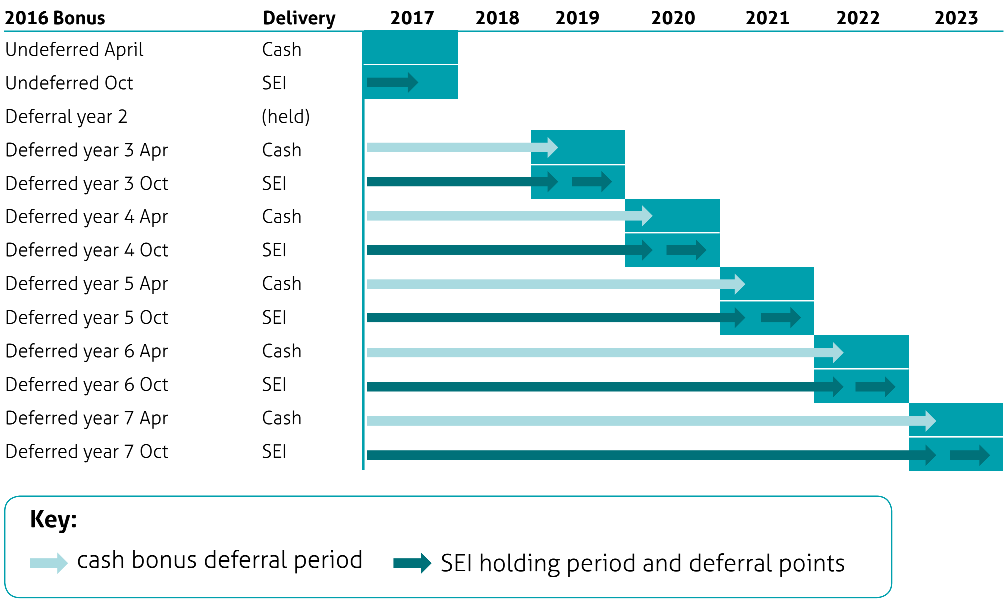
Remuneration Element	Purpose and link to strategy	Operation	Opportunity
Bonus (Cont'd)	The ability to pay a bonus is determined by the financial performance of the Group in a given year. This in turn generates a bonus pool that may be adjusted up or down according to the standard of customer experience provided to our members and customers, and individual performance.	These independent assessments form the basis of any recommendation to the committee to adjust bonus payments for consideration. The committee reserve the right to apply a malus[1] adjustment (reduce bonus or lapse deferred elements) and to apply clawback[2] as applicable. All bonus awards to the executive directors are subject to deferral. Bonus deferral ensures that the Group delivers variable pay in a form that prevents undue risk taking and achievement of sustainable performance and complies with the remuneration code.	The delivery of annual bonus awards will normally be delivered as cash paid over three years: **Year 1** – 50% of any bonus earned is paid out in the year following the performance year. **Years 2 & 3** – the remaining 50% is deferred, with 25% released in year 2 and 25% in year 3. This scenario applies unless a greater proportion of the award or a longer deferral period is required by regulations. Where also required by regulations, 50% of a payment will be delivered as SEI which is subject to a further retention period. **For example: Executive Directors designated as "Senior Managers" under the Senior Manager Regime and over the 'de-minimis' – paid via cash and SEI over 7 years:** **Year 1** – 40% of any bonus earned is paid out in the year following the performance year. Half of this amount is paid in cash in April and the other half is delivered in a SEI and subject to an additional retention period prior to revaluation and payment. **Deferral Years** – the remaining 60% is deferred for 7 years and paid equally each year from 3 years after the award. Each year, the award is split in two, with half the amount paid in cash in April and the second half held in a SEI and subject to an additional retention period prior to revaluation and payment. SEI valuations continue every six months until the bonus schedule is complete.

[1] **Malus:** Where issues associated with colleague conduct are evident, or where the Group or business unit in which a colleague is engaged suffers a material downturn, a material failure of risk management, or misstatement of the Group's audited results, the committee may reduce whole or part of a bonus and/or any unvested awards.

[2] **Clawback:** Where issues associated with colleague conduct are evident, or where the Group or business unit in which a colleague is engaged suffers a material downturn, a material failure of risk management, or misstatement of the Group's audited results, the committee, at its discretion, will be entitled to seek recovery of bonus payments already paid for a period of at least seven years from the date on which it is awarded.

Directors’ Remuneration Report continued...

Length of time variable pay is at risk – example of 7 year deferral:



Remuneration Element	Purpose and link to strategy	Operation	Opportunity
Benefits	Executive directors receive benefits to ensure their total package is in line with market practice to enable the attraction and retention of executive directors of the required calibre.	YBS provides a number of benefits, principally consisting of: ▪ Private medical insurance; ▪ Life assurance; ▪ Concessionary mortgage and savings accounts; ▪ Insured sick pay; ▪ Provision of a company car, or cash equivalent.	There is no ‘maximum’ level of benefits – the overall value of benefits to the Group’s executive directors is determined by the nature of its benefit offering which is subject to change throughout a given year.
Pension	The Group’s pension arrangements support the recruitment and retention of executive directors through the provision of competitive retirement benefits.	Executive directors are eligible to participate in the Group’s defined contribution pension scheme. Where contributions exceed the annual or lifetime allowance, executive directors may be permitted to take a cash supplement instead of contributions to the plan.	Executive directors receive a contribution (or cash allowance) equal to a maximum of 16% of base salary.

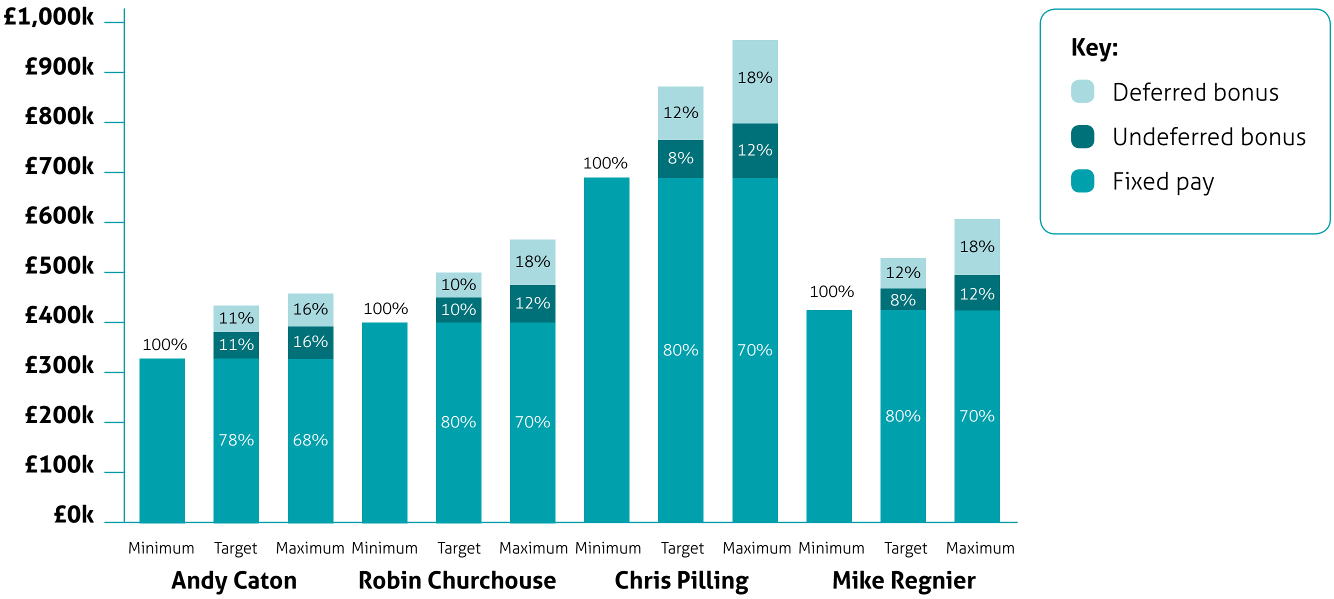
Directors' Remuneration Report continued...

Remuneration scenarios

The chart below shows the potential split of remuneration between fixed pay (salary, benefits and pension) and variable pay for the CEO and other executive directors under the following scenarios:

- Minimum – under certain performance conditions, bonus can be zero.
- Target – represents bonus remuneration (30% of base salary) that would be paid if Group and personal performance measures are achieved in 2016.
- Maximum – the maximum bonus (50% of base salary) that could be paid assuming Group and personal performance measures are fully realised.

Executive Directors' Potential Remuneration – 2016



The following assumptions have been made in developing the above scenarios:

- For illustrative purposes, salary, pension and benefit contributions are shown based on 1 January 2016 data.
- The delivery of bonus awards is determined by the executive directors' position against the 'de-minimis' criteria, resulting in payment in cash over three years, or via cash and SEI over seven years.
- Where applicable, the value of potential variable pay awards is shown prior to the valuation of the SEI.

Executive pay relative to the wider colleague population

The committee approves executive pay against the Remuneration Policy and in the wider context of colleague remuneration. Colleagues have the opportunity to share their views on subjects such as the remuneration policy via the colleague "Viewpoint" survey.

Directors' Remuneration Report continued...

Approach to new hires

Provision	Policy
New hires	When agreeing the components of a remuneration package for the appointment of executive directors, the committee will apply the following principles: - The packages will be sufficient to recruit individuals of the required calibre to lead the business and effectively execute the strategy for members; - The committee will look to align the remuneration package offered with the Group's broader remuneration policy; and, - The committee will ensure that the level of pay is necessary but not excessive. The committee has discretion within the policy to make remuneration decisions where it considers it appropriate to do so. In determining remuneration arrangements, the committee will consider similar positions in the market, the structure of the remuneration package and the experience of the candidate. This ensures that arrangements are in the best interests of both the Group and its members without paying in excess of what is necessary to recruit an executive director of the required calibre.
Bonus buyouts	The committee may make awards on hiring an external candidate to the Board to compensate them for the forfeiture of any award entered into with a previous employer. In determining any such 'buy out', the committee will consider all the relevant factors including the likelihood of the awards vesting should the candidate have remained in their previous employment, the form in which they were awarded and the time over which they would have vested. Bonus buyouts will be liable to forfeiture or 'clawback' in the event of early departure and are executed in line with the Remuneration Code.

Leaver arrangements and loss of office

The committee shall apply the policy in relation to leavers, taking into account performance, conduct and commercial justifications, as summarised below:

Provision	Policy
Notice period	The standard notice period is 12 months from the Group and 12 months from the executive directors. In normal circumstances, executive directors will be required to work their notice period. In the event executive directors are not required to fulfil their notice period, they will receive a payment in lieu of notice, or they may be placed on garden leave. Chief Officers and other MRTs have notice periods varying between three months and one year, depending on the role undertaken.
Termination payment	Typically, termination payments will consist of basic salary and other contractual benefits for the notice period, the emphasis being to not reward failure.

Directors' Remuneration Report continued...

Provision	Policy
Annual bonus – leaver provisions	On termination of office, the leaver provisions as set out below will apply. These are also outlined in the Group's bonus plan rules: ▪ In the event of retirement or redundancy, ill-health or disability, any bonus will be pro-rated to reflect the time served during the performance period. Any deferred payments due remain subject to future performance conditions and are payable at the end of the corresponding performance periods. They are also subject to the Group's risk overlay process, and therefore subject to the Group's malus and clawback provisions. ▪ In the case of death, any bonus payments will be pro-rated to reflect the time served during the performance period. Payment of any deferred amounts, including deferred amounts from previous years, is accelerated and payable at the next payment date. ▪ Subject to committee discretion, in the event of resignation, any eligibility to participate in the current year's bonus scheme will cease. Leavers under these circumstances will be eligible to receive deferred bonus payments earned in previous years, subject to the Group's risk overlay process. ▪ Where deferred awards continue, they remain subject to the Group's risk overlay process, malus and clawback provisions. Under resignation circumstances, the SEI value will remain at the original allocated amount.

Changes to the Remuneration Policy

As mentioned in the Chairman's letter on page 66, the Remuneration Policy will be subject to an advisory vote at the 2016 AGM as a result of planned changes to the Group's bonus arrangements. If approved by members the changes will take effect in respect of the 2016 performance year onwards. The changes are summarised below:

Element	Change
Bonus	The Group will adopt one consistent scheme structure that rewards all colleagues in the same way for their contribution to the Group's success. The key features of the scheme are: ▪ The development of a bonus pool determined by reference to the Group's financial performance. ▪ The bonus pool is moderated up or down as a result of the Customer Experience received by our members and customers. ▪ Individual awards are determined by an executive director's performance against his or her annual objectives. ▪ The payment of bonus will remain subject to the Group's risk overlay process and requirements of the PRA's Remuneration Code. ▪ The bonus opportunity for the executive directors in 2016 is unchanged from 2015: target performance will yield a payment of 30% of base salary, and maximum bonus opportunity of 50%. ▪ Bonus deferral will apply as detailed in the above Remuneration Policy and in line with the Remuneration Code.
Leaver arrangements	From 2016, subject to committee discretion and the Group's risk overlay process, executive directors who resign from the Group will be eligible to retain eligibility to any deferred bonus payments earned in previous years. Malus and clawback provisions continue to apply.

Directors' Remuneration Report continued...

Other changes (not being voted upon)

The Group's Defined Benefit pension scheme sections were closed to future accrual on 31 December 2015. Active members transferred to the Group's new Retirement Savings Plan (a Defined Contribution arrangement) from 1 January 2016.

From an executive director perspective, this change impacts Andy Caton who will no longer participate in the Defined Benefit pension scheme, rather, he will receive a cash allowance in lieu of pension contributions.

Non-executive directors

The below table details the construct of the non-executive directors' and the Chairman's remuneration package.

Role and element of remuneration	Purpose and link to strategy	Operation	Opportunity
Non-executive director and Chairman's fees	Sole element of remuneration set at a level that reflects market conditions and sufficient to attract individuals with appropriate knowledge and experience to provide a meaningful contribution to the Group. Fees are based on the level of fees paid to non-executive directors and chairs serving on boards of comparable organisations, the time commitment, and contribution expected from the role.	**Non-executive director** fees are determined and approved by the Board on recommendation from the CEO. The **Chairman's** fees are determined by the committee. Both the Chairman's and non-executive directors' fees are reviewed periodically, at least annually. Neither the Chairman nor any of the non-executive directors have any influence over the setting of their own fees. The Chairman's and non-executive directors' fees are not subject to any specific performance measures; however, their overall performance is reviewed on a regular basis.	**Non-executive directors** receive a basic fee and an additional fee for chairmanship and/ or membership of a committee and/or oversight roles, e.g Senior Independent Director. The **Chairman** does not receive any additional fee for chairmanship or membership of any committees. Aside from the above and reimbursable expenses, the non-executive directors and the Chairman receive no other form of remuneration from YBS Group.

Payments outside of policy

The committee retains the discretion to make payments outside the terms of this policy where there is a commercial need to do so (including interim executive director and non-executive director appointments) and in exceptional circumstances, taking into account the interests of members.

Member engagement

The Group maintains regular dialogue with members and welcomes feedback on executive director and non-executive director remuneration.

The role of the Remuneration Committee

The committee determines the YBS Remuneration Policy and uses it to set the remuneration for the Group's executive directors, Chief Officers and MRTs. The full Terms of Reference for the committee can be found at www.ybs.co.uk/committees

The committee monitors comparative remuneration packages within the financial services sector and takes independent external professional advice as appropriate. The committee consists of at least three non-executive directors. In 2015, they were Guy Parsons, Dame Kate Barker and David Paige. David resigned from the committee on 24 June 2015, and was replaced on the committee by Alison Hutchinson.

Directors' Remuneration Report continued...

Remuneration Committee attendance

The details relating to non-executive director attendance at the Remuneration Committee meetings can be found on page 56 in the Corporate Governance Report.

Remuneration Committee advisers

During 2015, the committee received independent advice from Deloitte. Deloitte is a member of the Remuneration Consultants Group and, as such, voluntarily operates under the Code of Conduct in relation to executive remuneration consulting in the UK. Deloitte's fees for providing reward policy and practice advice to the Society amounted to £24,500, inclusive of £11,950 specific to advice to the committee for the year ended 31 December 2015.

From 1 January 2016, PwC assumed the role of providing the committee with independent advice. PwC is also a member of the Remuneration Consultants Group and therefore also voluntarily operates under the Code of Conduct in relation to executive remuneration consulting in the UK.

Statement of member voting – 2015

The Group remains committed to ongoing member dialogue and takes an active interest in voting outcomes. The following table sets out actual voting in respect of the resolution to approve the Directors' Remuneration Report at the Society's Annual General Meeting (AGM) in 2015. Note that, since the Remuneration Policy was approved by members at the 2014 AGM, remained unchanged, there was no member vote on the Remuneration Policy at the 2015 AGM.

Resolution	Votes for	Votes against	% in favour	Votes withheld
To approve the Directors' Remuneration Report	147,160	17,594	89.32	3,609

As noted in the committee Chairman's letter, there will be an advisory vote on both the Annual Report on Remuneration and Directors' Remuneration Policy at the 2016 AGM.

On behalf of the Board

Guy Parsons
Chair of the Remuneration Committee
24 February 2016

Directors' Responsibilities Statement

The following statement, which should be read in conjunction with the statement of the Auditor's responsibilities on pages 85 to 89, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report.

The directors are required by the Building Societies Act 1986 (the Act) to prepare, for each financial year, Annual Accounts which give a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of the affairs of the Society and the Group as at the end of the financial year and which provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it.

The Act states that references to International Financial Reporting Standards (IFRS) accounts giving a true and fair view, are references to their achieving a fair presentation.

In preparing those Annual Accounts, the directors are required to:

- Select appropriate accounting policies and apply them consistently.
- Make judgements and estimates that are reasonable and prudent.
- State whether the Annual Accounts have been prepared in accordance with IFRS.
- Prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

In addition to the Annual Accounts, the Act requires the directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Society and its subsidiary undertakings.

The directors are responsible for the maintenance and integrity of statutory and audited information on the Society's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' responsibilities for accounting records and internal control

The directors are responsible for ensuring that the Society and its subsidiary undertakings:

- Keep accounting records in accordance with the Building Societies Act 1986.
- Take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Prudential Regulation Authority under the Financial Services Act 2012.

The directors have general responsibility for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

We consider that the Annual Report and Accounts, taken as a whole is fair, balanced, and understandable and provides the information necessary to assess the Group's performance, business model and strategy.

On behalf of the Board

John Heaps
Chairman
24 February 2016

Independent Auditor's Report
to the members of Yorkshire Building Society

In our opinion the financial statements:

- Give a true and fair view, in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2015 and of the Group's and the Society's income and expenditure for the year then ended; and
- Have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The financial statements comprise the Group and Society Income Statements, the Group and Society Statements of Comprehensive Income, the Group and Society Statements of Financial Position, the Group and Society Statements of Changes in Members' Interests, the Group and Society Statements of Cash Flows, and the related Notes 1 to 42. The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Going concern and the directors' assessment of the principal risks that would threaten the solvency or liquidity of the Group

We have reviewed the directors' statement regarding the appropriateness of the going concern basis of accounting contained within the introduction to the notes to the accounts on page 95 to the financial statements and the directors' statement on the longer-term viability of the Group contained within the strategic report on page 33.

We have nothing material to add or draw attention to in relation to:

- The directors' confirmation on page 84 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- The disclosures on pages 60 to 65 that describe those risks and explain how they are being managed or mitigated;
- The directors' statement on page 95 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements;
- The directors' explanation on page 46 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We agreed with the directors' adoption of the going concern basis of accounting and we did not identify any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Independence

We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and we confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards.

Independent Auditor's Report
to the members of Yorkshire Building Society continued...

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

Risk	How the scope of our audit responded to the risk
Loan loss provisions The Group holds £48.9 million of impairment provisions at year-end (2014 – £46.2million) against total loans and advances to customers of £33.3bn (2014 – £32.2bn). Determining impairment provisions against loans to customers is a judgemental area requiring an estimate to be made of the losses incurred within the residential mortgage and commercial lending portfolios. This requires the estimation of customer default rates, property values and movements, sales costs, forced sale discounts and likelihood of repossession and potential impairment indicators, all of which may be sensitive to changes in the economic environment. Loan loss provision balances are detailed within note 28. Management's associated accounting policies are detailed on page 97 with detail about judgements in applying accounting policies and critical accounting estimates on page 101.	We challenged the appropriateness of management's key assumptions used in the impairment calculations for loans and receivables, including the impairment trigger point, probability of default, the estimation of property values, sales costs, forced sale discounts and the likelihood of repossession. In order to assess the reasonableness and accuracy of these assumptions, we tested the design and implementation of controls around the lending cycle used to derive this data, and where relevant recalculated the Society's calculations, benchmarking the outputs against internal and external data. We tested the mechanical accuracy of the related models, including engaging our IT specialists to test the underlying key controls, including access controls to key spreadsheets, and to test data flows into the models to assess whether the data was complete and accurate. We performed substantive testing, including tests of existence and valuation, on the mortgage book, focusing on loans that display characteristics of audit interest. For commercial loans, we performed detailed file reviews of a sample of properties across the book, including identifying any breaches against the covenants in place and assessing whether these had been properly reflected within provision calculations by management. We tested the valuation of the underlying property collateral using our property valuation specialists.
Fair value adjustments The Group's assessment of the utilisation of the fair value adjustments that were established upon the merger of the Society with Norwich & Peterborough Building Society and Chelsea Building Society in prior years is an area that requires the use of significant judgement. The primary judgement relates to the level of lifetime losses that are expected from the acquired loan books, in particular those arising from the interest only and Iberian portfolios, compared with those anticipated at the dates of the mergers with any reduction in the required provision being reflected in the effective interest rate and any additional provision being reflected as an incurred loss impairment.	We tested the movement in the fair value adjustments that were established at the point the mergers took place and challenged the appropriateness of the utilisation and unwind of these adjustments over time. We challenged the key assumptions used in the calculation of the lifetime impairment adjustment, including comparing them with industry benchmarks (where available) and internally and externally available data. The principal assumptions include the lifetime probability of default, the estimation of property values, sales costs, forced sale discount, and future unemployment and interest rate predictions.

Independent Auditor's Report

to the members of Yorkshire Building Society continued...

Risk	How the scope of our audit responded to the risk
Fair value adjustments (cont'd) The re-estimation of the fair value adjustment has resulted in a credit to the income statement of £4.0 million in the year (2014 – £20.1 million). Management's associated accounting policies are detailed on page 96 with detail about judgements in applying accounting policies and critical accounting estimates on page 101.	We tested the mechanical accuracy of the related models and the controls around them, including assessing whether the data used to compile the models was complete and accurate, as well as engaging our IT specialists to test the underlying key controls including access controls to key spreadsheets.
Revenue recognition The recognition of revenue on loans using an effective interest rate method requires significant judgement by management to determine key assumptions related to the expected life of each loan and the cash flows relating thereto. Such assumptions are also sensitive to changes in the economic environment. The Group held £12.4 million of unamortised origination fees on the balance sheet at year-end which will be amortised over the expected life of the associated loan portfolios (2014: £23.7 million). Management's associated accounting policies are detailed on page 96 with detail about judgements in applying accounting policies and critical accounting estimates on page 101.	We challenged the appropriateness of management's key assumptions used in the recognition of revenue using the effective interest rate method as described in Note 1 by comparison against historical customer behaviour and assessing the sensitivity of key assumptions used to determine the behavioural lives of products. We have assessed the models and the changes made to those models during the year for compliance with the requirements of IAS 39. We have also considered the associated disclosures in the financial statements for consistency with the Group's accounting policies. We tested the mechanical accuracy of the models which are used to determine revenue and the controls around them, including assessing whether the data used to compile the models was complete and accurate, as well as engaging our IT specialists to test the underlying key controls including access controls to key spreadsheets. We considered the Board's review and approval process of fees and costs to be included in the model to assess whether other income is recognised on a basis that is consistent with the Group's accounting policies and relevant accounting standards.
Hedge accounting The Group holds derivative financial instruments in order to mitigate the risks associated primarily with fixed and floating coupon rate mismatches, managing basis risk, and eliminating where possible certain foreign currency exposures. The hedge accounting requirements are complex and require significant skilled input and oversight by management, as well as robust systems and controls particularly due to the number of both micro and macro hedge arrangements in the Group. Management's associated accounting policies are detailed on page 96 with detail about judgements in applying accounting policies and critical accounting estimates on page 101.	We tested management's application of hedge accounting which comprised testing hedge documentation for compliance with the requirements of IAS 39, and independently re-performing a sample of hedge effectiveness tests conducted by management during the year. We independently valued a sample of derivative instruments using our financial instruments valuation specialists and used analytics to identify derivatives which are outliers in the population to focus our testing on those items that exhibit more audit risk.

Independent Auditor's Report
to the members of Yorkshire Building Society continued...

Last year our report included one other risk which is not included in our report this year.

Provisions for customer remediation

With a number of the remediation projects being completed in the year the expected level of regulatory provisions in the current year is immaterial. With the reduction in the materiality of known exposures and the absence of any new relevant concerns being raised by the FCA we consider the significance of this risk to be reduced to normal levels.

The description of risks above should be read in conjunction with the significant issues considered by the Audit Committee discussed on page 57.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

The accumulation of profits is critical to maintaining and building capital for regulatory purposes and allowing the Group to invest in activities for its members. We have therefore selected profit before tax as the benchmark for determining materiality. We have determined materiality by applying 5.0% (2014 – 5.0%) of this benchmark.

We determined materiality for the Group to be £8.9m (2014 – £9.4m) which represents 0.02% of total Group assets (2014 – 0.03%).

We agreed with the Audit Committee that we would report to the committee all audit differences in excess of £0.15m (2014: £0.15m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

As in the prior year, our group audit scope involved performing full audits on the Group's parent and main subsidiaries which accounted for more than 98% of the Group's net assets and 96% of the Group's profit before tax. These audits were performed directly by the Group's audit team and executed at levels of materiality applicable to each individual entity which were lower than the Group's materiality and ranged from £3.8m to £4.9m.

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

- The Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- The information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the accounting records and the financial statements; and
- The information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

Opinion on other matters prescribed by the Capital Requirements (Country-by-Country Reporting) Regulations 2013

In our opinion the information given on page 46 for the financial year ended 31 December 2015 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Building Societies Act 1986 we are required to report to you if, in our opinion:

- Proper accounting records have not been kept by the Society; or
- The financial statements are not in agreement with the accounting records; or
- We have not received all the information and explanations and access to documents we require for our audit.

We have nothing to report on in respect of these matters.

Independent Auditor's Report

to the members of Yorkshire Building Society continued...

Our duty to read other information in the Annual Report

Under the International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- Materially inconsistent with the information in the audited financial statements; or
- Apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- Otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed.

We confirm that we have not identified any such inconsistencies or misleading statements.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors. We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

This report is made solely to the Society's members, as a body, in accordance with section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society or the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes: an assessment of whether the accounting policies are appropriate to the Group's and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Peter Birch ACA
(Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Leeds
24 February 2016

Income Statements
for the year ended 31 December 2015

	Notes	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Interest receivable and similar income	3	**1,260.1**	1,308.6	**1,213.5**	1,248.4
Interest payable and similar charges	4	**(725.5)**	(759.4)	**(806.0)**	(826.6)
Net interest income		**534.6**	549.2	**407.5**	421.8
Fees and commissions receivable		**33.3**	31.7	**25.4**	(28.9)
Fees and commissions payable		**(22.5)**	(15.4)	**(16.3)**	(14.3)
Net fee and commission income		**10.8**	16.3	**9.1**	14.6
Income from investments in subsidiaries	10	**–**	–	**100.0**	–
Net losses from fair value volatility on financial instruments	5	**(6.5)**	(10.9)	**(6.7)**	(3.5)
Net realised profits	6	**2.1**	1.3	**2.1**	1.3
Other operating income		**7.2**	9.3	**51.6**	42.9
Total income		**548.2**	565.2	**563.6**	477.1
Administrative expenses	7	**(323.2)**	(303.4)	**(323.0)**	(303.4)
Depreciation and amortisation		**(22.9)**	(27.6)	**(22.9)**	(27.3)
Operating profit before provisions		**202.1**	234.2	**217.7**	146.4
Impairment (losses)/releases on loans and advances to customers	9	**(12.8)**	(20.0)	**0.5**	(1.9)
Provisions for liabilities and charges	28	**(16.0)**	(26.0)	**(16.1)**	(25.8)
Impairment releases/(losses) on investments in subsidiaries	10	**–**	–	**1.4**	(1.4)
Operating profit and profit before tax		**173.3**	188.2	**203.5**	117.3
Tax expense	11	**(34.8)**	(40.8)	**(20.5)**	(24.0)
Net profit		**138.5**	147.4	**183.0**	93.3

Net profit arises from continuing operations and is attributable to members.

The notes on pages 95 to 164 form part of these accounts

Statements of Comprehensive Income
for the year ended 31 December 2015

	Notes	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Net profit		**138.5**	147.4	**183.0**	93.3
Items that may subsequently be reclassified to profit and loss:					
Available for sale investments:					
Valuation gains/(losses) taken to equity		**12.3**	(3.1)	**12.3**	(3.1)
Amounts transferred to Income Statement (included in net realised profits)		**(10.6)**	(3.2)	**(10.6)**	(3.2)
Tax on available for sale securities	11	**(0.3)**	1.4	**(0.3)**	1.4
Cash flow hedges:					
Gains/(losses) taken to equity		**7.5**	(43.4)	**7.6**	(43.5)
Amounts transferred to Income Statement (included in net realised profits)		**7.1**	3.6	**7.1**	3.6
Tax on cash flow hedge reserve	11	**(3.0)**	8.6	**(3.0)**	8.6
Effect of change in corporation tax rate	11	**1.9**	(0.7)	**1.9**	(0.7)
Subtotal		**14.9**	(36.8)	**15.0**	(36.9)
Items that will not be reclassified subsequently to profit and loss:					
Re-measurement of net retirement benefit obligations	26	**(9.5)**	50.3	**(9.5)**	50.3
Tax relating to retirement benefit obligations	11	1.9	(11.0)	1.9	(11.0)
Effect of change in corporation tax rate	11	**(3.3)**	1.0	**(3.3)**	1.0
Effect of change in corporation tax rate on prior year movements in general reserves	11	**2.1**	–	**2.1**	–
Subtotal		**(8.8)**	40.3	**(8.8)**	40.3
Total comprehensive income for the year		**144.6**	150.9	**189.2**	96.7

The notes on pages 95 to 164 form part of these accounts

Statements of Financial Position
as at 31 December 2015

	Notes	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Assets					
Liquid assets					
Cash in hand and balances with the Bank of England	13	**3,439.3**	3,670.6	**3,439.3**	3,670.6
Loans and advances to credit institutions	14	**695.9**	599.3	**270.3**	262.5
Debt securities	15	**269.5**	524.8	**4,253.4**	4,514.8
Loans and advances to customers	16	**33,321.7**	32,234.1	**18,076.7**	18,469.3
Derivative financial instruments	34	**180.1**	214.3	**102.0**	113.2
Investments	10	**1.4**	1.4	**16,762.5**	14,406.8
Intangible assets	17	**37.3**	36.2	**37.3**	36.2
Investment properties	18	**16.6**	16.5	**16.4**	16.3
Property, plant and equipment	19	**137.9**	136.7	**137.5**	136.3
Current tax assets		**–**	–	**5.0**	6.9
Deferred tax assets	20	**28.5**	42.8	**27.1**	39.1
Retirement benefit surplus	26	**61.7**	64.4	**61.7**	64.4
Other assets	21	**28.7**	30.9	**42.1**	42.6
Total assets		**38,218.6**	37,572.0	**43,231.3**	41,779.0
Liabilities					
Shares	22	**27,396.4**	27,241.4	**27,396.4**	27,241.4
Amounts owed to credit institutions	23	**3,302.4**	3,471.3	**3,293.0**	3,471.3
Other deposits	24	**544.3**	508.0	**6,442.9**	5,788.9
Debt securities in issue	25	**4,108.8**	3,523.2	**3,447.5**	2,719.2
Derivative financial instruments	34	**340.9**	413.6	**320.9**	389.6
Current tax liabilities		**5.8**	12.8	**–**	–
Deferred tax liabilities	20	**18.9**	15.3	**17.2**	14.8
Other liabilities	27	**77.6**	83.5	**77.1**	83.0
Provisions	28	**25.8**	36.2	**25.8**	35.9
Subordinated liabilities	29	**286.1**	299.5	**286.1**	299.5
Subscribed capital	30	**6.7**	6.9	**6.7**	6.9
Total liabilities		**36,113.7**	35,611.7	**41,313.6**	40,050.5
Total equity attributable to members		**2,104.9**	1,960.3	**1,917.7**	1,728.5
Total equity and liabilities		**38,218.6**	37,572.0	**43,231.3**	41,779.0

The accounts on pages 90 to 164 were approved by the Board of Directors on 24 February 2016 and were signed on its behalf by:

John Heaps — Chairman
Mark Pain — Vice Chairman
Chris Pilling — Chief Executive

The notes on pages 95 to 164 form part of these accounts

Statements of changes in Members' Interest
for the year ended 31 December 2015

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Group				
At 1 January 2015	**1,993.6**	**(36.8)**	**3.5**	**1,960.3**
Current year movement net of tax	**129.4**	**13.8**	**1.4**	**144.6**
At 31 December 2015	**2,123.0**	**(23.0)**	**4.9**	**2,104.9**
At 1 January 2014	1,805.9	(4.9)	8.4	1,809.4
Current year movement net of tax	187.7	(31.9)	(4.9)	150.9
At 31 December 2014	1,993.6	(36.8)	3.5	1,960.3

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Society				
At 1 January 2015	**1,761.8**	**(36.8)**	**3.5**	**1,728.5**
Current year movement net of tax	**174.0**	**13.8**	**1.4**	**189.2**
At 31 December 2015	**1,935.8**	**(23.0)**	**4.9**	**1,917.7**
At 1 January 2014	1,628.3	(4.9)	8.4	1,631.8
Current year movement net of tax	133.5	(31.9)	(4.9)	96.7
At 31 December 2014	1,761.8	(36.8)	3.5	1,728.5

The hedging reserve relates to fair value adjustments on derivative financial instruments designated as cash flow hedges. It is expected that the forecast transactions will largely occur over the next five years and the amount deferred will be recognised over this period.

The notes on pages 95 to 164 form part of these accounts

Statements of Cash Flows
for the year ended 31 December 2015

	Notes	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Cash flows from operating activities:					
Profit before tax		**173.3**	188.2	**203.5**	117.3
Working capital adjustments	42	**26.6**	(28.8)	**10.5**	(103.9)
Net increase in operating assets	42	**(1,220.2)**	(2,537.1)	**(2,099.6)**	(3,567.0)
Net increase in operating liabilities	42	**22.4**	1,807.6	**630.7**	5,624.0
Net cash flows (used in)/from operating activities		**(997.9)**	(570.1)	**(1,254.9)**	2,070.4
Cash flows from investing activities:					
Purchase of property, plant and equipment and intangible assets and investment properties		**(27.4)**	(42.9)	**(27.4)**	(59.1)
Proceeds from sale of property, plant and equipment		**1.6**	0.1	**1.6**	0.1
Purchase of debt securities		**(202.1)**	(251.7)	**(1,452.1)**	(3,693.7)
Proceeds from sale and redemption of debt securities		**461.2**	346.4	**1,717.4**	1,044.9
Net cash flows from/(used in) investing activities		**233.3**	51.9	**239.5**	(2,707.8)
Cash flows from financing activities:					
Redemption of securities		**(624.4)**	(515.6)	**(433.1)**	–
Issue of securities		**1,306.0**	1,281.8	**1,257.0**	906.8
Redemption of subordinated capital		**(10.0)**	–	**(10.0)**	–
Issue of subordinated capital		**–**	250.0	**–**	250.0
Interest paid on subordinated liabilities and subscribed capital		**(16.2)**	(7.4)	**(16.2)**	(7.4)
Net cash flows from financing activities		**655.4**	1,008.8	**797.7**	1,149.4
Taxation paid		**(24.6)**	(22.9)	**(4.9)**	(19.9)
Net (decrease)/increase in cash and cash equivalents		**(133.8)**	467.7	**(222.6)**	492.1
Opening balance		**4,219.6**	3,751.9	**3,882.8**	3,390.7
Total closing cash and cash equivalents		**4,085.8**	4,219.6	**3,660.2**	3,882.8
Cash and cash equivalents:					
Cash and balances with central banks		**3,389.9**	3,620.3	**3,389.9**	3,620.3
Loans and advances to credit institutions	14	**695.9**	599.3	**270.3**	262.5
		4,085.8	4,219.6	**3,660.2**	3,882.8

The statement of cash flows has been prepared in compliance with IAS 7 'Statement of Cash Flows' and has been presented under the indirect method.

For the purposes of the statements of cash flows, cash and cash equivalents comprise cash and other financial instruments with original maturities of less than three months.

The notes on pages 95 to 164 form part of these accounts

Notes to the Accounts

Introduction

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations (IFRICs) in issue, that have been endorsed by the European Union (EU), and are effective at 31 December 2015, and with those parts of the Building Societies Act 1986 and the Building Societies (Accounts and Related Provisions) Regulations 1998 (as amended) applicable to societies reporting under IFRS.

The financial statements have been prepared on the historical cost basis, as modified by the revaluation of available for sale financial assets, derivative contracts and financial assets held at fair value through the Income Statement.

The financial statements have been prepared on the going concern basis as discussed in the Directors' Report on page 46, under the heading, 'Principal risks, uncertainties and going concern'.

The preparation of financial statements under IFRS requires the use of certain critical accounting estimates and judgement. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are set out in Note 2.

Accounting developments

The following Accounting Standard amendments became effective for periods commencing on or after 1 January 2015 and have been adopted in the current year:

- Amendments to IAS 19 'Defined Benefit Plans: Employee Contributions' which clarify the requirements that relate to how contributions from employees or third parties that are linked to service should be attributed to periods of service. The application of this amendment did not have a material impact on the financial statements.
- Annual improvements to IFRSs 2010 – 2012 became effective on 1 February 2015. The following are relevant to the Group: IFRS 8 'Operating Segments', IFRS 13 'Fair Value Measurement' and IAS 24 'Related Party Disclosures'. These small improvements and amendments did not have a material impact on the financial statements.
- Annual improvements to IFRSs 2011 – 2013 became effective on 1 January 2015. The following are relevant to the Group: IFRS 3 'Business Combinations', IFRS 13 'Fair Value Measurement' and IAS 40 'Investment Property'. These small improvements and amendments did not have a material impact on the financial statements.

The following Standards which have not been adopted in these financial statements were in issue but not yet effective for the 2015 year end. Except otherwise stated, the adoption of the following new or amended standards are not expected to have material impact on the financial statements.

- IFRS 9 'Financial Instruments' published in July 2014 is effective for periods beginning on or after 1 January 2018, with early adoption permitted. This standard replaces the existing guidance in IAS 39 'Financial Instruments: Recognition and Measurement' and includes revised guidance on the classification and measurement of financial instruments and new general hedge accounting requirements. The Group is in the process of assessing the impact of adopting IFRS 9 but the calculation of impairment of financial assets on an expected credit loss basis is expected to result in an overall increase in loan loss provisioning.
- IFRS 15 'Revenue from Contracts with Customers' is effective for periods beginning on or after 1 January 2018, with early adoption permitted. IFRS 15 introduces a framework for determining whether, how much and when revenue is recognised and it replaces the existing guidance in IAS 18 'Revenue'. The Group is assessing the potential impact of adopting IFRS 15; however it is not expected to have a material impact on the financial statements.
- IFRS 16 'Leases' is effective for periods beginning on or after 1 January 2019, with early adoption permitted. IFRS 16 eliminates the distinction between operating and finance leases, with virtually all leases recognised on balance sheet. The Group is assessing the potential impact of adopting IFRS 16 which is expected to result in an increase in lease assets and financial liabilities.
- Amendments to IFRS 11 'Accounting for Acquisitions of Interests in Joint Operations' are effective for periods beginning on or after 1 January 2016 and provide clarification on how to account for the acquisition of an interest in a joint operation in which the activities constitute a business.
- Amendments to IAS 1 'Disclosure Initiative' are effective for periods beginning on or after 1 January 2016 and provide guidance on the application of the concept of materiality.
- Amendments to IAS 16 and IAS 38 'Clarification of Acceptable Methods of Depreciation and Amortisation' are effective for periods beginning on or after 1 January 2016 and prohibit entities from using a revenue-based depreciation method for items of property, plant and equipment except in limited circumstances.

Notes to the Accounts continued...

- Annual improvements to IFRSs 2012-2014 Cycle are effective for periods beginning on or after 1 January 2016 and include amendments to the following standards which may be relevant to the Group: IFRS 7 'Financial Instruments: Disclosures', IAS 19 'Employee Benefits' and IAS 34 'Interim Financial Reporting'.

1. Significant Accounting Policies

Basis of consolidation

The Group financial statements consolidate the financial statements of the Society and its subsidiary undertakings. Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Inter-company transactions and balances are eliminated upon consolidation.

Investments in subsidiary undertakings are stated in the Society accounts at cost less any provisions for impairment.

Interest income and expense

Interest income and expense on all financial instruments are recognised within interest receivable or payable on an effective interest rate basis.

The effective interest rate method is used to calculate the amortised cost of financial instruments and to recognise interest receivable or payable over the relevant period. The effective interest rate is the rate that exactly discounts estimated cash flows (excluding credit losses) to zero through the expected life of the instrument. The main impact for the Group relates to mortgage advances where fees (such as application and arrangement fees) and costs are incorporated in the calculation. This has the effect of spreading these fees and costs over the expected life of the mortgage. Expected lives are estimated using historic data and management judgement and the calculation is adjusted when actual experience differs from estimates, with changes in deferred amounts being recognised immediately in the Income Statement.

Fees and commissions

Fees payable and receivable in relation to the provision of loans are accounted for on an effective interest rate basis. Other fees and commissions are recognised on an accruals basis when the relevant service is provided.

Derivative financial instruments and hedge accounting

Derivative financial instruments
Derivative financial instruments are held at fair value with movements in fair value being recognised in the Income Statement. Fair values of exchange traded derivatives are valued using closing prices from the appropriate exchanges. Other derivatives are measured at fair value using valuation techniques including discounted cash flow models.

Embedded derivatives
Certain derivatives are embedded in other financial instruments. These are treated as separate derivatives where the economic characteristics and risks are not closely related to the host instrument and the host instrument is not measured at fair value. These embedded derivatives are measured at fair value with movements in value being recognised in the Income Statement. Where the Group is unable to value the embedded derivative separately, the entire instrument is measured at fair value with changes in value being taken to the Income Statement.

Hedging
All derivatives entered into by the Group are for the purposes of providing an economic hedge. Full details of hedging strategies are contained in Note 34. Hedge accounting is an optional treatment but the specific rules and conditions in IAS 39 have to be complied with before it can be applied. The Group has classified the majority of its derivatives as fair value and cash flow hedges in order to reduce volatility in the Income Statement.

Fair value hedges
Where the fair value hedging requirements are met, changes in the fair value of the hedged item arising from the hedged risk are taken to the Income Statement thereby offsetting the effect of parallel movements in the fair value of the derivative. Where the hedge no longer meets the criteria, or is terminated for any other reason, the adjustment to the hedged item is released to the Income Statement, over its remaining life, using the effective interest rate method.

Cash flow hedges
Where a derivative financial instrument is designated as a hedge of the variability in the cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity and recycled to the Income Statement over the life of the forecast transaction. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately. If the forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss recognised in equity is then recognised immediately in the Income Statement.

Notes to the Accounts continued...

1. Significant Accounting Policies continued...

Impairment of financial assets
At each reporting date the Group assesses whether or not there is objective evidence that individual financial assets (or groups of financial assets with similar credit characteristics) are impaired. In determining whether an impairment loss should be recognised, the Group makes judgements as to whether there is any evidence indicating a measurable decrease in the present value of cash flows expected from a financial asset or group of financial assets, resulting from an event (or events) that have occurred after initial recognition of the asset, but before the Statement of Financial Position date.

Loans and advances to customers

Individual assessments are made of all loans and advances on properties which are in possession or in arrears by two months or more for residential loans and two months or more and/or other qualitative factors for commercial loans. All other loans and advances are grouped according to their credit characteristics and a collective review is undertaken of any evidence of impairment. In all cases, future cash flows are estimated on grouped credit characteristics. The collective impairment provision includes an allowance against the risk of customer indebtedness arising from circumstances in existence at the reporting date, as these customers may be able to maintain their repayments only whilst interest rates remain low.

Where there is objective evidence of impairment or that trigger events exist at the Statement of Financial Position date, then the impairment loss is calculated as the difference between the assets' carrying value and the present value of the estimated cash flows from those assets. In assessing these cash flows a number of factors are taken into account, including; the Group's historic default experience, historic and current loss emergence periods, the effect of changes in house prices, credit bureau data and adjustments to allow for ultimate forced sale discounts.

The Group grants concessions to assist borrowers who experience difficulties in meeting their obligations to pay their mortgage (referred to as forbearance) as described in Note 39. Forbearance is included in the loan loss provision similar to other debt, whereby debt which is more than two months in arrears is treated as individually impaired. Debt which is less than two months is included in the calculation of the collective impairment provision.

Any increases or decreases in projected impairment losses are recognised through the Income Statement. If a loan is ultimately uncollectable, then any loss incurred by the Group on extinguishing the debt is written off against the provision for loan impairment. Any subsequent recoveries of amounts previously written off are recognised through the Income Statement.

Debt instruments

At each Statement of Financial Position date the Group assesses whether or not there is objective evidence that individual debt instruments are impaired. In determining whether there is any objective evidence of impairment the Group takes into account a number of factors including:

- Significant financial difficulties of the issuer or obligor.
- Any breach of contract or covenants.
- The granting of any concession or rearrangement of terms.
- The disappearance of an active market.
- Any significant downgrade of ratings of the issuer or obligor.
- Any significant reduction in market value of the instrument.

In some cases a significant adverse change in one of the above factors will cause the Group to determine that there is objective evidence of impairment. In other cases it may not be possible to identify a single event that identifies impairment. The Group may additionally determine that there is impairment where there are a number of factors contributing to that view.

Where the Group determines that there is objective evidence of impairment or that trigger events exist at the Statement of Financial Position date, then, in the case of available for sale instruments, the cumulative loss that had been recognised directly in reserves is removed from reserves and recognised in the Income Statement. In the case of held to maturity instruments an appropriate charge is made to the Income Statement.

If in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be related to an event occurring after the impairment loss was recognised through the Income Statement, the impairment loss is reversed, with the amount of the reversal recognised through the Income Statement.

Segmental reporting

The chief operating decision maker has been identified as the Board of directors, which reviews the Group's internal reporting and is responsible for all significant decisions.

Financial information provided in the segmental reporting note is consistent with that which is presented to the Board.

No segmental information is presented on geographical lines because substantially all of the Group's activities are in the United Kingdom.

Notes to the Accounts continued...

1. Significant Accounting Policies continued...

Business combinations between mutual organisations

Identifiable assets and liabilities were measured at fair value on merger. Intangible assets are amortised through the Income Statement over their estimated useful lives, being between one and ten years.

Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash and cash equivalents comprise cash and other financial instruments with less than three months original maturity.

The Statements of Cash Flows have been prepared using the indirect method.

Financial assets

The Group classifies its financial assets into the following categories:

Loans and receivables
Loans and receivables are predominantly mortgage loans to customers and money market advances held for liquidity purposes. They are initially recorded at fair value plus any attributable costs and less any attributable fees and are subsequently held at amortised cost less any impairment losses other than where an adjustment is made as part of a fair value hedging arrangement. Income is recognised on an effective interest rate basis.

Financial assets at fair value through profit and loss
These comprise assets that have been specifically designated as such at inception and certain structured investments containing embedded derivatives where the Group has been unable to separately calculate the fair value of the embedded derivative. Where the embedded derivative has not been separated from the host instrument the entire (hybrid) instrument has been recorded at fair value. Gains and losses arising from changes in fair value are recognised in the Income Statement. Interest income arising from financial assets measured at fair value through profit and loss is recognised on an effective interest rate basis.

Held to maturity
These comprise assets which the Group has both the intention and ability to hold to maturity. This category contains certain assets that have been specifically designated at inception and other assets that have been reclassified where we have the intention and ability to hold to maturity. They are initially recorded at fair value plus any attributable costs and less any attributable fees and are subsequently held at amortised cost less any impairment losses. Income is recognised on an effective interest rate basis.

Available for sale financial assets
Available for sale financial assets are securities held for liquidity and investment purposes. They comprise all non-derivative financial assets that are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit and loss. These are recorded at fair value with changes in value being taken to reserves. Interest is recognised on an effective interest rate basis. Any profit or loss on sale is recognised in the Income Statement on disposal.

Financial liabilities

The Group initially records all of its financial liabilities at fair value less directly attributable transaction costs, and subsequently measures them at amortised cost, other than derivative financial instruments and where an adjustment is made as part of a fair value hedging arrangement. Interest expense is recognised on an effective interest rate basis.

Joint ventures

Joint ventures are those entities over whose activities the Group has joint control, established by contractual agreement and requiring unanimous consent for strategic, financial and operating decisions. The results and assets and liabilities of the joint ventures are included in these consolidated financial statements using the equity method of accounting. The investment in the joint venture is recognised in the Statement of Financial Position at cost and is adjusted to recognise the Group's share of profit or loss and other comprehensive income of the joint venture, less any impairment losses in respect of the Group's investment in the joint venture.

Investment properties, property, plant and equipment

Investment properties
Investment properties comprise freehold properties and parts of freehold properties that are not used in the business. These properties are generally flats and offices ancillary to branch premises and earn rental income. Investment properties are stated at cost less accumulated depreciation and impairment losses.

Property, plant and equipment
Buildings, major alterations to office premises, fixtures and fittings, equipment and other tangible fixed assets are stated at cost less accumulated depreciation and impairment losses.

Subsequent costs
Costs incurred after the initial purchase of assets are expensed unless it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. Repairs and maintenance are treated as an expense.

Notes to the Accounts continued...

1. Significant Accounting Policies continued...

Depreciation
Depreciation is provided by the Group to write off the cost (excluding land) less the estimated residual value by equal instalments over estimated useful economic lives as follows:

Freehold/long leasehold buildings (including investment properties) – 50 years

Short leasehold property – Life of lease

Equipment, fixtures, fittings and vehicles – 3 to 20 years

Land is stated at cost less accumulated impairment losses and is not depreciated.

Impairment
The carrying values of investment properties and property, plant and equipment are reviewed for impairment where there is an indication that events or circumstances may mean that the carrying amount is not recoverable. Where the recoverable amount of the asset is estimated to be less than the carrying amount, the carrying amount is written down immediately to the recoverable amount.

Any impairment in the value of assets is dealt with through the Income Statement as it arises.

Intangible assets

Computer software
Computer software includes construction in progress, purchased software and internally generated assets as shown in Note 17.

Costs incurred in the development of computer software for internal use are capitalised as intangible assets where the expenditure leads to the creation of an identifiable non-monetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group. Purchased software is classified as an intangible asset where it is not an integral part of the related hardware. Computer software costs are amortised over their estimated useful lives, which are generally three to five years.

Computer software is tested for impairment at each reporting date or when there is an indication of impairment. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. The recoverable amount is the higher of fair value less costs of disposal and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value. If the recoverable amount of the asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Any impairment in the value of these assets is dealt with through the Income Statement as it arises.

Other intangibles
Other intangibles, which largely represent core deposit intangibles acquired by the Group, are amortised using the straight line method over their estimated useful lives of between one and ten years.

Employee benefits – Pension obligations

Defined contribution plans
Obligations for contributions to defined contribution pension plans are recognised as an expense in the Income Statement as incurred.

Defined benefit plans
The asset or liability recognised in the Statement of Financial Position in respect of the defined benefit pension scheme is the present value of the defined benefit obligation at the Statement of Financial Position date less the fair value of plan assets, together with adjustments for unrecognised past service costs. The asset is recognised in the Statement of Financial Position to the extent that it is recoverable by the Group, being the present value of available refunds and reductions in future contributions to the scheme. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. Projected benefit obligations are discounted to present value using the rate of return available on high quality corporate bonds of equivalent currency and term to the obligations. Actuarial gains or losses are recognised in full in the period in which they occur in the Statement of Comprehensive Income. Past service costs are recognised immediately in the Income Statement to the extent that benefits are already vested and otherwise are amortised on a straight-line basis over the average period until the benefits become vested.

Scheme surplus
The Group has received a legal opinion that it can recover in full any surplus valuation of the scheme.

Tax

Tax comprises current tax and deferred tax. Tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case the tax is recognised in the Statement of Comprehensive Income.

Current tax is the expected tax payable on the taxable profits for the year, using tax rates enacted or substantively enacted at the Statement of Financial Position date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised on temporary differences arising between the carrying amount of certain assets and liabilities for accounting purposes and for taxation purposes. Deferred tax is provided using tax rates enacted or substantively enacted at the

Notes to the Accounts continued...

1. Significant Accounting Policies continued...

Statement of Financial Position date, depending on the date at which they are expected to reverse.

The following temporary differences are not provided for:

- The initial recognition of assets or liabilities that affect neither accounting nor taxable profit.
- Differences relating to investments in subsidiaries, to the extent that the parent is able to control the reversal of temporary differences and it is probable they will not reverse in the foreseeable future.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available, against which temporary differences can be utilised.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. The asset is recorded in the Statement of Financial Position within property, plant and equipment and is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses. Depreciation is provided by the Group to write off the cost over the estimated useful economic life of the asset. Future instalments under such leases, net of finance charges, are included within payables. Rent payable on finance leases is apportioned between the finance element, charged to the Income Statement, and the reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. Operating lease rentals are expensed to the Income Statement on a straight-line basis over the period of the lease agreement.

Foreign currency

Assets and liabilities denominated in foreign currencies are translated into Sterling at the appropriate rates of exchange prevailing at the reporting date and exchange differences are recognised in the Income Statement as they arise. All income and expense is translated into Sterling at the rate of exchange on the day of receipt or payment.

Derecognition of financial assets and liabilities

Financial assets are only derecognised when the contractual rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership. The Group has not derecognised the loans securing its issue of covered bonds and securitisations because substantially all the risks and rewards are retained. Collateralised borrowing is recognised for the proceeds received. Financial liabilities are only derecognised when the obligation is discharged, cancelled, or has expired.

Notes to the Accounts continued...

2. Critical Accounting Estimates and Judgements in Applying Accounting Policies

The Group makes judgements in applying its accounting policies which affect the amounts recognised in the accounts. In addition estimates and assumptions are used which could affect the reported amounts of assets and liabilities in the next financial year. The most critical estimates and judgements are described below.

As explained on pages 57 to 58, the Audit Committee has confirmed that the accounting estimates and judgements applied are considered to be appropriate.

Impairment of loans and advances to customers

The creation of impairment provisions for a portfolio of mortgage loans is inherently uncertain and requires the exercise of a significant degree of judgement. Provisions are calculated using historic default and loss experience but require judgement to be exercised in predicting future economic conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time before impairments are identified (emergence period). In relation to retail mortgages the most critical estimate is the future level of house prices where a fall of 5 percentage points (from -5% to -10% in 2016) equates to an increase in the provision by £6.4m. Another sensitivity is the emergence period, where an increase in the emergence period by three months equates to £0.7m additional provision. Retail mortgages account for 97% of our loan book and 94% of our impairment provision. As such, sensitivities around our commercial book and other loans would not have a significant impact on the provision.

Effective interest rate

IAS 39 requires that all of the cash flows directly associated with financial instruments held at amortised cost must be recognised in the Income Statement through the interest margin using the effective interest rate method. When this approach is applied to a mortgage portfolio, judgements must be made to estimate the average life of that portfolio. These judgements are applied to segments of the mortgage portfolio, taking into account factors including the terms of the particular products, historic repayment data and economic conditions. These estimates are updated in each reporting period to reflect the portfolio's actual performance. The most critical estimate is the estimated proportion of the number of customer balances that will remain with the Group for one year following the end of the initial product deal period. A 1% increase in this estimate would increase the value of the loans by less than £1m.

During the previous year, there was a change in the estimate for calculating the interest margin using the effective interest rate method. This change relates to the de-recognition of the interest discount on products which have been priced at market competitive rates. The impact was a reduction in interest receivable on loans secured on residential property of £12m in 2014.

Fair values arising from business combinations

As described on page 98, identifiable assets and liabilities are initially measured at fair value. Such estimates are highly judgemental, particularly where a fair value is measured in respect of the critical judgements noted above. The amount recognised reflects management's best estimate. On the basis that both the Chelsea and N&P mergers are outside of the measurement period, the impact of identified changes in underlying assumptions is recognised immediately in the Income Statement. Management has been through an extensive evaluation to identify any significant changes, with any material changes being reflected in the year end results.

One of the critical accounting estimate used in the calculation of fair value provision for the impairment of retail mortgage assets is the future level of house prices. An immediate reduction in future house price growth of 5 percentage points (from -5% to -10% in 2016) would increase the losses in 2016 by £1.3m.

Regulatory and other provisions

Note 28 provides details of regulatory and other provisions which includes amounts provided in relation to customer redress claims totalling £11.1m (including fair value adjustments made on the merger with Norwich & Peterborough and Chelsea building societies). The customer redress provision is in respect of a range of customer claims and is calculated using management's estimate of the complaint volumes, redress payments, referral levels to the Financial Ombudsman Service, complaint handling costs and other costs. None of these assumptions are expected to be individually material to the provision.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the Statement of Financial Position date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

Notes to the Accounts continued...

2. Critical Accounting Estimates and Judgements in Applying Accounting Policies continued...

Financial Services Compensation Scheme (FSCS) levy

The FSCS levy in respect of failed financial institutions is calculated using the Group's share of industry protected deposits, historic interest rates and projected forward interest rates. A 100bps increase in the future interest rate assumption would increase the provision by £3.9m. More detail of the FSCS and the Society's provision are contained in Note 28.

Pensions

The Group operates a defined benefit pension scheme. Significant judgements (on areas such as future interest and inflation rates, membership levels and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme, and hence of its net surplus/deficit. These are outlined in Note 26. The impact of a 1.0% decrease in the rate used to discount the future value of the liabilities (from 3.8% to 2.8%) would be to increase the surplus by £28.7m. The impact of a one year increase in each of the quoted life expectancies at age 60 would be to decrease the surplus by £25.7m.

3. Interest Receivable and Similar Income

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
On assets held at amortised cost				
Loans secured on residential property	**1,146.4**	1,166.6	**627.0**	683.7
Connected undertakings	**–**	–	**455.4**	414.4
Other loans	**17.2**	17.5	**17.2**	17.5
Other liquid assets/cash and short-term funds	**17.0**	17.8	**16.3**	17.0
On available for sale securities	**3.3**	9.0	**3.3**	9.0
On held to maturity securities	**0.4**	0.9	**40.2**	35.8
On financial instruments held at fair value through the Income Statement				
Derivatives	**75.7**	96.7	**54.0**	70.9
Other assets	**0.1**	0.1	**0.1**	0.1
Total interest receivable	**1,260.1**	1,308.6	**1,213.5**	1,248.4

Included within interest receivable and similar income is interest earned on individually impaired loans: Group £10.4m, Society £5.0m (2014 – Group £12.9m, Society £5.8m).

Notes to the Accounts continued...

4. Interest Payable and Similar Charges

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
On liabilities held at amortised cost				
Shares held by individuals	**405.2**	459.7	**405.2**	459.7
Deposits from banks	**16.2**	18.1	**16.2**	18.1
Deposits from connected undertakings	**–**	–	**34.6**	23.8
Other deposits	**2.2**	2.4	**2.2**	2.4
Debt securities in issue	**89.2**	84.3	**78.8**	74.2
Subordinated liabilities	**15.9**	7.1	**15.9**	7.1
Subscribed capital	**0.3**	0.3	**0.3**	0.3
Other interest payable	**1.4**	1.8	**1.4**	1.8
On financial instruments held at fair value through the Income Statement				
Deposits from connected undertakings	**–**	–	**42.6**	40.3
Derivatives	**195.1**	185.7	**208.8**	198.9
Total interest payable	**725.5**	759.4	**806.0**	826.6

5. Net Losses from Fair Value Volatility on Financial Instruments

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Assets held at fair value	**0.5**	2.5	**0.5**	2.5
Embedded derivatives	**(1.1)**	8.7	**(1.1)**	8.7
Derivatives and hedging	**(5.9)**	(22.1)	**(6.1)**	(14.7)
Net (losses) from fair value volatility on financial instruments	**(6.5)**	(10.9)	**(6.7)**	(3.5)

Assets held at fair value relate to structured assets containing profit participation features that meet the definition of embedded derivatives. The Society is unable to separate the value of the embedded derivative from the host item and so has to treat the whole asset as held at fair value through the Income Statement in accordance with IAS 39 'Financial Instruments: Recognition and Measurement'.

The embedded derivative category relates to synthetic features contained in certain structured investments which can be valued separately from the host instruments.

The derivative and hedging category relates to changes in fair value of derivatives that provide effective economic hedges but where the Group has not achieved hedge accounting.

Notes to the Accounts continued...

6. Net Realised Profits

Net realised profits arose on the disposal of debt securities and associated asset swaps.

7. Administrative Expenses

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Staff costs				
Salaries and wages	**128.8**	129.6	**128.8**	129.6
Social security costs	**12.8**	12.5	**12.8**	12.5
Pension costs – defined benefit plans	**3.9**	4.6	**3.9**	4.6
Pension costs – defined contribution plans	**7.6**	6.9	**7.6**	6.9
Other staff costs	**2.0**	1.5	**2.0**	1.5
Operating lease rentals	**10.3**	11.1	**10.5**	12.5
Professional consultancy costs	**23.5**	24.2	**23.5**	24.1
Other expenses	**134.3**	113.0	**133.9**	111.7
	323.2	303.4	**323.0**	303.4

The Society operates a salary sacrifice scheme whereby the employee agrees to a reduction in salary in return for the Society making pension contributions that were previously paid by the employee. The amount shown above under Salaries and wages includes the headline salary (i.e. before the salary sacrifice deduction) and Pension costs excludes the additional contributions made by the Society as a result of the salary sacrifice scheme.

The Society's operating lease rentals include payments it makes to subsidiary companies which own properties and equipment.

Remuneration of the auditor and their associates

	Group		Society	
	2015 £000	2014 £000	**2015 £000**	2014 £000
Fees payable to the auditor and their associates for the audit of the annual accounts	**388**	376	**324**	314
Fees payable to the auditor and their associates for other services to the Group				
Audit-related assurance services (including £45,000 for review of interim accounts)	**172**	143	**172**	143
Other services				
Support for customer remediation	**–**	870	**–**	870
All other services	**65**	339	**65**	310
	625	1,728	**561**	1,637

Notes to the Accounts continued...

7. Administrative Expenses continued...

The above figures, relating to auditor's remuneration, exclude value added tax. Details of the Society's policy on non-audit work, which is implemented by the Audit Committee, is given in the Audit Committee Report on pages 57 to 59.

Staff numbers
The average number of persons employed by the Group during the year (including executive directors) was as follows:

	2015		2014	
	Full time	**Part time**	Full time	Part time
Building Society				
Central administration	**2,552**	**516**	2,398	487
Branches	**1,051**	**457**	1,179	452
	3,603	**973**	3,577	939

8. Remuneration of and Transactions with Directors

Total directors' remuneration amounted to £3.6m (2014 – £3.3m).

Full details of directors' remuneration, bonuses and pensions are given in the Directors' Remuneration Report on pages 66 to 83. In addition, past directors' pensions in respect of services as directors (closed scheme) amounted to £18,000 (2014 – £18,000).

None of the directors had any interest in the shares or debentures of any connected undertaking of the Society at any time during the financial year. Details of transactions with directors and loans held by directors and connected persons are disclosed in Note 41.

A register is maintained at the head office of the Society containing details of loans, transactions and arrangements between the Society and its directors and connected persons. A statement containing the details for 2015 will be available for inspection at the head office for a period of 15 days up to and including the Annual General Meeting. For further information see Note 41.

Notes to the Accounts continued...

9. Impairment

Loans and advances to customers

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
At 1 January				
Collective	**23.3**	12.7	**6.1**	8.2
Individual	**23.0**	33.5	**0.9**	1.5
	46.3	46.2	**7.0**	9.7
Amounts written off during the year				
Collective	**–**	–	**–**	–
Individual	**(12.4)**	(21.5)	**(0.2)**	(4.7)
	(12.4)	(21.5)	**(0.2)**	(4.7)
Impairment adjustment for the year				
Collective	**10.0**	10.6	**(0.4)**	(2.1)
Individual	**5.1**	11.0	**0.1**	4.1
	15.1	21.6	**(0.3)**	2.0
At 31 December				
Collective	**33.3**	23.3	**5.7**	6.1
Individual	**15.7**	23.0	**0.8**	0.9
	49.0	46.3	**6.5**	7.0
The charge/(release) for the year comprises:				
Impairment adjustment for loans and advances	**15.1**	21.6	**(0.3)**	2.0
Recoveries relating to amounts previously written off	**(2.3)**	(1.6)	**(0.2)**	(0.1)
Net provision charge/(release) for the year	**12.8**	20.0	**(0.5)**	1.9

The interest arising from the unwind of the discount of expected future recoveries is not material.

None (2014 – £1.6m) of the £49.0m (2014 – £46.3m) provision balance shown above, and £1.6m release (2014 – £1.5m release) within the £12.8m (2014 – £20.0m) net provision charge, relates to the commercial lending portfolio.

Notes to the Accounts continued...

10. Investments

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Equities	**1.4**	1.4	**1.4**	1.4
Joint ventures	**–**	–	**0.3**	0.3
Subsidiaries	**–**	–	**16,760.8**	14,405.1
	1.4	1.4	**16,762.5**	14,406.8

Investment in equities
The Group holds equity investments relating to participation in banking and credit card service operations which are classified as available for sale assets.

Investment in joint venture
The Society does not have material investments in joint ventures. The Society has a 50% interest in a joint venture, MutualPlus Ltd, a branch sharing company incorporated in England and Wales. The carrying amount of the investment at 31 December 2015 and 31 December 2014 was £0.3m.

Notes to the Accounts continued...

10. Investments continued...

Investment in subsidiaries
Society

	Shares £m	Loans £m	Total £m
Cost			
At 1 January 2015	106.3	14,300.7	14,407.0
Additions	–	3,039.3	3,039.3
Repayments	–	(685.0)	(685.0)
At 31 December 2015	106.3	16,655.0	16,761.3
Impairment provision			
At 1 January 2015	(0.5)	(1.4)	(1.9)
Written off	–	–	–
Released in the year	–	1.4	1.4
At 31 December 2015	(0.5)	–	(0.5)
Net book value			
At 31 December 2015	105.8	16,655.0	16,760.8
Cost			
At 1 January 2014	114.3	11,078.6	11,192.9
Additions	–	6,035.5	6,035.5
Repayments	(8.0)	(2,813.4)	(2,821.4)
At 31 December 2014	106.3	14,300.7	14,407.0
Impairment losses			
At 1 January 2014	(8.5)	–	(8.5)
Written off	8.0	–	8.0
Provided in the year	–	(1.4)	(1.4)
At 31 December 2014	(0.5)	(1.4)	(1.9)
Net book value			
At 31 December 2014	105.8	14,299.3	14,405.1

All loans are charged interest which is included within the net interest margin.

On 31 December 2015, Accord made a dividend payment of £100m to the Society (2014 – £Nil).

Notes to the Accounts continued...

10. Investments continued...

The Society has the following principal subsidiary undertakings, all of which are audited and consolidated:

Subsidiary	Principal activity
Accord Mortgages Ltd	Mortgage lending
BCS Loans and Mortgages Ltd	Non-trading
YBS Properties (Edinburgh) Ltd	Property holding
YBS Properties Ltd	Non-trading
Yorkshire Building Society Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds
Yorkshire Key Services Ltd	Computer services
Brass No. 1 PLC	Funding vehicle
Brass Mortgage Holdings Limited	Holding company
Brass No. 2 PLC	Funding vehicle
Brass No.2 Mortgage Holdings Limited	Holding company
Brass No. 3 PLC	Funding vehicle
Brass No.3 Mortgage Holdings Limited	Holding company
Brass No. 4 PLC	Funding vehicle
Brass No.4 Mortgage Holdings Limited	Holding company
Brass No. 5 PLC	Funding vehicle
Brass No.5 Mortgage Holdings Limited	Holding company
Norwich and Peterborough Estate Agents Ltd	Non-trading
Norwich and Peterborough Insurance Brokers Ltd	Non-trading
Norwich and Peterborough (LBS) Ltd	Mortgage finance
Tombac No. 1 PLC	Funding vehicle
Tombac No.1 Mortgage Holdings Limited	Holding company
Tombac No. 2 PLC	Funding vehicle
Tombac No.2 Mortgage Holdings Limited	Holding company

For certain subsidiaries, the Group has taken advantage of the audit exemptions available for small and dormant subsidiaries under Sections 479 and 480 of the Companies Act 2006. The Group has adopted such audit exemptions for the following subsidiary undertakings which are largely non-trading for the year ended 31 December 2015:

Chelsea Mortgage Services Ltd
Norwich and Peterborough (LP) Ltd
Norwich and Peterborough Covered Bonds LLP
Norwich and Peterborough Financial Services Ltd
Norwich and Peterborough General Insurance Services Ltd
Norwich and Peterborough Insurance Services Ltd
Norwich and Peterborough Ltd
Norwich and Peterborough Sharedealing Services Ltd
YBS Covered Bonds Finance (Holdings) Limited
YBS Covered Bonds Finance Limited
YBS Group Ltd
YBS Investments (No. 1) Ltd
YBS Investments (No. 2) Ltd
YBS Properties (York) Ltd
Yorkshire Building Society Estate Agents Ltd
Yorkshire Direct Ltd
Yorkshire Estate Agents Ltd
Yorkshire Group Ltd
Yorkshire Guernsey Ltd
Yorkshire Insurance Services Ltd
Yorkshire Key Services (No. 2) Ltd
Yorkshire Life Assurance Services Ltd
Yorkshire Mortgage Services Ltd
Yorkshire Personal Financial Services Ltd
Yorkshire Property Services Ltd
Yorkshire Services Ltd

All the companies are registered in England and operate in the United Kingdom, except Yorkshire Guernsey Ltd which is registered in Guernsey and is non-trading.

All the entities are wholly owned except for Yorkshire Building Society Covered Bonds LLP, YBS Covered Bonds Finance (Holdings) Limited, YBS Covered Bonds Finance Limited, Brass No. 1 PLC, Brass Mortgage Holdings Limited, Brass No. 2 PLC, Brass No.2 Mortgage Holdings Limited, Brass No. 3 PLC, Brass No.3 Mortgage Holdings Limited, Brass No. 4 PLC, Brass No.4 Mortgage Holdings Limited, Brass No. 5 PLC, Brass No. 5 Mortgage Holdings Limited, Tombac No. 1 PLC, Tombac No.1 Mortgage Holdings Limited, Tombac No. 2 PLC and Tombac No.2 Mortgage Holdings Limited. The Society's interests in these entities are, in substance, no different than if they were 100% held subsidiary undertakings and consequently they are consolidated in the Group accounts.

Notes to the Accounts continued...

11. Tax Expense

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Current tax:				
UK corporation tax at 20.25% (2014 – 21.49%)	**34.0**	44.5	**23.2**	24.8
Corporation tax – adjustment in respect of prior periods	**(1.4)**	–	**(1.4)**	–
Total current tax	**32.6**	44.5	**21.8**	24.8
Deferred tax (Note 20):				
Current year	**1.5**	(3.7)	**(2.0)**	(0.8)
Adjustment in respect of prior periods	**0.7**	–	**0.7**	–
Total tax expense in Income Statement	**34.8**	40.8	**20.5**	24.0

The actual tax expense for the year differs from that calculated using the standard rate of corporation tax in the UK. The differences are explained below:

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Profit before tax	**173.3**	188.2	**203.5**	117.3
Tax calculated at a tax rate of 20.25% (2014 – 21.49%)	**35.1**	40.4	**41.2**	25.2
Effects of:				
Income not subject to tax	**–**	(1.4)	**(20.5)**	(3.0)
Expenses not deductible for tax purposes	**1.4**	1.6	**1.4**	1.8
Adjustment to tax charge in respect of previous periods	**(0.7)**	–	**(0.7)**	–
Change in tax rate	**(1.0)**	0.2	**(0.9)**	–
Total tax expense in Income Statement	**34.8**	40.8	**20.5**	24.0
Tax expense/(credit) recognised directly in equity:				
Tax on available for sale securities	**0.3**	(1.4)	**0.3**	(1.4)
Effect of change in tax rate	**–**	–	**–**	–
Tax on re-measurement of net retirement benefit obligations	**(1.9)**	11.0	**(1.9)**	11.0
Effect of change in tax rate	**3.3**	(1.0)	**3.3**	(1.0)
Deferred tax on cash flow hedges	**3.0**	(8.6)	**3.0**	(8.6)
Effect of change in tax rate	**(1.9)**	0.7	**(1.9)**	0.7
Effect of change in tax rate on prior year movements in general reserves	**(2.1)**	–	**(2.1)**	–
	0.7	0.7	**0.7**	0.7

The main rate of UK corporation tax was reduced to 20% from 1 April 2015. Further reductions to 19% from 1 April 2017, and to 18% from 1 April 2020 were substantively enacted during 2015. In addition a surcharge of 8% on the profits of banking companies (including building societies) applies from 1 January 2016.

These rate changes are reflected in the financial statements resulting in a credit of £1.0m to the Group Income Statement and a credit of £0.7m to Other Comprehensive Income in the period, giving an overall credit of £1.7m in respect of the Group's net deferred tax asset.

Notes to the Accounts continued...

12. Segmental Reporting

This section analyses the Group's performance by business segment.

The chief operating decision maker has been identified as the Board, which reviews the Group's internal reporting and is responsible for all significant decisions. The Group's reportable segments under IFRS 8 'Operating Segments', based on the information reviewed by the Board, have been determined according to similar economic characteristics and the nature of the products and service. Details of the reportable segments are listed below:

Segment	Description	Basis of aggregation
Retail	Prime residential owner occupied lending, prime intermediary lending and non-owner occupied lending. Traditional member savings, non-traditional savings and consumer banking (excluding personal lending). Consumer banking also includes the sale of general insurance, protection and investment products provided by third parties.	These are the core activities and focus of the Group.
Non-retail	Prime commercial lending portfolio (including social housing).	These ongoing parts of the business support the Group's financial stability and primary businesses but are not considered core and have a non-retail customer base.
Secondary	Non-prime residential owner occupied lending, personal lending, non-prime commercial lending and non-owner occupied lending acquired through mergers.	These elements, originated and acquired through merger, are closed to new business and are historic areas in which the Group no longer operates.
Central	Supporting business units, the Treasury function and other head office group functions which have not been apportioned across the aforementioned segments.	These operations are not directly customer related.

No segmental information is presented on geographical lines, because substantially all of the Group's activities are in the United Kingdom.

The majority of the Group's revenues are in the form of interest and the Board monitors the Group's net interest income, to assess performance and direct the Group. Therefore interest receivable and similar income has been shown net of interest payable and similar expense.

Recharging of funding across the Group has been included using the Group's internal funds transfer pricing methodology, which includes the cost of raising external funds.

Income and directly attributable costs have been allocated to each segment as applicable, with support costs being apportioned based on levels of employees.

Notes to the Accounts continued...

12. Segmental Reporting continued...

The accounting policies for the reported segments are consistent with the Group's accounting policies outlined in Note 1.

2015	**Notes**	**Retail £m**	**Non-retail £m**	**Secondary £m**	**Central £m**	**Total £m**
Net interest income		**319.5**	**20.5**	**33.2**	**161.4**	**534.6**
Non-interest income (net)	**a**	**23.7**	**2.4**	**–**	**(8.1)**	**18.0**
Net realised profits and fair value		**–**	**–**	**–**	**(4.4)**	**(4.4)**
Management expenses	**b**	**(206.5)**	**(2.6)**	**(1.9)**	**(135.1)**	**(346.1)**
Operating profit/(loss) before provisions		**136.7**	**20.3**	**31.3**	**13.8**	**202.1**
Impairment and other provisions		**(22.3)**	**1.6**	**(3.6)**	**(4.5)**	**(28.8)**
Profit/(loss) before tax		**114.4**	**21.9**	**27.7**	**9.3**	**173.3**
Total assets		**31,445.0**	**857.0**	**940.0**	**4,976.6**	**38,218.6**
Total liabilities		**28,142.8**	**–**	**–**	**7,970.9**	**36,113.7**
Equity		**–**	**–**	**–**	**2,104.9**	**2,104.9**

2014	**Notes**	**Retail £m**	**Non-retail £m**	**Secondary £m**	**Central £m**	**Total £m**
Net interest income		389.6	14.6	49.1	95.9	549.2
Non-interest income (net)	a	27.7	4.6	–	(6.7)	25.6
Net realised profits and fair value		–	–	–	(9.6)	(9.6)
Management expenses	b	(198.4)	(3.3)	(0.7)	(128.6)	(331.0)
Operating profit/(loss) before provisions		218.9	15.9	48.4	(49.0)	234.2
Impairment and other provisions		(19.1)	1.5	1.6	(30.0)	(46.0)
Profit/(loss) before tax		199.8	17.4	50.0	(79.0)	188.2
Total assets		30,305.1	708.8	1,085.5	5,472.6	37,572.0
Total liabilities		28,023.2	–	–	7,588.5	35,611.7
Equity		–	–	–	1,960.3	1,960.3

Notes

a Non-interest income (net) includes fees and commissions receivable, fees and commissions payable, and other operating income.

b Management expenses include administrative expenses, depreciation and amortisation.

Notes to the Accounts continued...

12. Segmental Reporting continued...

Total income for the reportable segments can be analysed as follows:

2015	**Retail £m**	**Non-retail £m**	**Secondary £m**	**Central £m**	**Total £m**
External income	**684.6**	**35.4**	**53.4**	**(220.8)**	**552.6**
Income from other segments	**(341.4)**	**(12.5)**	**(20.2)**	**374.1**	**–**
Total income	**343.2**	**22.9**	**33.2**	**153.3**	**552.6**

2014	**Retail £m**	**Non-retail £m**	**Secondary £m**	**Central £m**	**Total £m**
External income	639.3	31.5	72.1	(168.1)	574.8
Income from other segments	(222.0)	(12.3)	(23.0)	257.3	–
Total income	417.3	19.2	49.1	89.2	574.8

13. Cash in Hand and Balances with the Bank of England

	Group		**Society**	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Cash in hand	**16.6**	18.6	**16.6**	18.6
Cash ratio deposit with the Bank of England	**49.4**	50.3	**49.4**	50.3
Other deposits with the Bank of England	**3,373.3**	3,601.7	**3,373.3**	3,601.7
	3,439.3	3,670.6	**3,439.3**	3,670.6

Cash ratio deposits are mandatory requirements of the Bank of England. They are considered to be encumbered assets as they are not available for use in the Group's day to day operations. These balances are non-interest-bearing, whereas other deposits are at variable money market rates.

14. Loans and Advances to Credit Institutions

	Group		**Society**	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Loans and advances to credit institutions	**695.9**	599.3	**270.3**	262.5

Included within loans and advances to credit institutions are balances held in collateral accounts relating to swap agreements, and bank account balances held in the Group's Covered Bond and Securitisation programmes. Such items are considered to be encumbered assets as they are not available for use in the Group's day to day operations.

Loans and advances to credit institutions are all due within one year.

Notes to the Accounts continued...

15. Debt Securities

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Debt securities issued by:				
Public bodies	**229.2**	390.2	**229.2**	390.2
Other borrowers	**40.3**	134.6	**40.3**	134.6
Group companies	**–**	–	**3,983.9**	3,990.0
	269.5	524.8	**4,253.4**	4,514.8

All debt securities are listed in a recognised investment exchange. Debt securities of £0.3bn (2014 – £0.5bn) are due in over one year.

Debt securities issued by Group companies comprise retained investments in the Group's Brass and Tombac securitisation vehicles.

Group	Held at fair value £m	Embedded derivatives £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1 January 2015	**9.2**	**(8.9)**	**524.5**	**–**	**524.8**
Transfers	**–**	**–**	**–**	**–**	**–**
Additions	**–**	**–**	**202.1**	**–**	**202.1**
Disposals and repayments	**–**	**0.8**	**(463.4)**	**–**	**(462.6)**
Exchange translation	**(0.5)**	**–**	**1.4**	**–**	**0.9**
Other changes in value	**0.4**	**(1.7)**	**5.6**	**–**	**4.3**
At 31 December 2015	**9.1**	**(9.8)**	**270.2**	**–**	**269.5**
Movements in debt securities during the year were:					
At 1 January 2014	7.4	(2.4)	531.9	87.7	624.6
Transfers	–	–	64.2	(64.2)	–
Additions	–	–	251.6	–	251.6
Disposals and repayments	–	–	(361.7)	(24.7)	(386.4)
Exchange translation	–	–	1.3	0.8	2.1
Other changes in value	1.8	(6.5)	37.2	0.4	32.9
At 31 December 2014	9.2	(8.9)	524.5	–	524.8

Notes to the Accounts continued...

15. Debt Securities continued...

Society	Held at fair value £m	Embedded derivatives £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1 January 2015	**9.2**	**(8.9)**	**524.5**	**3,990.0**	**4,514.8**
Transfers	**–**	**–**	**–**	**–**	**–**
Additions	**–**	**–**	**202.1**	**1,250.0**	**1,452.1**
Disposals and repayments	**–**	**0.8**	**(463.4)**	**(1,255.7)**	**(1,718.3)**
Exchange translation	**(0.5)**	**–**	**1.4**	**–**	**0.9**
Other changes in value	**0.4**	**(1.7)**	**5.6**	**(0.4)**	**3.9**
At 31 December 2015	**9.1**	**(9.8)**	**270.2**	**3,983.9**	**4,253.4**
Movements in debt securities during the year were:					
At 1 January 2014	7.4	(2.4)	531.9	1,334.3	1,871.2
Transfers	–	–	64.2	(64.2)	–
Additions	–	–	251.6	3,442.0	3,693.6
Disposals and repayments	–	–	(361.7)	(723.6)	(1,085.3)
Exchange translation	–	–	1.3	0.8	2.1
Other changes in value	1.8	(6.5)	37.2	0.7	33.2
At 31 December 2014	9.2	(8.9)	524.5	3,990.0	4,514.8

The held to maturity portfolio has a £6m impairment provision held against it which relates entirely to individually assessed collateralised debt obligations. There has been no movement in this provision since 31 December 2014 when it also totalled £6m.

Notes to the Accounts continued...

16. Loans and Advances to Customers

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Loans and advances to customers comprise:				
Loans secured on residential property				
Loans fully secured on residential property	**32,806.2**	31,687.1	**17,557.9**	17,927.5
Other loans secured on residential property	**50.5**	57.5	**11.4**	13.0
Unsecured loans	**0.9**	2.0	**0.9**	2.0
Loans secured on commercial property	**433.4**	399.1	**433.4**	399.1
Fair value hedging adjustments	**79.6**	134.7	**79.6**	134.7
Impairment provisions	**(48.9)**	(46.3)	**(6.5)**	(7.0)
	33,321.7	32,234.1	**18,076.7**	18,469.3

Loans and advances to customers are held at amortised cost, with interest and associated costs being recognised in the interest receivable and similar income line of the Income Statement on an effective interest rate basis. Amounts totalling £33.0bn (2014 – £32.0bn) are due in over one year.

Fair value hedging adjustments of £79.6m (2014 – £134.7m) have been made to certain fixed rate mortgages that are in fair value hedging relationships.

Note 35 details the extent to which these assets are encumbered.

The held to maturity portfolio of mainly Residential Mortgage Backed Securities was transferred to the available for sale accounting classification in 2014 to reflect our intention to dispose of this portfolio when market conditions allow.

The disposals and repayments for the held to maturity category relate entirely to repayments.

A number of debt securities are structured so that they can pay a return over and above their regular coupon. This feature is regarded as an embedded derivative. The Group is unable to value this element separately from the host instrument so, in accordance with IAS 39, has designated these securities as being held at fair value with movements in value being taken to the Income Statement.

The Group also holds synthetic collateralised debt obligations which contain embedded derivatives. These embedded derivatives are separated from the host instrument and are held at fair value with movements in fair value taken to the Income Statement.

Notes to the Accounts continued...

17. Intangible Assets

	Construction in progress £m	Purchased software £m	Internally generated assets £m	Other £m	Total £m
Group					
Cost					
At 1 January 2015	**14.0**	**26.8**	**12.8**	**18.5**	**72.1**
Additions	**4.9**	**2.3**	**2.0**	**–**	**9.2**
Disposals	**–**	**(1.4)**	**(3.6)**	**–**	**(5.0)**
Transfers	**(12.6)**	**2.6**	**9.7**	**–**	**(0.3)**
At 31 December 2015	**6.3**	**30.3**	**20.9**	**18.5**	**76.0**
Amortisation					
At 1 January 2015	**–**	**16.4**	**10.5**	**9.0**	**35.9**
Charged in year	**–**	**3.5**	**1.5**	**1.5**	**6.5**
Impairment	**1.1**	**0.1**	**–**	**–**	**1.2**
Disposals	**–**	**(1.3)**	**(3.6)**	**–**	**(4.9)**
Transfers	**–**	**–**	**–**	**–**	**–**
At 31 December 2015	**1.1**	**18.7**	**8.4**	**10.5**	**38.7**
Net book value					
At 31 December 2015	**5.2**	**11.6**	**12.5**	**8.0**	**37.3**
Cost					
At 1 January 2014	6.6	24.9	18.0	18.5	68.0
Additions	9.3	4.1	0.2	–	13.6
Disposals	–	(3.9)	(5.6)	–	(9.5)
Transfers	(1.9)	1.7	0.2	–	–
At 31 December 2014	14.0	26.8	12.8	18.5	72.1
Amortisation					
At 1 January 2014	–	16.0	9.5	7.6	33.1
Charged in year	–	3.1	1.9	1.4	6.4
Impairment	–	0.4	4.7	–	5.1
Disposals	–	(3.1)	(5.6)	–	(8.7)
Transfers	–	–	–	–	–
At 31 December 2014	–	16.4	10.5	9.0	35.9
Net book value					
At 31 December 2014	14.0	10.4	2.3	9.5	36.2

Notes to the Accounts continued...

17. Intangible Assets continued...

	Construction in progress £m	Purchased software £m	Internally generated assets £m	Other £m	Total £m
Society					
Cost					
At 1 January 2015	**14.0**	**25.8**	**12.8**	**18.5**	**71.1**
Additions	**4.9**	**2.3**	**2.0**	**–**	**9.2**
Disposals	**–**	**(1.4)**	**(3.6)**	**–**	**(5.0)**
Transfers	**(12.6)**	**2.6**	**9.7**	**–**	**(0.3)**
At 31 December 2015	**6.3**	**29.3**	**20.9**	**18.5**	**75.0**
Amortisation					
At 1 January 2015	**–**	**15.4**	**10.5**	**9.0**	**34.9**
Charged in year	**–**	**3.5**	**1.5**	**1.5**	**6.5**
Impairment	**1.1**	**0.1**	**–**	**–**	**1.2**
Disposals	**–**	**(1.3)**	**(3.6)**	**–**	**(4.9)**
Transfers	**–**	**–**	**–**	**–**	**–**
At 31 December 2015	**1.1**	**17.7**	**8.4**	**10.5**	**37.7**
Net book value					
At 31 December 2015	**5.2**	**11.6**	**12.5**	**8.0**	**37.3**
Cost					
At 1 January 2014	6.6	23.9	18.0	18.5	67.0
Additions	9.3	4.1	0.2	–	13.6
Disposals	–	(3.9)	(5.6)	–	(9.5)
Transfers	(1.9)	1.7	0.2	–	–
At 31 December 2014	14.0	25.8	12.8	18.5	71.1
Amortisation					
At 1 January 2014	–	15.0	9.5	7.6	32.1
Charged in year	–	3.1	1.9	1.4	6.4
Impairment	–	0.4	4.7	–	5.1
Disposals	–	(3.1)	(5.6)	–	(8.7)
Transfers	–	–	–	–	–
At 31 December 2014	–	15.4	10.5	9.0	34.9
Net book value					
At 31 December 2014	14.0	10.4	2.3	9.5	36.2

Notes to the Accounts continued...

17. Intangible Assets continued...

Other intangible assets primarily comprise the intrinsic value of items acquired on mergers (current accounts, retail savings and brands) and an amount paid for the transfer of a number of employee sharesave schemes to the Society.

Amortisation is provided to write off the cost less the estimated residual value of intangible assets over their estimated useful economic lives of between one and ten years.

Transfers relate to the reclassification of assets from construction in progress to purchased software and internally generated assets. Any impairment in the value of intangible assets is dealt with through the Income Statement as it arises. During the period, £0.1m of purchased software and £1.1m of construction in progress was written off as the recoverable amount based on the value in use was deemed to be nil.

18. Investment Properties

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Cost				
At 1 January	**21.5**	20.4	**21.3**	20.2
Additions	**0.5**	0.3	**0.5**	0.3
Disposals	**–**	–	**–**	–
Transfers	**(0.1)**	0.8	**(0.1)**	0.8
At 31 December	**21.9**	21.5	**21.7**	21.3
Depreciation				
At 1 January	**5.0**	3.9	**5.0**	3.9
Charged in year	**0.3**	0.3	**0.3**	0.3
Impairment	**–**	0.7	**–**	0.7
Disposals	**–**	–	**–**	–
Transfers	**–**	0.1	**–**	0.1
At 31 December	**5.3**	5.0	**5.3**	5.0
Net book value				
At 31 December	**16.6**	16.5	**16.4**	16.3
Fair value				
At 31 December	**21.9**	20.9	**21.6**	20.6

Notes to the Accounts continued...

18. Investment Properties continued...

Investment properties are generally flats and offices, ancillary to branch premises and not used by the Group. Rental income of £2.0m on investment properties has been included within other operating income (2014 – £2.1m).

Transfers relate to the reclassification of assets between investment properties and property, plant and equipment, usually due to changes in occupancy.

Depreciation is provided by the Group to write off the cost less the estimated residual value of investment properties (excluding land) by equal instalments over their estimated useful economic life of 50 years.

The fair value of the Group's investment properties at 31 December 2015 has been arrived at on the basis of an internal valuation carried out by the Group's Estates Manager, an appropriately qualified surveyor.

The method used to estimate the fair value of investment properties is to obtain their market value as an approximation of their fair value. Market value is calculated in accordance with the RICS Appraisal and Valuation Manual issued by the Royal Institution of Chartered Surveyors and is defined as 'the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion, assuming that the buyer is granted vacant possession of all parts of the property required by the business'. The fair value measurements for investment properties have been classified as Level 2 as they have been calculated based on observable market prices (as defined in Note 40).

The directors have considered the previous independent valuation of the investment properties undertaken on the basis of open market value. In the opinion of the directors the open market valuation of such investment properties as at 31 December 2015 was not materially different from their valuation disclosed in the financial statements.

Notes to the Accounts continued...

19. Property, Plant and Equipment

	Construction in progress £m	Land and buildings £m	Equipment fixtures, fittings and vehicles £m	Total £m
Group				
Cost				
At 1 January 2015	**4.3**	**135.3**	**72.2**	**211.8**
Additions	**2.7**	**2.4**	**12.6**	**17.7**
Disposals	**–**	**(4.1)**	**(9.2)**	**(13.3)**
Transfers	**(6.4)**	**5.2**	**1.6**	**0.4**
At 31 December 2015	**0.6**	**138.8**	**77.2**	**216.6**
Depreciation				
At 1 January 2015	**–**	**34.1**	**41.0**	**75.1**
Charged in year	**–**	**3.8**	**10.2**	**14.0**
Impairment	**–**	**–**	**1.0**	**1.0**
Disposals	**–**	**(2.5)**	**(8.9)**	**(11.4)**
Transfers	**–**	**–**	**–**	**–**
At 31 December 2015	**–**	**35.4**	**43.3**	**78.7**
Net book value				
At 31 December 2015	**0.6**	**103.4**	**33.9**	**137.9**
Cost				
At 1 January 2014	0.4	123.8	74.3	198.5
Additions	11.9	6.9	10.1	28.9
Disposals	–	(0.3)	(14.5)	(14.8)
Transfers	(8.0)	4.9	2.3	(0.8)
At 31 December 2014	4.3	135.3	72.2	211.8
Depreciation				
At 1 January 2014	–	27.7	46.8	74.5
Charged in year	–	2.8	8.3	11.1
Impairment	–	3.9	–	3.9
Disposals	–	(0.2)	(14.1)	(14.3)
Transfers	–	(0.1)	–	(0.1)
At 31 December 2014	–	34.1	41.0	75.1
Net book value				
At 31 December 2014	4.3	101.2	31.2	136.7

Notes to the Accounts continued...

19. Property, Plant and Equipment continued...

	Construction in progress £m	Land and buildings £m	Equipment fixtures, fittings and vehicles £m	Total £m
Society				
Cost				
At 1 January 2015	**4.3**	**129.2**	**72.1**	**205.6**
Additions	**2.7**	**2.4**	**12.6**	**17.7**
Disposals	**–**	**(4.1)**	**(9.2)**	**(13.3)**
Transfers	**(6.4)**	**5.2**	**1.6**	**0.4**
At 31 December 2015	**0.6**	**132.7**	**77.1**	**210.4**
Depreciation				
At 1 January 2015	**–**	**28.6**	**40.7**	**69.3**
Charged in year	**–**	**3.8**	**10.2**	**14.0**
Impairment	**–**	**–**	**1.0**	**1.0**
Disposals	**–**	**(2.5)**	**(8.9)**	**(11.4)**
Transfers	**–**	**–**	**–**	**–**
At 31 December 2015	**–**	**29.9**	**43.0**	**72.9**
Net book value				
At 31 December 2015	**0.6**	**102.8**	**34.1**	**137.5**
Cost				
At 1 January 2014	0.4	101.8	61.9	164.1
Additions	11.9	6.9	10.1	28.9
Disposals	–	(0.3)	(2.5)	(2.8)
Transfers	(8.0)	20.8	2.6	15.4
At 31 December 2014	4.3	129.2	72.1	205.6
Depreciation				
At 1 January 2014	–	22.4	35.0	57.4
Charged in year	–	2.6	8.2	10.8
Impairment	–	3.9	–	3.9
Disposals	–	(0.2)	(2.5)	(2.7)
Transfers	–	(0.1)	–	(0.1)
At 31 December 2014	–	28.6	40.7	69.3
Net book value				
At 31 December 2014	4.3	100.6	31.4	136.3

Notes to the Accounts continued...

20. Deferred Tax Assets and Liabilities

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
The movement on the net deferred tax asset is as follows:				
At 1 January	**27.5**	42.4	**24.3**	42.1
Income Statement (charge)/credit (Note 11)	**(2.2)**	3.7	**1.3**	0.8
Tax expense recognised directly in equity	**(15.7)**	(18.6)	**(15.7)**	(18.6)
At 31 December	**9.6**	27.5	**9.9**	24.3
Deferred tax assets and liabilities are attributable to the following items:				
Deferred tax assets				
Provision for loan impairment	**–**	0.1	**–**	0.1
Other provisions	**–**	0.1	**–**	–
Other temporary differences	**0.7**	0.5	**0.6**	0.5
Depreciation in excess of capital allowances	**2.6**	2.6	**2.6**	2.5
Transfer of engagements – tax value of losses carried forward	**4.7**	7.2	**4.7**	7.2
Pensions and other post retirement benefits	**1.6**	1.8	**1.6**	1.8
Implementation of IAS 39 – mortgages and hedging	**1.4**	1.0	**1.4**	1.0
Cash flow hedging	**8.1**	9.2	**8.1**	9.2
Transfer of engagements – fair value adjustments	**8.1**	16.8	**8.1**	16.8
Fair value volatility on financial instruments in securitisation entities	**1.3**	3.5	**–**	–
	28.5	42.8	**27.1**	39.1
Deferred tax liabilities				
Pensions and other post retirement benefits	**16.0**	12.9	**16.0**	12.9
Implementation of IAS 39 – mortgages and hedging	**–**	1.1	**–**	0.9
Other temporary differences	**0.7**	0.5	**0.6**	0.5
Transfer of engagements – fair value adjustments	**0.6**	0.5	**0.6**	0.5
Fair value volatility on financial instruments in securitisation entities	**1.6**	0.3	**–**	–
	18.9	15.3	**17.2**	14.8

Notes to the Accounts continued...

20. Deferred Tax Assets and Liabilities continued...

Within deferred tax assets are balances in respect of fair value adjustments and tax value of losses acquired on transfer of engagements. These are expected to be recoverable against future taxable profits (as projected in the latest Strategic Plan) within two to three years. The deferred tax assets have not been discounted.

The deferred tax charge/(credit) in the Income Statement comprises the following temporary differences:

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Accelerated tax depreciation	**–**	0.1	**(0.1)**	0.4
Pensions and other post retirement benefits	**(0.1)**	(0.3)	**(0.1)**	(0.3)
Other provisions	**0.1**	0.1	**0.1**	0.1
Other temporary differences	**(1.4)**	(1.3)	**(1.3)**	(1.1)
Release of fair value adjustments on merger	**0.1**	0.6	**0.1**	0.1
Fair value volatility on financial instruments in securitisation entities	**3.5**	(2.9)	**–**	–
	2.2	(3.7)	**(1.3)**	(0.8)

21. Other Assets

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Prepayments and accrued income	**19.4**	20.1	**17.7**	16.7
Due from subsidiary undertakings	**–**	–	**16.9**	16.6
Other assets	**9.3**	10.8	**7.5**	9.3
	28.7	30.9	**42.1**	42.6

22. Shares

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Shares comprising balances held by individuals	**27,479.8**	27,347.0	**27,479.8**	27,347.0
Fair value adjustments	**(83.4)**	(105.6)	**(83.4)**	(105.6)
	27,396.4	27,241.4	**27,396.4**	27,241.4

Notes to the Accounts continued...

23. Amounts Owed to Credit Institutions

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Amounts owed to:				
Banks	**3,302.4**	3,469.8	**3,293.0**	3,469.8
Other credit institutions	**–**	1.5	**–**	1.5
	3,302.4	3,471.3	**3,293.0**	3,471.3

Included within amounts owed to credit institutions are amounts deposited by counterparties under swap collateralisation agreements.

24. Other Deposits

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Amounts owed to:				
Group companies	**–**	–	**6,187.5**	5,562.9
Other customers	**544.3**	508.0	**255.4**	226.0
	544.3	508.0	**6,442.9**	5,788.9

Amounts due to Group companies comprise balances due to subsidiary undertakings.

25. Debt Securities in Issue

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Covered bonds	**2,433.2**	2,231.8	**2,433.2**	2,231.8
Medium term notes	**1,014.3**	487.4	**1,014.3**	487.4
Residential mortgage backed securities	**661.3**	804.0	**–**	–
	4,108.8	3,523.2	**3,447.5**	2,719.2

Debt securities in issue include secured on certain loans and advances to customers Group £3.1bn (2014 – £3.0bn) and Society £2.4bn (2014 – £2.2bn).

Notes to the Accounts continued...

26. Retirement Benefit Obligations

The Group operates one main employee benefit scheme (the Scheme), the costs of which are borne by the Society, with both defined benefit and defined contribution sections.

In addition, the Group operates unfunded defined benefit pension schemes for certain current and former members of staff. The present value at 31 December 2015 of the defined benefit obligation in relation to these schemes was £7.2m (2014 – £7.1m) and the relevant disclosures have been aggregated with those of the main employee benefits scheme.

Defined contribution post-employment benefits
In addition to the defined benefit section (see below) the Group operates a defined contribution section of the main scheme for new employees and for existing employees who are not members of a defined benefit scheme. The Group also contributes to a group personal pension arrangement in relation to the Society's transfer of engagements of Chelsea Building Society and Norwich and Peterborough Building Society. The total expense recognised for these defined contribution benefits is £7.6m (2014 – £6.9m). This excludes contributions made by the Society in relation to a salary sacrifice scheme whereby employees have accepted a reduction in salary in return for the Society agreeing to make the contributions that were previously paid by the employee).

Defined benefit post-employment benefits
The Group operates a funded defined benefit scheme for certain employees, providing benefits based on final salary. However, benefits earned by members of the defined benefit section of the main scheme, with the exception of N&P Section Members, since 1 April 2010 are based on career average revalued earnings. N&P Section members earn benefits based on their Final Pensionable Salary (following the removal of the 31 March 2010 freeze). The assets of the scheme are held in a separate trustee-administered fund. Contributions are assessed in accordance with the advice of an independent qualified actuary using the projected unit method. The defined benefit section was closed to new employees in 2000 and to future accrual on 31 December 2015. The link to final salary has been maintained for the deferred members and hence no curtailment gain has arisen in the year.

The defined benefit section of the Scheme has a weighted average maturity of around 20 years.

Summary of assumptions	**31 Dec 2015 %**	31 Dec 2014 %
Retail Prices index (RPI) Inflation	**3.3**	3.3
Consumer price index (CPI) inflation	**2.3**	2.3
Discount rate	**3.8**	3.7
Rate of increase in pay	**4.3**	4.3
Rate of increase of pensions in payment*		
in line with RPI, subject to a min of 3% and a max of 5% pa	**3.8**	3.8
in line with RPI, subject to a min of 0% and a max of 5% pa	**3.1**	3.0
in line with RPI, subject to a min of 0% and a max of 2.5% pa	**2.0**	2.0
in line with CPI, subject to a min of 0% and a max of 3% pa	**2.0**	1.9
Rate of increase for deferred pensions*		
in line with CPI, subject to a min of 0% and a max of 5% pa	**2.3**	2.3
in line with CPI, subject to a min of 0% and a max of 2.5% pa	**2.3**	2.3

*In excess of any Guaranteed Minimum Pension (GMP) element.

Notes to the Accounts continued...

26. Retirement Benefit Obligations continued...

The most significant non-financial assumption is the assumed rate of longevity. The assumptions made are equivalent to the following life expectancies for scheme members at age 60:

	2015 Years	2014 Years
For a current 60 year old male	**28.5**	28.3
For a current 60 year old female	**29.1**	28.9
For a current 45 year old male	**30.3**	30.2
For a current 45 year old female	**31.0**	30.8

Reconciliation of funded status	**31 Dec 2015 £m**	31 Dec 2014 £m
Present value of defined benefit obligation	**(735.2)**	(725.4)
Assets at fair value	**796.9**	789.8
Funded status/defined benefit asset	**61.7**	64.4

Statement of comprehensive income (SCI)	**2015 £m**	2014 £m
Cumulative actuarial gains/(losses) recognised at 1 January	**28.2**	(22.1)
Gain/(loss) on change of financial assumptions	**9.9**	(80.3)
(Loss) on change of demographic assumptions	**(3.5)**	(4.0)
Experience adjustments	**(2.1)**	1.4
Return on plan assets (less)/greater than discount rate	**(13.8)**	133.2
Total actuarial (loss)/gain recognised in SCI	**(9.5)**	50.3
Cumulative actuarial gains recognised at 31 December	**18.7**	28.2

Components of pension expense as shown in the Income Statement	**2015 £m**	2014 £m
Service cost	**6.9**	5.8
Administrative expenses	**0.6**	0.5
Interest on net defined benefit surplus	**(2.1)**	(0.2)
Total pension expense	**5.4**	6.1

Service cost is the Group's cost, net of employee contributions and inclusive of interest to the reporting date.

Notes to the Accounts continued...

26. Retirement Benefit Obligations continued...

Reconciliation of present value of defined benefit obligation	2015 £m	2014 £m
Present value of defined benefit obligation at 1 January	**725.4**	626.5
Defined benefit service cost	**6.9**	5.8
Administrative expenses	**0.6**	0.5
Interest cost	**26.6**	27.5
Actuarial (gain)/loss	**(4.3)**	82.9
Defined benefit actual benefits paid	**(20.0)**	(17.8)
Present value of defined benefit obligation at 31 December	**735.2**	725.4

Movement in defined benefit fair value of assets	2015 £m	2014 £m
Fair value of assets at 1 January	**789.8**	626.9
Interest income on scheme assets	**28.7**	27.7
Actuarial (loss)/gain on assets	**(13.8)**	133.2
Defined benefit actual Society contributions	**12.1**	19.8
Defined benefit actual benefits and costs paid	**(19.9)**	(17.8)
Fair value of plan assets at 31 December	**796.9**	789.8

Defined benefit actual contributions paid wholly relate to contributions made by the Society. Society contributions include deficit contributions of £7.5m (2014 – £5.0m). In addition, Society contributions include £1.5m (2014 – £1.5m) in relation to a salary sacrifice scheme whereby employees have accepted a reduction in salary in return for the Society agreeing to make the contributions that were previously paid by the employee.

None of the assets were invested in the Group's own financial instruments (2014 – £nil) or the Group's own property (2014 – £nil).

Notes to the Accounts continued...

26. Retirement Benefit Obligations continued...

Scheme specific risks
The ultimate cost of the Scheme to the Society will depend upon actual future events rather than the assumptions made. Many of the assumptions made are unlikely to be borne out in practice and, as such, the cost of the schemes may be higher or lower than disclosed. In general, the risk to the Society is that the assumptions underlying the disclosures, or the calculation of contribution requirements, are not borne out in practice and the cost to the Society is higher than expected. This could result in higher contributions being required from the Society and a higher deficit being disclosed. This may also impact the Society's ability to grant discretionary benefits or other enhancements to members.

The assumptions not being borne out in practice could include:

i. The investment return on the Scheme's assets being lower than assumed, resulting in an unaffordable increase in the contributions required from the Society. The level of bond returns will be a key determinant of overall investment return; the investment portfolio is also subject to a range of other risks typical of the asset classes held, in particular equity returns, credit risk on bonds and exposure to the property market.

ii. Falls in asset values (particularly equities) not being matched by similar falls in the value of liabilities. This risk has been mitigated to some degree by the implementation of an asset liability matching investment strategy which is designed to match a proportion of the Scheme's interest rate exposure.

iii. Future levels of inflation being higher than assumed, resulting in higher than anticipated annual increases to benefits in payment, revaluations of benefits prior to retirement and salary increases. This risk has been mitigated to some degree by the implementation of an asset liability matching investment strategy which is designed to match a proportion of the Scheme's inflation exposure.

iv. Unanticipated improvements in the longevity of members leading to an increase in the Scheme's liabilities.

Assets
The Scheme's investment strategy, with a significant proportion of the assets invested in an asset liability matching strategy (consisting of index linked government and corporate bonds and swaps), is expected to reduce the volatility of the difference between the market value of the assets and the IAS 19 liabilities (at the date of implementation in October 2012, the strategy hedged around 70% of the Scheme's interest rate and inflation rate risk).

Disaggregation of assets	31 Dec 2015 %	31 Dec 2014 %
Equities	**19**	28
Index-linked bonds	**54**	42
Corporate and other bonds	**9**	13
Cash and other	**10**	9
Swaps	**8**	8
	100	100

The majority of the Scheme's investments are in quoted assets, with the exception of the liability matching assets classified as 'Swaps' and reinsurance assets included in 'Cash and other', where a proportion of these will be invested in unquoted assets.

Sensitivities
The IAS19 liability measurement and the service cost are sensitive to the assumptions made about future inflation and salary growth levels, as well as the assumptions made about life expectation. They are also sensitive to the discount rate, which depends on market yields on Sterling-denominated high quality corporate bonds. A decrease in corporate bond yields will increase the liabilities although this will be partially offset by an increase in matching assets.

Notes to the Accounts continued...

26. Retirement Benefit Obligations continued...

The table below shows the sensitivity of the defined benefit obligation and Scheme assets to changes in these assumptions. The final assumptions are chosen by the Society.

Principle Sensitivity Illustrations	Defined benefit obligation £m	Assets £m	Net effect £m
Total as at 31 December 2015	(735.2)	796.9	**61.7**
Change in defined benefit obligation/assets given the following change of assumption:			
Discount Rate[1]: 1.00% decrease	(160.9)	189.4	**28.5**
Salary Escalation: 0.75% increase	(9.9)	–	**(9.9)**
Inflation[2]: 0.50% increase	(45.4)	39.8	**(5.6)**
Life Expectancy: 1 year average increase	(25.7)	–	**(25.7)**

[1] The change in the discount rate is assumed to be equivalent to a 1% decrease in gilt, swap and credit based interest rates.

[2] The sensitivities to the inflation assumption change include corresponding changes to the future salary and pension increase assumptions, where the pension increases are subject to the relevant maximum and minimum rates of increase that apply to each tranche of benefit.

The sensitivity illustrations above are calculated changing each assumption in isolation, keeping all other assumptions constant. In practice this is unrealistic as the set of financial measures are in fact correlated.

The asset liability matching strategy implemented for the Scheme means that a change in discount rate or inflation assumption has a similar impact on the liabilities and the assets, reducing the volatility of the net impact.

27. Other Liabilities

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Accruals and deferred income	**46.6**	47.3	**46.2**	46.8
Income tax deducted at source	**25.6**	29.9	**25.6**	29.9
Other	**5.4**	6.3	**5.3**	6.3
	77.6	83.5	**77.1**	83.0

Notes to the Accounts continued...

28. Provisions

Movements in provisions during the year were as follows:

Group	FSCS levy £m	Customer redress £m	Other £m	Total £m
2015				
At 1 January 2015	**16.3**	**14.1**	**5.8**	**36.3**
Amounts utilised during the year	**(18.8)**	**(7.1)**	**(0.5)**	**(26.5)**
Provision charge during the year	**11.5**	**–**	**4.5**	**16.0**
At 31 December 2015	**9.0**	**7.0**	**9.8**	**25.8**
2014				
At 1 January 2014	25.9	54.8	3.3	84.0
Amounts utilised during the year	(22.0)	(51.8)	–	(73.6)
Provision charge/(release) during the year	12.4	11.1	2.5	26.0
At 31 December 2014	16.3	14.1	5.8	36.2

Society	FSCS levy £m	Customer redress £m	Other £m	Total £m
2015				
At 1 January 2015	**16.3**	**13.8**	**5.8**	**35.9**
Amounts utilised during the year	**(18.8)**	**(6.9)**	**(0.5)**	**(26.2)**
Provision charge during the year	**11.5**	**0.1**	**4.5**	**16.1**
At 31 December 2015	**9.0**	**7.0**	**9.8**	**25.8**
2014				
At 1 January 2014	25.9	52.8	3.3	82.0
Amounts utilised during the year	(22.0)	(49.9)	–	(71.9)
Provision charge/(release) during the year	12.4	10.9	2.5	25.8
At 31 December 2014	16.3	13.8	5.8	35.9

Notes to the Accounts continued...

28. Provisions continued...

Financial Services Compensation Scheme (FSCS)
The FSCS provides compensation if a firm is unable to pay claims against it. As a consequence of the default of a number of deposit taking institutions, FSCS has borrowings of £16bn in the form of loans from HM Treasury to compensate the protected deposits. The FSCS levies member firms to recover the interest cost on those loans. The FSCS has advised of expected shortfalls, and the third and final levy payment on the outstanding capital balance was repaid in 2015; any remaining principal is expected to be recovered from the failed institutions estates. The FSCS has communicated that the level of the future levies will be reviewed following developments with the failed legacy estates.

The Group has recognised a provision charge for estimated levies due of £11.5m, for the scheme year 2015/2016, in this year's results. Fair value adjustments were made on merger with Chelsea and Norwich & Peterborough building societies to provide for future FSCS levies in respect of the acquired protected deposits, which reduce the charge for the year.

Customer remediation and conduct issues
Provisions have been made in respect of various customer claims and represent management's best estimate of the likely costs. The largest provision (£4.2m) relates to sales of payment protection insurance (PPI) and is calculated using management's estimate of complaint volumes, referral levels to the Financial Ombudsman Service (FOS), claim rates upheld internally and by FOS, redress payments and complaint handling costs. The second largest provision (£4.0m) is the cost associated with a property taken into possession. Of the remaining provision, (£1.1m) relates to the Group's approach to sales of investments linked to stock market performance and administration fee charging in relation to mortgage collection. These have been calculated using management's estimates of complaint volumes, redress payments and other costs. The costs are not expected to vary materially given that the remediation exercises are in their final stages.

Other
Other provisions include provisions for the cost associated with a property taken into possession (£4.0m),claims relating to negligent valuations undertaken prior to 2010 by a subsidiary of Norwich & Peterborough Building Society (£2.4m) and property related provisions in respect of onerous leases (£3.4m).

29. Subordinated Liabilities

Group and Society	**2015 £m**	2014 £m
6.63% Subordinated Bonds 2015	**–**	10.2
Floating Subordinated Bonds 2018	**5.0**	5.0
11⅜% Subordinated Bonds 2022	**5.0**	5.0
6⅜% Subordinated Bonds 2024	**4.1**	4.1
4⅛% Subordinated Bonds 2024	**248.7**	248.2
13½% Convertible Tier 2 Capital Notes 2025	**25.9**	25.8
Fair value hedging adjustments	**(2.6)**	1.2
	286.1	299.5

Notes to the Accounts continued...

29. Subordinated Liabilities continued...

All subordinated liabilities are denominated in Sterling. The following notes are repayable at the dates stated or earlier at the option of the Society and with the prior consent of the Prudential Regulation Authority under the following conditions:

- Redemption of all (but not some only) of the 11⅜% Notes at par on 27 November 2017 after giving not less than thirty nor more than sixty days' notice to the holders. In the event the Society does not redeem the notes on 27 November 2017 the fixed rate of interest will become the greater of 11⅜% and an aggregate of 3.10% and the then current five year benchmark Gilt rate.
- Redemption of all (but not some only) of the 4⅛% Notes at par on 20 November 2019 after giving not less than thirty nor more than sixty days' notice to the holders. In the event the Society does not redeem the notes on 20 November 2019 the fixed rate of interest will become the sum of the five year Gilt rate and 2.90%.
- Redemption of all (but not some only) of the 13½% Convertible Tier 2 Capital Notes will occur on 1 April 2025 unless the notes are converted to Profit Participating Deferred Shares (PPDS). The 'Conversion Trigger' shall occur if on any Calculation Date the Society's Common Equity Tier 1 Capital Ratio, as confirmed in a report of the auditor to the Society and addressed to the Board of Directors of the Society, is less than 5%. Should the Conversion Trigger occur on the 13½% Convertible Notes and these notes convert into PPDS, the PPDS will be perpetual in nature, ranking pari passu with the currently issued Subscribed Capital (detailed in Note 30).

The rights of repayment of the holders of subordinated liabilities are subordinated to the claims of all depositors, creditors and members holding shares in the Society, as regards the principal of their shares and interest due on them.

30. Subscribed Capital

Group and Society	**2015 £m**	2014 £m
5.649% Permanent Interest Bearing Shares	**6.1**	6.2
Fair value hedging adjustments	**0.6**	0.7
	6.7	6.9

All Permanent Interest Bearing Shares (PIBS) are unsecured and denominated in Sterling. Interest is payable half yearly on 27 March and 27 September. PIBS are repayable at the option of the Society, in whole, in March 2019 or any interest payment date thereafter.

Repayment requires the prior consent of the Prudential Regulation Authority. If the PIBS are not repaid on a call date the interest rate is reset at a margin to the then prevailing LIBOR rate. They are deferred shares of the Society and the rights of repayment of the holders of PIBS are subordinated to the claims of all depositors, creditors, members holding shares in the Society and holders of subordinated liabilities, as regards the principal of their shares and interest due on them. The interest rate risk arising from the issuance of fixed rate PIBS has been mitigated through the use of interest rate swaps.

Notes to the Accounts continued...

31. Capital Management

On 1 January 2014 the Basel III regulatory capital framework was written into European law in the form of a regulation and directive commonly known as CRD IV. This replaced the Basel II framework.

The ratios, deductions and definitions below are in accordance with CRD IV regulations.

	2015 £m	2014 £m
Tier 1		
Common Equity Tier 1 (CET1)		
General reserve	**2,123.1**	1,993.5
AFS reserve [1]	**4.9**	–
Deferred tax assets that rely on future profitability	**(4.7)**	(7.2)
Pension fund adjustments [2]	**(45.7)**	(51.5)
Intangible fixed assets[3]	**(36.8)**	(35.7)
Deductions from Tier 1 capital [4]	**(27.8)**	(27.4)
Total Common Equity Tier 1 capital	**2,013.0**	1,871.7
Additional Tier 1 Capital		
Subscribed Capital [5]	**4.7**	5.5
	2,017.7	1,877.2
Tier 2		
Subordinated liabilities [6]	**282.9**	288.3
Collective allowances for impairment	**33.3**	23.4
	316.2	311.7
Other items excluded	**–**	–
Total capital	**2,333.9**	2,188.9
Risk weighted assets	**13,883.0**	13,555.7
Common Equity Tier 1 ratio	**14.5%**	13.8%
Tier 1 ratio	**14.5%**	13.8%
Total capital ratio	**16.8%**	16.1%
Leverage ratio [7]	**5.0%**	4.8%

[1] From 1 January 2015 AFS reserves can be included in Common Equity Tier 1 Capital.

[2] CRD IV allows a pension fund surplus, net of any associated deferred tax liabilities, to be deducted from Tier 1 capital. CRD IV does not permit a pension fund deficit to be added back to regulatory capital.

[3] CRD IV allows intangible fixed assets, net of any associated deferred tax liabilities, to be deducted from Tier 1 capital.

[4] Securitisation positions that are unrated or have low external ratings have been deducted from Tier 1 capital, with deductions applied to Tier 1. Under Basel II, this balance was split, after the deduction of tax, equally between Tier 1 and Tier 2 capital.

[5] Under CRD IV, subscribed capital is being phased out as qualifying for regulatory Tier 1 capital over a ten year period. Currently 70% of the subscribed capital balance sheet carrying value qualifies as Tier 1 capital.

[6] Subordinated liabilities are adjusted for amortisation in the regulatory capital value of instruments with less than five years to maturity.

[7] CRD IV regulatory capital rules have introduced a non-risk based leverage requirement that measures the relationship between capital resources and an adjusted measure of total on and off balance sheet assets. A minimum leverage ratio of 3% is in force for the UK's largest institutions until 2017, when it will be become mandatory for all other institutions (including the Group) from 2018.

Notes to the Accounts continued...

31. Capital Management continued...

Throughout the year the Risk Overlap Committee has reviewed the Group's capital position and regulatory developments under CRD IV.

More detail of the Group's capital management strategies can be found in the Risk Management Report on page 61.

For a detailed analysis of the Group's capital position and disclosures please refer to the Pillar 3 Disclosure for 2015 which can be found on our website.

32. Financial Commitments

Group and Society	2015 £m	2014 £m
Committed undrawn standby facilities	**156.3**	161.3

The Society has an obligation under the Building Societies Act 1986 to discharge the liabilities incurred up to 11 June 1996 of all subsidiaries in so far as those subsidiaries are unable to discharge the liabilities out of their own assets. The Society has given undertakings whereby it has agreed to discharge the liabilities incurred after 11 June 1996 by certain of its subsidiaries, in the event that these subsidiaries may be unable to discharge them out of their own assets. In addition, the Society guarantees certain of Accord's mortgage buyback obligations regarding the Group's securitisation entities (discussed in note 35) in the event that Accord may be unable to discharge these obligations.

The Society accounts for these guarantees in accordance with IFRS 4 'Insurance Contracts'.

Capital commitments contracted for at 31 December 2015, but for which no provision has been made in the accounts, amounted to Group £0.9m and Society £0.9m (2014 – Group £2.3m and Society £2.3).

Amounts payable under non-cancellable operating leases are as follows:

	2015		2014	
Group	**Land and buildings £m**	**Other £m**	Land and buildings £m	Other £m
Within one year	**7.1**	0.5	**7.6**	0.8
Between one and five years	**20.0**	0.6	**22.9**	0.8
Over five years	**11.3**	–	**15.8**	–
	38.4	1.1	**46.3**	1.6

The Group is not in default on any of its financial liabilities or commitments.

Notes to the Accounts continued...

33. Financial Instruments

The table below summarises the main financial instruments, their significant terms and conditions and the accounting treatment adopted.

Financial instrument	Significant terms and conditions	Accounting treatment
Cash in hand and balances with the Bank of England	Short-term cash balances and statutory deposits Fixed, variable and non-interest bearing rates	Amortised cost
Loans and advances to credit institutions	Short-term Fixed and variable interest rates	Amortised cost
Debt securities	Short-term, medium-term and long-term Fixed and variable interest rates	Generally held at fair value as available for sale assets. Certain investments are held at fair value through the Income Statement or held to maturity at amortised cost. Detail is given in Note 15
Loans and advances to customers	Loan period is typically up to 25 years Primarily mortgage products offering a variety of fixed and variable interest rates	Amortised cost*
Derivative financial instruments	Primarily medium-term Value derived from underlying price, rate or index	Fair value through profit and loss
Intercompany deposit from Covered Bond Limited Liability Partnerships	Long-term Fixed and variable interest rates	Fair value through profit and loss
Investments	Investment in subsidiary companies	Amortised cost/cost
Shares	Deposits made by individuals Varying withdrawal notice periods Fixed and variable interest rates	Amortised cost*
Amounts owed to credit institutions and other customers	Primarily short-term Time Deposits Fixed and variable interest rates	Amortised cost*
Debt securities in issue	Medium-term Fixed and variable interest rates	Amortised cost*
Subordinated liabilities	Long-term Fixed and variable interest rates	Amortised cost*
Subscribed capital	Long-term Fixed interest rates	Amortised cost*

* Except where hedge accounting allows a fair value adjustment to be made for interest rate risk.

Notes to the Accounts continued...

34. Derivative Financial Instruments

Instruments used for the management of market risk include derivative financial instruments (derivatives) which are contracts or agreements whose value is derived from one or more underlying price, rate or index inherent in the contract or agreement, such as interest rates, exchange rates or stock market indices.

Derivatives are only used by the Group in accordance with the Building Societies Act 1986. This means that such instruments are not used in trading activity or for speculative purposes and are only used to reduce the risk of loss on core assets or liabilities arising from changes in interest rates, currency rates or other factors of a prescribed description.

The principal derivatives used in balance sheet risk management are interest rate swaps, interest rate options, cross-currency interest rate swaps, forward rate agreements, futures contracts and foreign exchange contracts. These are used to hedge Group exposures arising from fixed rate mortgage lending and savings products, funding and investment activities.

The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the type of derivatives which are typically used in managing such risks. Such risks may alternatively be managed using 'on-balance sheet' instruments as part of the Group's integrated approach to risk management.

Activity	Risk	Type of hedge
Management of the investment of reserves and other net non-interest bearing liabilities	Sensitivity to changes in interest rates	Interest rate swaps
Fixed rate savings products and options, forward fixed rate funding	Sensitivity to changes in interest rates	Interest rate swaps, forward rate agreements and futures
Fixed rate mortgage lending and options, forward fixed rate investments	Sensitivity to changes in interest rates	Interest rate swaps, forward rate agreements and futures
Management of the interest basis risk arising from differences in the underlying pricing basis of assets and liabilities	Sensitivity to changes in relationships between interest rate bases	Interest rate swaps where one leg is referenced to LIBOR or SONIA and the other to Bank Base Rate
Equity linked investment products	Sensitivity to changes in equity indices	Equity linked interest rate swaps
Investment and funding in rate swaps and foreign currencies	Sensitivity to changes in foreign exchange rates	Cross-currency interest rate swaps and foreign exchange contracts

The Group's objective is to manage risk within its risk tolerance, irrespective of the accounting treatment.

Those derivative products which are combinations of more basic derivatives are used only in circumstances where the underlying position being hedged contains the same risk features. In such cases the derivatives used will be designed to match the risks of the underlying asset or liability and therefore to hedge the associated market risk.

Certain financial instruments (including some retail products) contain features that are similar to derivatives. In the majority of such cases, the Group manages the associated risks by entering into derivative contracts that match these features.

Whilst all derivatives have been entered into for hedging purposes, only certain ones have been designated as such for accounting purposes. In some cases a natural offset can be achieved without applying the requirements of IAS 39. The Group only designates hedges where a high degree of effectiveness can be achieved.

Fair value hedges are designated where interest rate swaps are used to minimise the variability in the fair value of fixed interest financial instruments (mainly fixed rate mortgages).

Cash flow hedges are designated where interest rate swaps are used to convert the interest rate variability on short-term financial instruments into fixed rates.

Notes to the Accounts continued...

34. Derivative Financial Instruments continued...

The following tables summarise the notional and fair value of all derivative financial instruments held at the year end and the hedging designations in place at that date.

	Contract/ notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Group			
At 31 December 2015			
Interest rate swaps designated as fair value hedges	**22,738.7**	**122.8**	**212.1**
Equity linked interest rate swaps designated as fair value hedges	**208.3**	**25.8**	**–**
Interest rate swaps designated as cash flow hedges	**1,075.1**	**3.9**	**33.6**
Cross-currency interest rate swaps designated as fair value hedges	**2,094.0**	**24.5**	**66.8**
Derivatives not designated as hedges:			
Interest rate swaps	**5,052.4**	**3.1**	**27.9**
Forward foreign exchange	**39.7**	**–**	**0.5**
Total derivatives held for hedging	**31,208.2**	**180.1**	**340.9**
Society			
At 31 December 2015			
Interest rate swaps designated as fair value hedges	**21,988.7**	**60.5**	**214.9**
Equity linked interest rate swaps designated as fair value hedges	**208.3**	**25.8**	**–**
Interest rate swaps designated as cash flow hedges	**1,075.1**	**3.9**	**33.6**
Cross-currency interest rate swaps designated as fair value hedges	**991.9**	**8.7**	**44.0**
Derivatives not designated as hedges:			
Interest rate swaps	**5,052.4**	**3.1**	**27.9**
Forward foreign exchange	**39.7**	**–**	**0.5**
Total derivatives held for hedging	**29,356.1**	**102.0**	**320.9**

In line with industry best practice, expected future cash flows for derivative financial instruments have been discounted using the Overnight Indexed Swap (OIS) curve.

Credit risk on derivative exposures is significantly mitigated within the Group by the existence of a Credit Support Annex (CSA) with the vast majority of our derivative counterparties. Under a CSA, cash is passed between parties to mitigate the counterparty risk inherent in the outstanding positions. Where cash collateral is received, to mitigate the risk inherent in amounts due to the Group, it is included as a liability within amounts owed to credit institutions. Where cash collateral is given to mitigate the risk inherent in amounts due from the Group, it is included as an asset in loans and advances to credit institutions. Credit risk is also mitigated by the use of central counterparties (CCPs) for eligible derivatives.

Notes to the Accounts continued...

34. Derivative Financial Instruments continued...

	Contract/ notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Group			
At 31 December 2014			
Interest rate swaps designated as fair value hedges	18,784.7	169.3	277.8
Equity linked interest rate swaps designated as fair value hedges	239.7	22.4	–
Interest rate swaps designated as cash flow hedges	1,288.0	3.7	44.2
Cross-currency interest swaps designated as fair value hedges	1,323.9	–	43.9
Derivatives not designated as hedges:			
Interest rate swaps	5,121.9	18.8	47.0
Forward foreign exchange	65.2	0.1	0.7
Total derivatives held for hedging	26,823.4	214.3	413.6
Society			
At 31 December 2014			
Interest rate swaps designated as fair value hedges	18,034.7	68.2	281.4
Equity linked interest rate swaps designated as fair value hedges	239.7	22.4	–
Interest rate swaps designated as cash flow hedges	1,288.0	3.7	44.2
Cross-currency interest swaps designated as fair value hedges	467.3	–	16.3
Derivatives not designated as hedges:			
Interest rate swaps	5,121.9	18.8	47.0
Forward foreign exchange	65.2	0.1	0.7
Total derivatives held for hedging	25,216.8	113.2	389.6

Notes to the Accounts continued...

35. Liquidity Risk

Liquidity risk is an intrinsic part of the Group's business as long-term mortgages are funded by short-term retail customer balances. Most mortgages have a contractual maturity date of around 25 years but in practice are frequently repaid early; currently the estimated average life of a mortgage is approximately five years. Conversely, experience shows that retail deposits, nominally repayable on demand or with short notice periods, actually remain with the Society for relatively long periods. It is this inherent mismatch in the maturity profiles of retail assets and liabilities that creates liquidity risk.

The Group's liquidity management policy is designed to ensure the maintenance of adequate investments in liquid assets to cover statutory, regulatory and operational requirements. The primary function of liquidity is the provision of sufficient 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.

The Group's liquidity management comprises the following key areas:

- At the highest level, the Group manages its liquidity levels to ensure compliance with the Overall Liquidity Adequacy Rule, as set out by the PRA in Chapter 2 of the ILAA (Internal Liquidity Adequacy Assessment) rules.
- Limits are established by the Board that govern the quantity, quality and marketability of and returns from the Group's portfolio of liquidity investments. The portfolio is managed by the Treasury function, monitored by the first and second line Risk functions and overseen by the Asset and Liability Committee (ALCO) under a series of delegated authorities.
- The Group conducts a series of daily stress tests that are designed to ensure that its liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include ones caused by both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding. They are constructed on various timescales as far out as three months.
- The Group also manages liquidity in line with prevailing regulatory requirements. Up until 30 September 2015, this was the Individual Liquidity Guidance (ILG) as issued by the PRA following submission and regulatory review of the ILAAP (Internal Liquidity Adequacy Assessment Process) document. Up until the point at which ILG ceased to be binding, there had been no breaches of internal or regulatory liquidity levels under this basis of measurement.
- Effective 1 October 2015, the regulatory requirement migrated to the Liquidity Coverage Ratio (LCR), as prescribed under the European Capital Requirements Directive IV (CRD IV) as part of the Capital Requirements Regulation (CRR) element. The LCR measures the quantity of high quality liquid assets (HQLA) against net liquidity outflows over a 30 day period. YBS currently reports to the PRA on a monthly basis at a Group and Society-only level, with the lower of the two being reported as 172.02% for December 2015 month end. For comparison, a PRA thematic review exercise as at 31 December 2014 reported a figure of 131.69%.
- During 2015, internal backstop limits for liquidity were also implemented within the Group, to mitigate the potential risk of liquidity levels under a risk-based approach being reduced below what is considered a minimum appropriate level for the Group. These limits are linked to balance sheet size, and also take account of sources of contingent liquidity, including the ability of the Group to access funding through the various Bank of England facilities.
- The liquidity position of the Group is forecast across the next two years and measured against forecasts of the requirements on both a regulatory and internal basis. This is to ensure that the short-term plans of the Group do not lead to liquidity limits being breached and the financial sustainability of the organisation being threatened. These forecasts are refreshed on a weekly basis and are discussed at the weekly ALCO meetings.

The above metrics are the key elements of the suite of measures by which the Group actively seeks to manage its liquidity position, along with other complimentary metrics which are included within the Group's risk appetite framework.

Liquidity risk in subsidiary companies, with the exception of other deposits, is mitigated by the use of appropriate inter-company loans and deposits.

Notes to the Accounts continued...

35. Liquidity Risk continued...

Pledged assets

The Group's asset backed funding programmes, reported within debt securities in issue (see Note 25) are secured against certain loans and advances to customers.

In addition, as part of its liquidity management, the Group enters into sale and repurchase agreements, whereby the Group sells but agrees to repurchase assets at a future date. Typically this is for up to three months and for UK Government securities and listed transferable debt securities. Proceeds of these sale and repurchase agreements are included within amounts owed to credit institutions (see Note 23).

Assets pledged and the nominal values of the notes in issue are as follows:

	2015		2014	
	Assets pledged £m	Secured funding £m	Assets pledged £m	Secured funding £m
Covered bond programme	**3,796.5**	**2,352.1**	3,396.8	2,106.7
Securitisation programme	**1,650.9**	**1,007.0**	1,549.4	897.2
Whole mortgage loan pools	**3,094.3**	**2,328.5**	3,857.6	2,587.1
Available for sale – Debt Securities	**203.2**	**204.0**	373.8	372.0
	8,744.9	**5,891.6**	9,177.6	5,963.0

All of the assets pledged as security are shown in the Statement of Financial Position as the Group has retained substantially all the risk and rewards of ownership.

The Society established Yorkshire Building Society Covered Bonds LLP in November 2006. The LLP provides security for issues of covered bonds made by the Society to external counterparties. The Society issued a new five year €500m fixed rate bond in June 2015 followed by a seven year €500m fixed rate bond in November 2015. As at 31 December 2015 the Society had in issue £1,250m and €1,500m of covered bonds.

The Group established its first securitisation programme in 2011. This year the latest securitisation structure, Tombac No.2 PLC was established and in December 2015 issued £1,250m of listed debt securities secured against certain loans of Accord Mortgages Ltd. All of these debt securities were retained by the Group to be used as collateral for use in sale and repurchase agreements or central bank operations. As at 31 December 2015, the Group had in issue £4,642m of securitisation notes, of which £3,981m were retained.

The whole mortgage loan pools are pre-positioned at the Bank of England under the Funding for Lending Scheme (FLS). The whole loan pool is pledged and drawings are made directly against the eligible collateral. However, values shown are the whole mortgage loan pool balances.

Notes to the Accounts continued...

35. Liquidity Risk continued...

The tables below show contractual future cash flows for all financial liabilities including interest payments. Further details of liquidity management are contained within the Risk Management Report on pages 62 to 63.

	Repayable on demand and up to three months £m	In more than three months but not more than one year £m	In more than one year but not more than five years £m	Over five years £m	Total £m
Group					
As at 31 December 2015					
Shares	**19,354.1**	**3,771.9**	**4,538.5**	**5.1**	**27,669.6**
Amounts owed to credit institutions	**867.2**	**2,152.6**	**234.5**	**–**	**3,254.3**
Other deposits					
Society	**251.8**	**–**	**3.0**	**–**	**254.8**
Subsidiaries	**289.4**	**–**	**–**	**–**	**289.4**
Debt securities in issue	**505.0**	**112.5**	**1,841.8**	**744.8**	**3,204.1**
Subordinated liabilities	**–**	**14.6**	**63.4**	**343.4**	**421.4**
Subscribed capital*	**0.2**	**0.2**	**1.4**	**1.7**	**3.5**
Operating lease payments	**1.9**	**5.8**	**20.7**	**11.3**	**39.7**
Derivative financial liabilities	**41.0**	**128.7**	**379.8**	**67.4**	**616.9**
Total	**21,310.6**	**6,186.3**	**7,083.1**	**1,173.7**	**35,753.7**
Group					
As at 31 December 2014					
Shares	19,260.4	4,555.2	3,634.9	9.3	27,459.8
Amounts owed to credit institutions	2,396.9	721.7	322.3	–	3,440.9
Other deposits					
Society	217.1	11.0	–	–	228.1
Subsidiaries	281.9	–	–	–	281.9
Debt securities in issue	15.3	539.2	2,717.3	399.1	3,670.9
Subordinated liabilities	10.4	14.6	63.4	358.0	446.4
Subscribed capital*	0.1	0.2	1.4	1.7	3.4
Operating lease payments	2.0	6.4	23.7	15.8	47.9
Derivative financial liabilities	38.4	175.8	429.3	72.5	716.0
Total	22,222.5	6,024.1	7,192.3	856.4	36,295.3

* The table includes interest payments on subscribed capital for ten years.

Notes to the Accounts continued...

36. Market Risk

Market risk is the risk to earnings and capital arising from changes in interest rates, foreign currency exchange rates, structural mismatches within the Statement of Financial Position and the price of financial instruments.

Value at Risk (VaR)

VaR is a risk management tool which evaluates the potential losses that may be incurred as a result of movements in market conditions over a specified holding period and to a given level of confidence. The model used is based on a 10 day holding period and a 99% confidence level.

The VaR model calculates potential movements in market prices by reference to market data from the last 252 days and incorporates underlying risk factors based on historic interest rate volatilities and correlations.

VaR for the Treasury portfolios is calculated and reported on a daily basis and for the Group on a monthly basis. A back test of the VaR model is performed to test the validity of the assumptions and parameters within the model.

A number of limitations should be considered in relation to the VaR model:

1. Historic data is not necessarily a good guide to future events
2. The model, by definition, does not capture potential losses outside the 99% confidence level, i.e. those events that are extreme in nature
3. VaR is calculated on the basis of exposures outstanding at the close of business and, therefore, does not necessarily reflect intra-day exposures

VaR measures below are based upon full balance sheet positions excluding the investment of the Group's free reserves.

Structural risk analysis (basis risk)

An analysis of interest bearing items by rate type is performed to illustrate key areas of structural mismatch. It identifies mismatches between administered rates, fixed rates and other rates including those linked to Bank Base Rate, SONIA and LIBOR. The effect of LIBOR and SONIA mismatches within the Balance Sheet is measured as the impact on net interest income (for a 12 month rolling period) of an isolated increase in LIBOR/SONIA of one basis point (0.01%).

Basis point value (BP) sensitivity

This measure calculates the change in value of the assets and liabilities resulting from a one basis point parallel shift in interest rates. Within the Treasury portfolio this is calculated and reported on a daily basis separately for each currency and at the full Statement of Financial Position level on a monthly basis.

Repricing gap analysis

Repricing dates are analysed primarily to avoid repricing risk concentrations, i.e. the situation where too great a proportion of the Group's assets and liabilities see the interest rates earned or charged on them resetting within a given time period. The aim is to prevent excessive volatility in the net interest margin that could arise if rates shifted adversely within a given time period, and since the Group cannot dictate interest rate movements themselves, the best approach is to limit the amount of assets or liabilities that are exposed in this way. The analysis identifies the net asset/liability repricing position across a series of time intervals. Positions are calculated using nominal amounts and exclude interest flows. General reserves, fixed assets and other liabilities are classified as having 'non-specific' repricing characteristics with a zero rate of interest. The measure is calculated as a reverse cumulative gap.

Notes to the Accounts continued...

36. Market Risk continued...

All market risk is managed in the Society on behalf of the Group, hence the tables below apply to the Group.

2015	**Year end £000**	**Average £000**	**Maximum £000**	**Minimum £000**
VaR	**1,056**	**2,112**	**3,179**	**1,056**
Basis risk	**99**	**88**	**119**	**50**
BP sensitivity	**(88)**	**(108)**	**(27)**	**(199)**

	Greater than one year £m	**Greater than five years £m**	**Greater than 10 years £m**
Repricing gap	**1,249**	**(67)**	**(1)**

2014	Year end £000	Average £000	Maximum £000	Minimum £000
VaR	2,401	3,216	7,410	947
Basis risk	11	30	71	4
BP sensitivity	(148)	(158)	(2)	(337)

	Greater than one year £m	Greater than five years £m	Greater than 10 years £m
Repricing gap	785	11	(3)

Detail of how the Group manages its interest rate risk is included in the Risk Management Report on page 63.

37. Currency Risk

Currency exchange risk is monitored daily and the Group seeks to minimise its net exposure to assets and liabilities denominated in currencies other than Sterling. Maximum positions throughout the year represented less than 0.01% of total assets. More detail of this policy can be found in the Risk Management Report on page 63. Actual exposures were:

	2015 £m	2014 £m
Year end	**0.3**	–
Maximum	**0.3**	0.7

Notes to the Accounts continued...

38. Wholesale Credit Risk

The Group's wholesale credit risk arises principally from assets held for liquidity purposes. The risk is that counterparties with whom the Group invests liquid assets fail to repay those investments when they fall due. The Group, through the Group Risk function, undertakes its own internal rating of all its counterparties and sets individual limits accordingly. These limits are regularly reviewed internally and against the external rating agencies, with revocation or suspension taking place where considered appropriate.

Limits are in place governing the types of instrument in which the Group will invest, as well as geographic limits designed to prevent overexposure to a given country.

The Group uses an internal credit ratings process to identify potential risks and wholesale related credit risks are reported and discussed monthly at the Wholesale and Commercial Credit Committee.

Whilst recognising that exposures will be maintained across a spectrum of counterparties the Board has maintained a low risk appetite for wholesale credit risk resulting in our inter-bank exposures being limited to operational requirements. A diversified range of counterparties is in place to meet business and regulatory requirements with no credit risk exposures being undertaken by Treasury to counterparties that have not been through an internal approvals process including a formal second line of defence function. Wholesale and Commercial Credit Committee are responsible for overseeing the approach taken and is mandated to approve or decline recommendations.

The following tables break down Wholesale Group exposures[1] by type using the composite external ratings[2].

2015	**Aaa-Aa3 £m**	**A1-A3 £m**	**Baa1-Baa3 £m**	**Ba1-B3 £m**	**Caa1-C3 £m**	**Total £m**
Central Bank and Sovereigns	**5,574.3**	–	–	–	–	**5,574.3**
Financial Institutions	**226.7**	**455.9**	**24.3**	–	–	**706.9**
Structured	–	–	**9.0**	–	**27.9**	**36.9**
RMBS	–	–	–	–	–	–
Other	–	–	–	**3.4**	–	**3.4**
Total	**5,801.0**	**455.9**	**33.3**	**3.4**	**27.9**	**6,321.5**

[1] Exposures are measured and reported equivalent to those under CRR 575/2013: Part Four.

[2] The composite rating is derived from an average external rating.

2014	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Ba1-B3 £m	Caa1-C3 £m	Total £m
Central Bank and Sovereigns	5,412.3	–	–	–	–	5,412.3
Financial Institutions	186.6	438.8	–	–	5.7	631.1
Structured	7.8	20.1	–	17.0	27.4	72.3
RMBS	56.1	5.1	–	–	–	61.2
Other	–	–	–	3.1	–	3.1
Total	5,662.8	464.0	–	20.1	33.1	6,180.0

[1] Exposures are measured and reported equivalent to those under CRR 575/2013: Part Four.

[2] The composite rating is derived from an average external rating.

Notes to the Accounts continued...

38. Wholesale Credit Risk continued...

The Group's low risk appetite outside the UK is reflected in the country exposures[3] by type shown in the tables below.

2015	Central Banks and Sovereigns £m	Financial Institutions £m	Structured £m	RMBS £m	Other £m	Total £m
United Kingdom	**5,574.3**	**504.2**	–	–	**3.4**	**6,081.9**
United States	–	**141.1**	–	–	–	**141.1**
Netherlands	–	–	**9.0**	–	–	**9.0**
Switzerland	–	**22.0**	–	–	–	**22.0**
Ireland	–	–	**8.8**	–	–	**8.8**
Cayman Islands	–	–	**19.1**	–	–	**19.1**
France	–	**32.2**	–	–	–	**32.2**
Canada	–	**4.2**	–	–	–	**4.2**
Denmark	–	**0.4**	–	–	–	**0.4**
Australia	–	**0.7**	–	–	–	**0.7**
Germany	–	**1.5**	–	–	–	**1.5**
Belgium	–	**0.1**	–	–	–	**0.1**
Spain	–	**0.5**	–	–	–	**0.5**
Total	**5,574.3**	**706.9**	**36.9**	–	**3.4**	**6,321.5**

[3] Country risk exposures for structured and RMBS are based on the country of origination for the asset.

2014	Central Banks and Sovereigns £m	Financial Institutions £m	Structured £m	RMBS £m	Other £m	Total £m
United Kingdom	5,412.3	434.2	–	61.2	3.1	5,910.8
United States	–	139.1	10.7	–	–	149.8
Netherlands	–	–	24.8	–	–	24.8
Switzerland	–	21.8	–	–	–	21.8
Ireland	–	1.5	19.3	–	–	20.8
Cayman Islands	–	–	17.5	–	–	17.5
France	–	17.3	–	–	–	17.3
Denmark	–	11.8	–	–	–	11.8
Australia	–	3.3	–	–	–	3.3
Germany	–	2.1	–	–	–	2.1
Belgium	–	–	–	–	–	–
Total	5,412.3	631.1	72.3	61.2	3.1	6,180.0

[3] Country risk exposures for structured and RMBS are based on the country of origination for the asset.

Notes to the Accounts continued...

38. Wholesale Credit Risk continued...

The Group's only Sovereign exposure is to the UK which has an average external rating of 'AA+'. At the year end, UK Sovereign exposure was £5,345m (2014 – £5,039m) to the Bank of England and £229m (2014 – £373m) in UK Government bonds.

The largest exposure to a single institution (other than the UK Government) was £223m (2014 – £195m) in both instances to a UK clearing bank.

None of the wholesale exposures is either past due or impaired and there are no assets that would otherwise be past due or impaired whose terms have been renegotiated. The key trigger events used to evaluate impairments are set out in Note 1 on pages 96 to 100.

In addition to the above direct exposures the Group regularly monitors indirect exposures (the primary exposures of our counterparties) to establish whether any second order concentration risks exist. This is performed on a best efforts basis given the inconsistency and timings of information that exists in the public domain with regards to this information.

Wholesale credit risk is recorded in the following Statement of Financial Position captions:

	2015 £m	2014 £m
Cash in hand and balances with the Bank of England	**3,439.3**	3,670.6
Loans and advances to credit institutions	**695.9**	599.3
Debt securities	**269.5**	524.8
Derivative financial instruments	**180.1**	214.3
Investments[1]	**1.4**	1.4
Total wholesale credit risk	**4,586.2**	5,010.4

Debt securities, which are shown after fair value and impairment adjustments, can be further analysed as:

	2015 £m	2014 £m
UK Government securities	**229.2**	390.2
Medium-term notes issued by financial institutions	**3.3**	3.3
Mortgage backed securities[2]	**–**	60.4
Combination note[3]	**9.1**	9.2
Synthetic credit investments[4]	**27.9**	46.9
Collateralised debt obligations[5]	**–**	14.8
	269.5	524.8

[1] Principally an equity investment in VocaLink Holdings Limited which is associated with the Group's operation of cash machines.

[2] Mortgage backed securities are primarily backed by AAA rated UK prime residential mortgages.

[3] The combination note continues to pay contractual coupons with no evidence of impairment. Changes in fair value are taken directly to the Income Statement.

[4] There are two holdings in synthetic credit investments. These contain embedded derivatives that have been separated with changes in fair value being taken directly to the Income Statement.

[5] These were investments in two collateralised debt obligations, each of which repaid in full during the year. These investments were classified as available for sale.

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers

Credit risk management

The Group articulates its desired level of credit risk through a series of risk appetite statements. These statements are supported by a number of qualitative and quantitative measures that are monitored closely by the Group Risk function and reported monthly to the Group's credit risk committees. Further challenge and oversight is provided by the Group Risk Committee which reviews credit risk reporting as part of their quarterly meetings.

The Group's exposure to credit risk on loans and advances to customers can be broken down as follows:

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Retail mortgages	**32,592.6**	31,661.3	**17,325.7**	17,866.9
Commercial lending	**896.6**	716.4	**893.4**	712.8
Unsecured lending	**4.1**	6.2	**4.1**	6.2
Total gross exposure (contractual amounts)	**33,493.3**	32,383.9	**18,223.2**	18,585.9
Impairment, fair value, EIR and hedging adjustments	**(171.6)**	(149.8)	**(146.5)**	(116.6)
Total net exposure	**33,321.7**	32,234.1	**18,076.7**	18,469.3

Retail mortgages

The Group's exposure to mortgage related credit risk is monitored closely by the Credit Risk area within Group Risk. Reporting on risk exposures is provided monthly to the Retail Credit Committee. Reports include analysis of the movement of loans into arrears and between arrears bands by differing loan portfolios, as well as monitoring of the overall characteristics of the loan portfolios (e.g. geographic location, indexed loan-to-value concentrations and affordability metrics). In addition, Group Risk undertakes a number of stress tests periodically that subject the mortgage portfolios to different levels of default, house price deflation and other factors to identify the potential loan losses under the different economic conditions represented by those stress tests.

At an operational level, adherence to the Group's retail credit risk appetite is supported through the use of a suite of tools used in activities such as credit decisioning, portfolio management and arrears management.

Geographic distribution of retail mortgage balances	**2015 %**	2014 %
Scotland	**6.6**	6.7
North East	**3.5**	3.7
Yorkshire & Humberside	**9.4**	9.6
North West	**8.9**	9.2
Midlands	**10.0**	10.0
East of England	**4.3**	4.4
South West	**7.0**	7.0
Greater London	**21.4**	20.7
South East	**25.0**	24.5
Wales & Northern Ireland	**3.8**	4.0
Non-UK	**0.1**	0.2
	100.0	100.0

*In 2015 we have refined the classification of regions and have aligned the 2014 data.

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers continued...

Substantially all retail mortgage balances are secured on property. As part of the portfolio monitoring process, these properties are subject to regular updates in respect of their loan-to-value by way of an indexation process. This is applied to provide some measure of relative house price movements across the UK and their impact on the relative properties values. Although the indexation approach is very broad, typically at the regional level, it is an industry standard for providing senior management with a view as to the value and risk of the properties on which retail mortgages are secured.

Loan-to-value distribution of retail mortgage balances

	Book		**New Lending**	
	2015 %	2014 %	**2015 %**	2014 %
Greater than 100%	**0.6**	1.1	**–**	–
90% to 100%	**1.9**	3.1	**2.7**	2.9
75% to 90%	**17.2**	18.7	**37.8**	42.1
50% to 75%	**51.4**	51.5	**49.1**	46.2
Less than 50%	**28.9**	25.6	**10.4**	8.8
	100.0	100.0	**100.0**	100.0

The average indexed loan-to-value, based on a simple average of each loan's indexed loan-to-value, is 49.5% (2014 – 50.9%).

Loan-to-value distribution of retail mortgage balances

	2015		2014	
	Not individually impaired %	**Individually impaired %**	Not individually impaired %	Individually impaired %
Greater than 100%	**0.5**	**0.1**	0.9	0.2
90% to 100%	**1.7**	**0.2**	2.8	0.3
75% to 90%	**16.9**	**0.3**	18.2	0.5
50% to 75%	**50.9**	**0.5**	50.9	0.6
Less than 50%	**28.7**	**0.2**	25.4	0.2
	98.7	**1.3**	98.2	1.8

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers continued...

Retail mortgage customer type

	Book		New Lending	
	2015 %	2014 %	**2015 %**	2014 %
First time buyer	**19.6**	19.5	**20.7**	23.5
Other buyers e.g. movers	**41.7**	42.5	**37.9**	43.9
Remortgage	**29.4**	30.0	**28.8**	25.5
Buy to let	**9.3**	8.0	**12.6**	7.1
	100.0	100.0	**100.0**	100.0

*In 2015 we have refined the classification of buy to let and have aligned the 2014 data.

Retail mortgage arrears

	Group		Society	
	2015 %	2014 %	**2015 %**	2014 %
Arrears outstanding as a percentage of debt				
No arrears	**96.4**	95.4	**96.1**	95.6
Less than three months	**2.7**	3.4	**3.0**	3.4
Three months or more	**0.8**	1.1	**0.8**	0.9
Property in possession	**0.1**	0.1	**0.1**	0.1
	100.0	100.0	**100.0**	100.0
Number of properties in possession at the year end	**126**	236	**72**	110

The percentage of retail mortgages with arrears of three months or more (as a % of outstanding balances, including possessions) has fallen during 2015 from 1.17% to 0.89%. The Council of Mortgage Lending (CML) industry average ratio for mortgage arrears is measured using the number of accounts (including possessions). On this basis, the Group's retail mortgage arrears ratio 0.96% (2014 – 1.21%) is below the comparable CML ratio 1.20% (2014 – 1.35%). Arrears on more recent lending are minimal, reflecting the Group's credit risk appetite.

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers continued...

Commercial lending

Commercial lending credit risk exposures are monitored by Group Risk and reported to the Wholesale and Commercial Credit Committee. Reporting includes analysis of book growth, sector distribution of book, geographic distribution, loan-to-value analysis and the movement of loans into arrears and between arrears bands. Loans against specialist properties are strictly limited and we do not lend against land only. The Group assesses whether current valuations are appropriate by re-valuing properties periodically using third party valuation data which takes into account the property type and geographical location. Third party valuation data is also used to assess the risk of loss on individual loans and to monitor whether loan-to-value covenants are met. Where borrowers are more than two months in arrears, consideration is given to obtaining a professional valuation of the property.

At 31 December 2015 the Group had a commercial lending book (including lending to housing associations on residential properties) of £896.6m. The Group originates commercial lending via its N&P brand, providing loans to commercial owner occupiers, commercial and residential property landlords (where the borrower is a corporate entity) and a small number of housing associations. The N&P commercial loan portfolio, which comprises 64.9% (2014 – 68.4%) of the total commercial lending book, is managed by a specialist team using a combination of lending policy rules, underwriting and close relationship management to assess new applicants and manage existing loans. The majority of loans are advanced against commercial properties using a vacant possession valuation to mitigate against future losses.

This proactive approach to account management has resulted in only 0.34% of N&P commercial accounts being more than three months in arrears (as a % of outstanding balances, including repossessions) as at the year end (2014 – 0.44%). While arrears and losses to date have been low, as part of the merger all acquired N&P commercial loans were subject to a fair value adjustment to reflect likely future losses on the portfolio.

We have a small closed commercial loan book which arose from the merger with Chelsea Building Society. The book is in run off and we do not write any new commercial business under the Chelsea brand. At 31 December 2015 there were 4 loans remaining with outstanding balances totalling £18.9m (2014 – £29.1m). All loans are performing and are covenant compliant.

In addition to the N&P commercial lending book, we have an active business lending to housing associations, in England and Wales, via the Yorkshire Building Society brand, properly known as ‘Registered Providers’. This sector has particularly robust credit characteristics and the lending is low risk albeit at low margins. We have an opportunistic approach to attracting new business, within the constraints of a Board approved risk appetite, and do so when returns and capital efficiency contribute to financial sustainability. At 31 December 2015 the loan book was £296.2m (2014 – £197.1m). We have written further term loan facilities in the region of £156.0m (2014 – £184.5m) and these will draw down over the next 2 to 3 years.

The Group commercial loan portfolio (including lending to housing associations) is spread throughout the UK as follows:

Geographic distribution of commercial mortgage balances

	2015 %	2014 %
Scotland	**0.0**	0.1
North East	**1.4**	1.2
Yorkshire & Humberside	**2.6**	2.6
North West	**10.5**	10.7
Midlands	**6.6**	8.1
East of England	**4.1**	4.7
South West	**4.7**	4.4
Greater London	**24.4**	25.8
South East	**36.7**	33.6
Wales	**9.0**	8.8
	100.0	100.0

*In 2015 we have refined the classification of regions and have aligned the 2014 data.

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers continued...

N&P commercial mortgages by customer type

	2015 %	2014 %
Housing associations	**2.9**	3.4
Buy to let	**25.3**	19.8
Commercial mortgages	**71.8**	76.8
	100.0	100.0

N&P commercial mortgages by property type

	2015 %	2014 %
Office	**46.8**	36.7
Industrial	**6.6**	8.5
Retail and leisure	**24.6**	27.8
Housing Associations	**2.9**	3.4
Other, including mixed use	**19.1**	23.6
	100.0	100.0

The average loan-to-value of the N&P commercial loan portfolio is 51.7% (2014 – 55.4%). The loan-to-value calculation has been undertaken using a combination of external professional valuations and indexation of the original valuation using data from the Investment Property Databank (IPD). IPD provides performance measurement services in the UK and Ireland. N&P commercial BTL and social housing mortgages are indexed using Halifax adjusted HPIs.

The total value of the security held against N&P commercial loans is estimated to be £1,297m (2014 – £1,033m). £13.8m of the N&P exposures have an estimated LTV of greater than 100% (2014 – £21.7m). Of these, loans totalling £0.4m are in arrears. The largest N&P exposure to a single counterparty at 31 December 2015 is £8.0m (2014 – £8.8m).

Loans monitored on the "watch list" include those where there are circumstances which could impact on the quality and safety of the loan. Examples include borrowers requesting forbearance (such as changing loan repayments to interest only for a period), or reporting trading losses. Loans on the watch list total £8.5m (2014 – £8.4m). Our appetite and approach to the provision of commercial lending is to provide amortising term loans, typically over 10 – 25 years. We do not provide short-term, interest only facilities which require repayment on expiry through refinance. Where a period of interest only is agreed, it will be for a short period following which the loan will be structured to amortise over the remaining term. Buy to let loans are mainly interest only (N&P BTL £146.5m, 2014 – £96.5m). These loans are continuously monitored to ensure that full repayment is made on the expiry of the loan term.

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers continued...

N&P commercial mortgage arrears

	2015 %	2014 %
Arrears outstanding as a percentage of debt		
No arrears	**98.9**	98.3
Less than three months	**0.7**	1.3
Three months or more	**0.3**	0.3
Property in possession	**0.1**	0.1
	100.0	100.0

Unsecured lending

The Group originates unsecured lending in the form of current accounts, via its N&P brand. In addition, the Group has an N&P branded personal loan portfolio that is in run-off. As at 31 December 2015 unsecured lending balances stood at £4.1m (current account overdrafts of £1.8m, personal loans of £2.3m). Within the Group, unsecured lending is managed by the Credit Risk area within Group Risk, with monthly reporting provided to the Retail Credit Committee. Reporting includes analysis of accounts in arrears and overdraft limits.

Current account overdrafts are assessed and managed using a combination of statistical credit models, lending policy rules and underwriting, with all overdraft limits reviewed on at least a monthly basis. Accounts are monitored closely for early signs of distress and advice offered to customers where deemed appropriate. Customers who are unable to repay overdrafts when due are passed to the Collections department who review individual customer circumstances before deciding what appropriate action to take. As at 31 December 2015, accounts that have been in excess of their agreed overdraft for three or more consecutive months stood at 1.1% of the portfolio by volume (2014 – 1.4%).

The personal loan portfolio is currently in run-off. Customers who are unable to repay personal loans are passed to the Collections department who review individual customer circumstances before deciding what appropriate action to take. As at 31 December 2015, accounts which were within term and three or more months in arrears stood at 6.8% of the portfolio by volume (2014 – 9.3%).

At the point of merger, as with all N&P loan books, a fair value adjustment was applied against all unsecured lending.

Impairment

All loans (retail mortgage, commercial and unsecured) are reviewed at each reporting date for indications of impairment.

The following table shows as at the year end, impairment on the overall loan balances as well as a prudent assessment of collateral held against total loans and advances. The collateral is calculated as the lower of the value of the property and the outstanding loan amount. It is not the overall value of properties secured against the loans.

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers continued...

	Loans and advances		Collateral	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Group				
Not individually impaired:				
Neither past due nor individually impaired	**32,291.4**	30,905.1	**32,282.8**	30,891.1
Past due but not individually impaired	**757.7**	906.2	**759.8**	904.3
Individually impaired	**444.2**	572.6	**421.3**	544.3
Total loans and advances	**33,493.3**	32,383.9	**33,463.9**	32,339.7
Society				
Not individually impaired:				
Neither past due nor individually impaired	**17,530.6**	17,762.5	**17,533.2**	17,757.1
Past due but not individually impaired	**458.2**	529.1	**461.2**	528.9
Individually impaired	**234.4**	294.3	**216.0**	284.1
Total loans and advances	**18,223.2**	18,585.9	**18,210.4**	18,570.1

The loans and advances shown above exclude effective interest rate adjustments and credit loss fair values and therefore do not tie through directly to Note 16.

Impairment is assessed based on the arrears of each loan. Where retail or commercial mortgages are in arrears by two months or more, they are individually assessed for impairment. Commercial loans less than two months in arrears are also individually impaired where other qualitative factors suggest a measurable decrease in the present value of their future cash flows, i.e. where they are included on the watch list noted previously. All such mortgages that are past due but not individually impaired are less than two months in arrears. Where retail or commercial mortgages are less than two months in arrears they are assessed for collective impairment.

Loans acquired on the merger with Chelsea in 2010 and Norwich & Peterborough in 2011 were measured at fair value on acquisition, which makes allowances for expected losses over the remaining life of the loans. Any further losses from the past due loans totalling £472.0m at 31 December 2015 (2014 – £585.0m), are unlikely to be significant to the Group.

Note 1 on page 97 describes the Group's approach to impairment provisioning and the key factors used in the calculation. The key model assumptions underpinning the current mortgage impairment provisions (shown in Note 9) are forecast house price inflation/(deflation), probability of possession, emergence period, loss given possession and forced sale discount.

Personal loans are individually assessed for impairment where they are more than one month in arrears and assessed for collective impairment if they are one month or less in arrears. Current accounts with overdraft facilities are assessed for impairment on a collective basis and the estimation of future losses takes into account historic experience.

Notes to the Accounts continued...

39. Credit Risk on Loans and Advances to Customers continued...

Forbearance

The Group uses forbearance tools where they are deemed appropriate for an individual customer's circumstances, and are used in line with industry guidance. Forbearance tools which the Group may offer include capitalisation, interest only concessions, arrears arrangements, direct debit suspension and term extensions. The use of account management tools are either fully recognised within provisioning or are low in materiality.

The analysis below sets out a total of £417.5m (2014 – £467.1m) retail mortgage balances which were subject to some form of forbearance during the past 12 months. Balances totalling £232.3m (2014 – £270.2m) are more than two months in arrears and therefore fall within the Group's individual provision calculation. The remaining £185.2m (2014 – £196.9m) are covered by the Group's collective provision through the assumptions surrounding emergence period. There is nothing in the forbearance data to suggest that the impairment provisioning methodology or assumptions do not provide adequate cover in respect of lending which is subject to forbearance. Forbearance is included in mortgage provisions in the same way as any other debt, with that which is more than two months in arrears being recorded as impaired, and that which is less than or equal to two months being collectively assessed. If it were all to be incorporated as impaired the increase to the mortgage provision of £48.9m would be less than £0.1m (2014 – increase from £46.3m to £46.5m).

	Positive arrears arrange-ments* £m	Negative arrears arrange-ments** £m	Capitali-sation £m	Permanent interest only £m	Temporary interest only £m	Term extension £m	Direct debit suspension £m	Total £m
Not in arrears	12.2	1.0	0.2	2.1	0.6	17.4	14.2	**47.7**
Less than one month	57.0	3.1	–	–	0.1	0.4	1.1	**61.7**
One to two months	68.4	5.5	–	0.4	–	0.2	1.3	**75.8**
Two to three months	56.6	5.1	–	–	0.2	0.2	0.4	**62.5**
Three to six months	93.3	7.5	–	–	–	–	0.1	**100.9**
Six to 12 months	50.4	1.9	–	–	–	0.2	0.1	**52.6**
12 months or over	15.6	0.3	–	–	0.3	–	–	**16.2**
Property in possession	0.1	–	–	–	–	–	–	**0.1**
	353.6	**24.4**	**0.2**	**2.5**	**1.2**	**18.4**	**17.2**	**417.5**

* A positive arrears arrangement is one where the customer's regular monthly repayment is in excess of their contractual repayment amount in order to reduce their arrears.

** A negative arrears arrangement is one where an agreement is in place, due to the borrower's circumstances, that allows the customer to repay less than their contractual repayment amount for a short period. In this circumstance interest will continue to accrue on the unpaid amounts.

All requests for forbearance on commercial loans are subject to full credit risk appraisal and are predominately for a period of interest only which allows the borrower to improve income from trading or rent receipts, or pending the sale of the property. The appraisal process considers the likelihood of a loss being sustained from any borrower granted a concession and ensures that the concession is in the interests of both the borrower and the Group. At 31 December 2015 there are 17 accounts in the N&P commercial loans portfolio totalling £2.6m with an interest only concession (2014 – 39 accounts totalling £6.5m).

Notes to the Accounts continued...

40. Fair Values

Fair value is the price that would be received to sell an asset or the price paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Where external market prices are available they have been used to determine fair value. Otherwise, internal pricing models using external market data have been used. The Group measures fair value using the following fair value hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The table below summarises the book value and fair value of financial assets and liabilities as at the Statement of Financial Position date.

	Book Value £m	Level 1 £m	Fair Values Level 2 £m	Level 3 £m	Total Fair Value £m
Group					
At 31 December 2015					
Assets					
Cash in hand and balances with the Bank of England	**3,439.3**	**–**	**3,439.3**	**–**	**3,439.3**
Loans and advances to credit institutions	**695.9**	**–**	**695.9**	**–**	**695.9**
Debt securities – fair value	**9.1**	**–**	**9.1**	**–**	**9.1**
Embedded derivatives	**(9.8)**	**–**	**(9.8)**	**–**	**(9.8)**
Debt securities – available for sale	**270.2**	**229.2**	**41.0**	**–**	**270.2**
Debt securities – held to maturity	**–**	**–**	**–**	**–**	**–**
Loans and advances to customers	**33,321.7**	**–**	**33,868.4**	**–**	**33,868.4**
Derivative financial instruments	**180.1**	**–**	**180.1**	**–**	**180.1**
Investments	**1.4**	**–**	**–**	**1.4**	**1.4**
Liabilities					
Shares	**27,396.4**	**–**	**27,374.3**	**–**	**27,374.3**
Amounts due to credit institutions	**3,302.4**	**–**	**3,302.4**	**–**	**3,302.4**
Other deposits	**544.3**	**–**	**544.3**	**–**	**544.3**
Debt securities in issue	**4,108.8**	**–**	**4,125.6**	**–**	**4,125.6**
Derivative financial instruments	**340.9**	**–**	**340.9**	**–**	**340.9**
Subordinated liabilities	**286.1**	**–**	**301.5**	**–**	**301.5**
Subscribed capital	**6.7**	**–**	**5.8**	**–**	**5.8**

Notes to the Accounts continued...

40. Fair Values continued...

	Book Value £m	Level 1 £m	Fair Values Level 2 £m	Level 3 £m	Total Fair Value £m
Society **At 31 December 2015**					
Assets					
Cash in hand and balances with the Bank of England	**3,439.3**	**–**	**3,439.3**	**–**	**3,439.3**
Loans and advances to credit institutions	**270.3**	**–**	**270.3**	**–**	**270.3**
Debt securities – fair value	**9.1**	**–**	**9.1**	**–**	**9.1**
Embedded derivatives	**(9.8)**	**–**	**(9.8)**	**–**	**(9.8)**
Debt securities – available for sale	**270.2**	**229.2**	**41.0**	**–**	**270.2**
Debt securities – held to maturity	**3,983.9**	**–**	**3,980.2**	**–**	**3,980.2**
Loans and advances to customers	**18,076.7**	**–**	**18,377.2**	**–**	**18,377.2**
Derivative financial instruments	**102.0**	**–**	**102.0**	**–**	**102.0**
Investments	**16,762.5**	**–**	**–**	**16,762.5**	**16,762.5**
Liabilities					
Shares	**27,396.4**	**–**	**27,374.3**	**–**	**27,374.3**
Amounts due to credit institutions	**3,293.0**	**–**	**3,293.0**	**–**	**3,293.0**
Other deposits	**6,442.9**	**–**	**6,442.9**	**–**	**6,442.9**
Debt securities in issue	**3,447.5**	**–**	**3,464.7**	**–**	**3,464.7**
Derivative financial instruments	**320.9**	**–**	**320.9**	**–**	**320.9**
Subordinated liabilities	**286.1**	**–**	**301.5**	**–**	**301.5**
Subscribed capital	**6.7**	**–**	**5.8**	**–**	**5.8**

Notes to the Accounts continued...

40. Fair Values continued...

	Book Value £m	Level 1 £m	Fair Values Level 2 £m	Level 3 £m	Total Fair Value £m
Group At 31 December 2014					
Assets					
Cash in hand and balances with the Bank of England	3,670.6	–	3,670.6	–	3,670.6
Loans and advances to credit institutions	599.3	–	599.3	–	599.3
Debt securities – fair value	9.2	–	9.2	–	9.2
Embedded derivatives	(8.9)	–	(8.9)	–	(8.9)
Debt securities – available for sale	524.5	450.6	73.9	–	524.5
Debt securities – held to maturity	–	–	–	–	–
Loans and advances to customers	32,234.1	–	32,737.2	–	32,737.2
Derivative financial instruments	214.3	–	214.3	–	214.3
Investments	1.4	–	–	1.4	1.4
Liabilities					
Shares	27,241.4	–	27,197.0	–	27,197.0
Amounts due to credit institutions	3,471.3	–	3,471.3	–	3,471.3
Other deposits	508.0	–	508.0	–	508.0
Debt securities in issue	3,523.2	–	3,561.2	–	3,561.2
Derivative financial instruments	413.6	–	413.6	–	413.6
Subordinated liabilities	299.5	–	314.3	–	314.3
Subscribed capital	6.9	–	5.6	–	5.6

Notes to the Accounts continued...

40. Fair Values continued...

	Book Value £m	Level 1 £m	Fair Values Level 2 £m	Level 3 £m	Total Fair Value £m
Society At 31 December 2014					
Assets					
Cash in hand and balances with the Bank of England	3,670.6	–	3,670.6	–	3,670.6
Loans and advances to credit institutions	262.5	–	262.5	–	262.5
Debt securities – fair value	9.2	–	9.2	–	9.2
Embedded derivatives	(8.9)	–	(8.9)	–	(8.9)
Debt securities – available for sale	524.5	450.6	73.9	–	524.5
Debt securities – held to maturity	3,990.0	–	3,990.4	–	3,990.4
Loans and advances to customers	18,469.3	–	18,588.1	–	18,588.1
Derivative financial instruments	113.2	–	113.2	–	113.2
Investments	14,406.8	–	–	14,406.8	14,406.8
Liabilities					
Shares	27,241.4	–	27,197.0	–	27,197.0
Amounts due to credit institutions	3,471.3	–	3,471.3	–	3,471.3
Other deposits	5,788.9	–	5,788.9	–	5,788.9
Debt securities in issue	2,719.2	–	2,755.1	–	2,755.1
Derivative financial instruments	389.6	–	389.6	–	389.6
Subordinated liabilities	299.5	–	314.3	–	314.3
Subscribed capital	6.9	–	5.6	–	5.6

Notes to the Accounts continued...

40. Fair Values continued...

The fair values of all cash in hand, balances with the Bank of England and loans and advances to credit institutions have been recorded at par as they are all due in under one year and there is no impairment.

The fair values of debt securities are determined wherever possible from external market prices. Where reliable prices are not available, valuations are determined using models and externally verifiable market factors. The main inputs used in these models are underlying asset credit ratings, credit spreads, defaults in underlying instruments and credit enhancement or subordination factors.

The fair value of loans and advances to customers uses a Level 2 method and is assessed as the value of the expected future cash flows. Future cash flows are projected using contractual interest payments, contractual repayments and the expected prepayment behaviour of borrowers. Prudent assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The resulting expected future cash flows are discounted at current market rates to determine fair value. Overall the fair value is higher than the carrying value by £547m which arises primarily due to the product rates being above prevailing market rates.

All of the Group's financial liabilities are initially recorded at fair value less directly attributable costs and are subsequently measured at amortised cost other than derivative financial instruments or where an adjustment is made to certain fixed rate shares balances that are in hedging relationships. In addition, shares balances acquired as part of mergers are carried at fair value in accordance with IFRS 3 'Business Combinations'. In 2015, the estimated fair value of share balances, using a Level 2 method is now lower than the carrying value by £22m which arises primarily due to the product rates being above prevailing market rates.

The fair value of debt securities, subordinated liabilities and subscribed capital are calculated using a Level 2 method based on observable market prices. The fair value of subordinated liabilities is higher than carrying value by £15m which arises primarily due to the interest rates on the notes being significantly below prevailing market rates.

Fair values of derivative financial instruments are disaggregated further in Note 34.

Transfers between levels of the fair value hierarchy are recognised as of the end of the reporting period during which the change has occurred. There have been no transfers of assets or liabilities between the levels of the fair value hierarchy during the period.

Notes to the Accounts continued...

41. Related Parties

Identity of related parties

The Group and Society have related party relationships with their subsidiaries, joint venture, the pension schemes and key management personnel. The Group considers its key management personnel to be its directors.

Contributions to the pension scheme

The Society paid contributions of £23.8m to the pension scheme (2014 – £30.1m).

Key management compensation

The key management personnel compensations are as follows:

	No. of key management personnel	**2015 £000**	No. of key management personnel	2014 £000
Short-term employee benefits		**2,876**		3,275
Post employment benefits		**44**		64
Total key management personnel compensation	**15**	**2,920**	14	3,339

Key management compensation in 2015 includes amounts paid to key management personnel who both retired and joined the Society during 2015. The number of key management personnel at 31 December 2015 totalled 12.

Transactions with key management personnel

Key management personnel and their close family members have undertaken the following transactions with the Society under normal business terms.

	No. of key management personnel 2015	**Amounts in respect of key management personnel and their close family members* 2015 £000**	No. of key management personnel 2014	Amounts in respect of key management personnel and their close family members* 2014 £000
Mortgage loans				
At 1 January		**355**		388
Net movements in the year		**105**		(33)
At 31 December	**2**	**460**	2	355
Deposit accounts and investments				
At 1 January		**667**		1,052
Net movements in the year		**(56)**		(385)
At 31 December	**11**	**611**	14	667

* Net movements in the year include amounts relating to directors who retired during 2015 in addition to new directors appointed, one of whom took out a mortgage with the Society during the year.

Notes to the Accounts continued...

41. Related Parties continued...

Mortgage loans made to key management personnel and their close family members were granted in the ordinary course of business and are subject to repayment under normal lending terms. The maximum outstanding balances during the year were £581,056 (2014 – £388,307).

Amounts deposited by key management personnel and their close family members earn interest at the same rates offered to the public.

Key management personnel and their close family members paid interest totalling £2,246 (2014 – £1,952), received interest totalling £4,262 (2014 – £12,042), and paid no fees and commissions during the year. Interest paid reflects amounts relating to 'offset' mortgages where savings balances are used to reduce the interest bearing balance of mortgage loans.

Transactions with subsidiaries

The Society enters into a number of transactions with its subsidiaries in the normal course of business. These include loans and shares. The value of related party transactions, outstanding balances at the year end and related income and expense for the financial year are as follows:

	2015 £m	2014 £m
Shares in subsidiaries		
At 1 January	**105.8**	105.8
Net movements	**–**	–
At 31 December	**105.8**	105.8
Loans to subsidiaries		
At 1 January	**14,299.3**	11,078.6
Net movements	**2,355.7**	3,220.7
At 31 December	**16,655.0**	14,299.3
Deposits from subsidiaries		
At 1 January	**5,562.9**	1,693.5
Net movements	**624.6**	3,869.4
At 31 December	**6,187.5**	5,562.9
Interest receivable on loans	**455.4**	414.4
Interest payable on deposits	**(77.2)**	(64.1)
Fees and expenses receivable	**42.0**	33.6
Fees and expenses payable	**(0.2)**	(1.4)

Notes to the Accounts continued...

41. Related Parties continued...

Transactions with joint venture

The outstanding investment in MutualPlus Ltd at 31 December 2015 and 31 December 2014 was £0.3m.

Other

The Society has an investment in Arkose Funding Limited. During the prior year, a loan to Arkose Funding Limited was fully written off (£4.0m).

Subsequent to Alison Hutchinson's appointment to the YBS Board, the acquisition of the Friends Life business by Aviva created a related party relationship with Sesame Bankhall Group Limited (SBG) as Mrs Hutchinson is a non-executive director of an (indirect) parent company of SBG, Aviva Life Holdings UK Limited. SBG is a lending partner of Accord Mortgages Limited, a subsidiary of the Society. During the year, Accord Mortgages Limited paid commission of £2.6m to SBG, in relation to lending completed via their network of independent financial advisers. As at 31 December 2015, there was £11k outstanding between the two firms. Transactions are made on an arm's length basis.

The Group also has a related party relationship with Aviva Insurance Limited, as Mark Pain is a non-executive director of this company. The Group historically sold insurance products provided by Aviva Insurance Limited, the income from these sales is £489k.

On 30 April 2015, John Heaps retired as a partner with Eversheds, who provided legal and regulatory advice to the YBS Group. Mr Heaps was not involved in the appointment of Eversheds, which pre-dates his directorship with the Society, nor in the provision of advice. All transactions were conducted at arm's length and in the normal course of business. In the period 1 January to 30 April 2015, the Group paid Eversheds £93k (incl. VAT) in fees. As at 31 December 2015, there were no amounts outstanding between the two firms.

Notes to the Accounts continued...

42. Cash Flows from Other Operating Activities

	Group		Society	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Working capital adjustments:				
Depreciation and amortisation	**22.9**	27.6	**22.9**	27.3
Profit on sale of assets	**0.4**	1.2	**0.4**	0.8
Interest on subordinated liabilities and subscribed capital	**16.2**	7.4	**16.2**	7.4
Provisions	**28.8**	45.9	**14.2**	29.1
(Decrease)/increase in subordinated liabilities and subscribed capital	**(3.6)**	0.9	**(3.6)**	0.9
Profit on realisation of debt securities	**(2.1)**	(1.3)	**(2.1)**	(1.3)
Increase in other assets	**(3.7)**	(31.2)	**(5.4)**	(27.7)
Decrease in other liabilities	**(32.3)**	(79.3)	**(32.1)**	(140.4)
Working capital adjustments	**26.6**	(28.8)	**10.5**	(103.9)
(Increase)/decrease in operating assets:				
Loans and advances to customers	**(1,100.4)**	(2,738.2)	**393.1**	(523.2)
Investments	**–**	–	**(2,354.3)**	(3,222.0)
Derivative financial instruments	**(119.8)**	201.1	**(138.4)**	178.2
Net (increase) in operating assets	**(1,220.2)**	(2,537.1)	**(2,099.6)**	(3,567.0)
Increase/(decrease) in operating liabilities:				
Shares	**155.0**	951.1	**155.0**	951.1
Amounts owed to credit institutions	**(168.9)**	849.9	**(178.3)**	849.9
Other deposits	**36.3**	6.6	**654.0**	3,823.0
Net increase in operating liabilities	**22.4**	1,807.6	**630.7**	5,624.0

Annual Business Statement

1. Statutory Percentages

	2015 %	Statutory Limit %
Lending limit	**2.3**	25.0
Funding limit	**22.5**	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986.

The Lending limit measures the proportion of business assets not in the form of loans fully secured on residential property.

The Funding limit measures the proportion of shares and borrowings not in the form of shares.

The statutory limits are as laid down under the Building Societies Act 1986 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

2. Other percentages

	2015 %	2014 %
As a percentage of shares and borrowings:		
Gross capital	**6.78**	6.52
Free capital	**6.33**	6.05
Liquid assets	**12.46**	13.80
Profit after taxation for the financial year as a percentage of mean total assets	**0.37**	0.41
Management expenses as a percentage of mean total assets	**0.91**	0.92

The above percentages have been prepared from the Group accounts and in particular:

- 'Shares and borrowings' represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.
- 'Gross capital' represents the aggregate of general reserve, hedging reserve, available for sale reserve, subordinated liabilities and subscribed capital.
- 'Free capital' represents the aggregate of gross capital and collective impairment provision less property, plant and equipment, intangible assets and investment properties.
- 'Liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets.
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- 'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

Annual Business Statement continued...

3. Information Relating to the Directors at 31 December 2015

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
J. R. Heaps, LLB 8 July 1953	Chairman	20 November 2014	Garden Bridge Trust
K. M. Barker, DBE, CBE 29 November 1957	Economist	5 November 2010	Coal Pension Trustee Services Ltd Coal Staff Superannuation Scheme Trustees Ltd Electra Private Equity Plc Essex Community Foundation Kate Barker Ltd Society of Business Economists Taylor Wimpey Plc
A. M. Caton, BA 27 July 1963	Chief Corporate Affairs & Treasury Officer & Executive Director	1 July 2004	Arkose Funding Ltd Business and Enterprise Finance Ltd Chelsea Building Society Charitable Foundation Chelsea Mortgage Services Ltd Norwich and Peterborough (LBS) Ltd West and North Yorkshire Chamber of Commerce and Industry YBS Investments (No. 1) Ltd YBS Investments (No. 2) Ltd Yorkshire Building Society Charitable Foundation Yorkshire Guernsey Ltd
R. J. Churchouse, MA, ACA 16 January 1966	Finance Director	1 June 2010	BCS Loans and Mortgages Ltd Chelsea Mortgage Services Ltd Norwich and Peterborough General Insurance Services Ltd Norwich and Peterborough Insurance Brokers Ltd Norwich and Peterborough Insurance Services Ltd Norwich and Peterborough Sharedealing Services Ltd YBS Investments (No.1) Ltd YBS Investments (No.2) Ltd Yorkshire Building Society Estate Agents Ltd Yorkshire Key Services Ltd Yorkshire Key Services (No. 2) Ltd
A. Hutchinson, BSc 5 February 1967	Charity CEO	4 February 2015	Aviva Life Holdings UK Ltd Aviva Annuity UK Ltd Aviva Life & Pensions UK Ltd Aviva Life Services UK Ltd CAF Nominees Ltd Your Penny Ltd Friends Annuities Ltd Friends Life and Pensions Ltd Friends Life Ltd Friends Life Services Ltd
G. R. Ireland, BSc, FCA 17 May 1953	Non-executive Director	1 September 2015	Aspen Insurance Holdings Ltd Iccaria Insurance ICC Ltd

Annual Business Statement continued...

3. Information Relating to the Directors at 31 December 2015 continued...

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
D. V. Paige, BSc, FCA 3 July 1951	Non-executive Director	31 December 2006	IFG Group PLC Willis Ltd
M. A. Pain, BSc, FCA 15 June 1961	Non-executive Director	1 August 2013	Aviva Insurance Ltd Johnston Press Plc London Square (Caledonian Road) Ltd London Square (Chigwell) Ltd London Square (Crimscott Street) Ltd London Square Developments (Holdings) Ltd London Square (Holdings) Ltd London Square (Leonard St.) Ltd LSQ Management Ltd Somerset House Enterprises Ltd Somerset House Trust Ladbrokes Plc
G. P. C. Parsons, BA 31 July 1965	Company Director	1 May 2013	EasyHotel Plc EasyHotel UK Ltd
C. J. Pilling, MA 30 March 1965	Chief Executive Officer	31 December 2011	The Department of Health
M. C. Regnier, MEng, MBA 30 September 1971	Chief Customer Officer and Executive Director	3 June 2014	Accord Mortgages Ltd BCS Loans and Mortgages Ltd

The standard contractual notice period for all executive directors is one year. Mr A. M. Caton and Mr R. J. Churchouse entered into renegotiated contracts in 2009, Mr C. J. Pilling entered into a contract on 31 December 2011 and Mr M. C. Regnier entered into a contract on 3 June 2014 on this basis.

Documents may be served on the above-named directors: Ref. 'Yorkshire Building Society' c/o Deloitte LLP at the following address: 1 City Square, Leeds LS1 2AL.

4. Registered Office

Yorkshire Building Society is a building society incorporated and domiciled in the United Kingdom. The address of the principal office is Yorkshire House, Yorkshire Drive, Bradford BD5 8LJ.

Glossary

The following glossary defines terminology used within the Annual Report and Accounts:

Additional Tier 1 (AT1) capital	Any remaining eligible Permanent Interest Bearing Shares.
Arrears	A customer is defined as in arrears when they fall behind in meeting their obligations to pay their mortgage and as a result there is an outstanding loan commitment that is overdue.
Bank Rate	The interest rate at which the Bank of England lends money to domestic banks.
Basel	The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Enacted in the European Union via capital requirements directives.
Buffer liquidity	Cash and investments with the UK Government (deposits with the Bank of England or holdings of UK Gilts and similar investments) and with supranational institutions.
Buy to let (BTL)	Lending on property that is to be let to individuals but excluding loans which were originally advanced on an owner-occupier basis that now carry a consent to let.
Capital Requirements Directive (CRD)	European legislation giving force to the Basel regulatory capital framework in the UK. The latest legislation – the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) (together commonly referred to as CRD IV) came in to effect from 1 January 2014.
Collateralised debt obligations	Structured financial products issued by a third party which reference asset backed securities and/or certain other related assets purchased by the issuer.
Collateral (for loans and advances to customers)	Security (property) pledged for the repayment of a loan. Collateral is valued as the lower of the value of the property or the outstanding loan amount.
Commercial lending	Secured loans to a commercial borrower.
Common Equity Tier 1 (CET1) capital	The highest quality regulatory capital resources, comprising of retained earnings less regulatory adjustments, as defined under CRD IV. Equivalent to Core Tier 1 defined under previous CRD legislation.
Common Equity Tier 1 capital ratio	The ratio of Common Equity Tier 1 Capital to Risk Weighted Assets.
Contractual maturity	The final payment date of a loan or financial instrument, at which all the outstanding loan and interest is repayable.
Cost:income ratio	A ratio that represents management expenses as a percentage of total income.
Council of Mortgage Lending (CML)	A not-for-profit organisation and trade association for the mortgage lending industry.
Covered bonds	A type of wholesale funding backed by cash flows from mortgages.
Credit risk	The risk of financial loss arising from a failure of a customer or counterparty to settle their financial and contractual obligations as they fall due.
Currency risk	The exposure to risk from assets and liabilities denominated in currencies other than Sterling.
Debt securities in issue	Transferable certificates of indebtness including certificates of deposits, and fixed and floating rate notes.

Glossary continued...

Derivative financial instruments	Contracts or agreements whose value is derived from one or more underlying prices, rates or indices inherent in the contract or agreement, such as interest rates, exchange rates or stock market indices. Examples of derivatives include interest rate swaps, forward rate agreements and futures.
Effective interest rate (EIR)	The method used to calculate the amortised cost of financial instruments and to recognise interest receivable or payable over the relevant period. The effective interest rate is the rate that exactly discounts estimated cash flows (excluding credit losses) to zero, through the expected life of the instrument.
Expected loss	An estimate of the potential losses on current exposures due to potential defaults on a mid-cycle assumption.
Exposure	The maximum loss that a financial institution might suffer if a borrower or counterparty fails to meet its obligations to the Group.
Fair value	The price that would be received to sell an asset or the price paid to transfer a liability in an ordinary transaction between market participants at the measurement date.
Financial Conduct Authority (FCA)	The UK conduct regulator which is responsible for regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets. The FCA's objective is to protect consumers, promote competition and enhance market integrity.
Financial Ombudsman Service (FOS)	An independent service which provides a service for settling disputes between financial service providers and their customers.
Financial Services Compensation Scheme (FSCS)	A protection fund for depositors of failed institutions. This is funded by the financial services industry and each firm, including the Society, is obliged to pay an annual levy.
Forbearance	The Group grants concessions to assist borrowers who experience difficulties in meeting their obligations to pay their mortgage. Examples of forbearance tools are described in Note 39.
Funding for Lending Scheme (FLS)	A scheme launched by the Bank of England and HM Treasury designed to boost lending to households and businesses. Banks and building societies participating in the scheme can access funding at rates below the natural market rate.
Impaired loans	Loans where there is evidence to suggest a measurable decrease in the present value of cash flows expected which has occurred after initial recognition of the asset, but before the statement of financial position date.
Individual Liquidity Adequacy Assessment (ILAA)	The Group's internal assessment of the levels of liquidity that need to be held to meet its regulatory liquidity requirements.
Individually impaired loans	Where retail or commercial mortgages are in arrears by two months or more, they are individually assessed for impairment. Commercial loans less than two months in arrears are also individually impaired where other factors suggest a measurable decrease in the present value of their future cash flows.
Internal Capital Adequacy Assessment Process (ICAAP)	The Group's internal assessment of the levels of capital that need to be held by the Society to meet its regulatory capital requirements.
Internal ratings methodology	An assessment of wholesale counterparties and the risks they pose to the Group with limits set accordingly.

Glossary continued...

International Financial Reporting Standards (IFRS)	International Financial Reporting Standards issued by the International Accounting Standards Board (IASB).
Leverage Ratio	A non-risk based requirement that measures the relationship between capital resources, and an adjusted measure of total on- and off- balance sheet assets.
Liquidity Coverage Ratio (LCR)	A liquidity metric which aims to ensure that a firm maintains an adequate level of liquidity to meet its needs for a 30 calendar day time horizon under a severe stress scenario.
LIBOR (London Interbank Offered Rate)	A benchmark interest rate which banks can borrow funds from other banks in the London interbank market.
Liquidity risk	The risk that the Group does not hold sufficient liquidity, in terms of quantity and quality, to meet its liabilities as they fall due.
Loan loss provisions	A provision which is held against loans and advances to customers, which represent management's best estimate of losses incurred in the loan portfolio at the reporting date.
Loan-to-value ratio (LTV)	A ratio showing outstanding loan balance as a percentage of the value of the security.
Loss given possession	The loss that is expected to crystallise when a repossessed property is sold.
Medium-term notes (MTN)	Corporate notes continuously offered by a company to investors through a dealer. Investors can choose from differing maturities.
Member	A person who has a share account or a mortgage loan with the Society.
Net interest income	The difference between the interest received on assets and the interest paid on liabilities.
Net interest margin	This ratio calculates the net interest income as a percentage of mean total assets.
Net Stable Funding Ratio (NSFR)	A liquidity ratio, under Basel III, to calculate the proportion of long-term assets that are funded by stable, long-term sources (customers deposits and long-term wholesale funding).
Non-prime lending	Mortgage lending to borrowers with adverse credit histories or self-certification lending where borrowers are not required to provide their income levels.
Operational risk	The risk of direct and indirect loss resulting from inadequate or failed internal processes, people and systems or from external events.
Other income	The income received from selling non-mortgage and savings products (e.g. home and contents insurance, investment products and other insurances).
Permanent Interest Bearing Shares (PIBS)	Unsecured, Sterling denominated Tier 1 capital instruments repayable at the option of the Society.
PRA Remuneration Code	Guidance provided by the PRA on directors' remuneration.
Prime lending	The Group's core business of providing residential mortgages to customers with no known default history.
Probability of possession	The likelihood of an account moving into possession. This is used when calculating loan loss provisions.
Prudential Regulation Authority (PRA)	The UK prudential regulator, which is a part of the Bank of England and alongside the FCA has responsibility for the oversight of building societies, banks and insurers. The PRA's objective is to promote the safety and soundness of regulated firms.

Glossary continued...

Mortgage Backed Security/Residential Mortgage Backed Securities (RMBS)	An asset-backed security that represents a claim on the cash flows from residential mortgage loans through a process known as securitisation.
Repossessions	Property taken into ownership by the Group as a result of the borrower's failure to make contractual loan repayments.
Risk appetite	The level of risk that the Group is willing to take (or not take) in order to safeguard the interests of members whilst achieving business objectives.
Risk weighted assets	A regulatory measure that adjusts the value of assets to reflect their level of risk when calculating capital requirements.
Shares	Money deposited by members in a retail savings account with the Society and held as a liability in the Statement of Financial Position.
Small Change Big Difference®	Our unique scheme which allows each member to donate the pence of their interest to the Yorkshire Building Society Charitable Foundation.
SONIA (Sterling Overnight Indexed Average)	An index that tracks actual market overnight funding rates calculated as a weighted average overnight deposit rate for each business day.
Standardised approach	A method of calculating capital requirements under CRD IV.
Structured credit investments	A small percentage of Group liquidity invested in high risk and higher yielding treasury investments.
Subordinated liabilities	Tier 2 capital that is subordinated to the claims of all depositors, creditors and members holding shares in the Society (other than holders of PIBS).
Tier 1 (T1) capital	The sum total of Common Equity Tier 1 and Additional Tier 1 capital.
Tier 1 capital ratio	The ratio of Tier 1 capital to Risk Weighted Assets.
Tier 2 (T2) capital	A measure of regulatory capital that includes subordinated liabilities and provisions for collective impairment, less regulatory adjustments.
Total capital	The total capital resources, including retained earnings, PIBS, provisions for collective impairment and subordinated liabilities, less regulatory adjustments.
Total capital ratio	The ratio of total capital to Risk Weighted Assets.
UK Corporate Governance Code	The UK code on corporate governance, published by the Financial Reporting Council in October 2012, which sets out standards of good practice in relation to Board leadership and effectiveness, accountability and remuneration.
Value at Risk (VaR)	A risk management tool which evaluates the potential losses that may be incurred as a result of movements in market conditions over a specified holding period and to a given level of confidence.
Watch list	The watch list is used by the N&P commercial lending team to flag those loans where there are circumstances which could impact on the quality and safety of the loan.
Weighted average maturity	Provides a measure of the weighted average remaining term of outstanding wholesale funding.
Wholesale funding	The funding that is available between banks and other financial or commercial institutions. Examples of wholesale funding include covered bonds, deposits and government guarantees.

Principal Office:
Yorkshire House, Yorkshire Drive, Bradford BD5 8LJ.
ybs.co.uk

Auditors:
Deloitte LLP, 1 City Square, Leeds LS1 2AL.

YBS GROUP

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