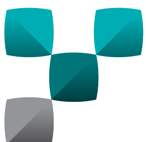
PILLAR 3 DISCLOSURES

2016



YBS GROUP

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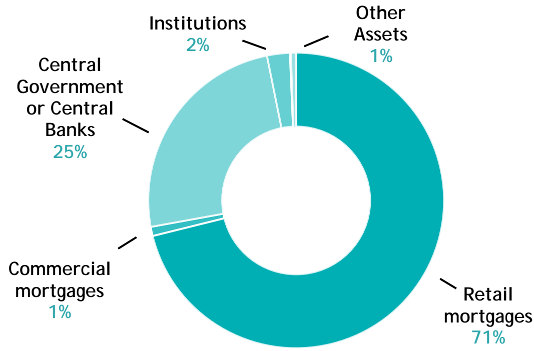
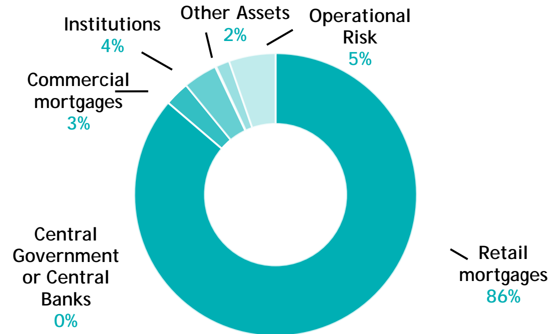
Capital Position at a Glance

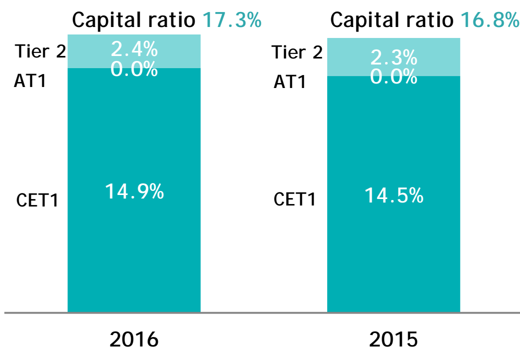
Group Credit Risk Exposures 2016



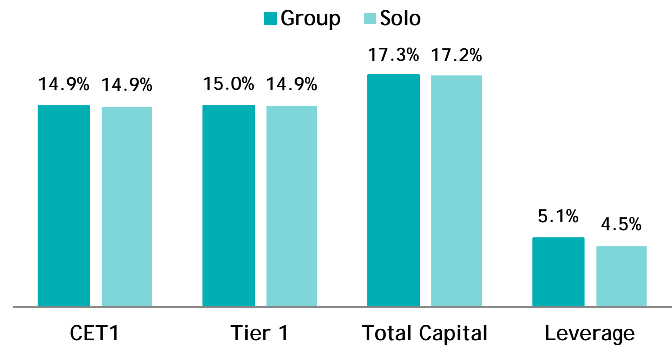
Group Risk-Weighted Assets 2016



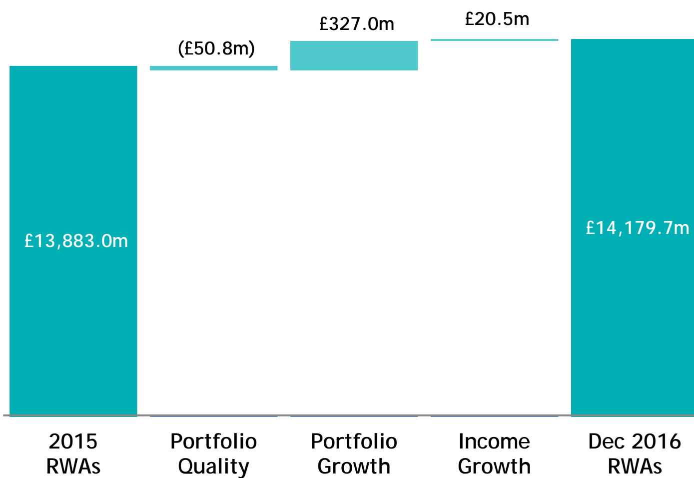
Capital Base



Capital Ratios 2016



RWAs Flow Chart



1 Overview

1.1 Background

This document is prepared under the European Union's Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD) (together commonly referred to as CRD IV) in place on 31 December 2016.

CRD IV came into force on 1 January 2014 and updates the three "pillars" of the Basel Framework which first came into force from 1 January 2008. Pillar 1 of the standards sets out the minimum capital requirements firms are required to meet for credit, market and operational risk. Under Pillar 2, firms and supervisors have to take a view on whether a firm should hold additional capital against risks not covered in Pillar 1, assess the suitability of Pillar 1 capital requirements and demonstrate their ability to manage their capital position through a period of stress. Pillar 3 aims to improve market discipline by requiring firms to publish key details of their risks, capital and risk management.

The Yorkshire Building Society Group ("the Group") has adopted the Pillar 1 standardised approach to credit risk, counterparty credit risk and operational risk and does not use any internal models or advanced methods. The Group is also subject to Pillars 2 and 3. The rules are enforced in the UK by the Prudential Regulation Authority (PRA). This document is produced annually and is published at the same time as the Group's Annual Report and Accounts.

1.2 Basis and Frequency of Disclosures

This disclosure document has been prepared by the Group in accordance with the requirements of Pillar 3 set out in Articles 431-455 of the CRR. Unless otherwise stated, all figures are as at 31 December 2016, the Group's financial year-end.

1.3 Scope

Yorkshire Building Society (YBS) is an EEA parent institution that is regulated in the UK by the PRA and Financial Conduct Authority (FCA). CRD IV therefore applies to YBS and its subsidiary undertakings.

Consolidation of the Group position for regulatory capital purposes (the "Capital Group") is similar to the statutory consolidated Group position produced for the Annual Report and Accounts but differs in the following respects:

- One Group company, Yorkshire Key Services Limited, which is no longer trading and use to provide computer services, is outside of the scope of CRD IV and is therefore not consolidated for capital purposes due to the non-financial nature of its activities, but is fully consolidated in the Annual Report and Accounts, excluding the Capital Management Note which reports on the Capital Group basis. The Group's investment in Yorkshire Key Services is neither deducted nor consolidated on grounds of materiality but is risk weighted.
- Some definitions of assets and capital differ between the regulatory capital adequacy rules under CRD IV and the statutory accounting requirements under International Financial Reporting Standards (IFRS); Table 2 gives a detailed reconciliation of statutory accounting capital values to regulatory capital values.

There are no restrictions or impediments to the movement of capital between legal entities within the Capital Group, and there is no material capital surplus or deficit relating to Group legal entities that do not form part of the Capital Group.

Under CRD IV, YBS as a legal entity must also meet a solo-consolidated capital requirement. In this area, YBS has made use of provisions laid down in CRD IV to provide capital resources and requirements to the PRA under a solo-consolidated basis. Solo-consolidation enables both the intra-group exposures and investments of YBS in its subsidiaries within the Solo-consolidated Group to be eliminated when calculating capital requirements and the reserves of such subsidiaries to be aggregated with the parent when calculating capital resources.

The Group entities included under Solo-consolidation in 2016 were:

Yorkshire Building Society

Accord Mortgages Limited

Norwich & Peterborough (LBS) Limited

Further details of the Group's principal subsidiary undertakings are included in Note 10 to the Annual Report and Accounts.

1.4 Location and Verification

These disclosures have been reviewed by the Group's Audit Committee on behalf of the Group's Board and are published on the Group's corporate website (www.ybs.co.uk) at the same time as the Group's Annual Report and Accounts. The disclosures are not subject to external audit except where they are equivalent to those prepared under accounting requirements for inclusion in the Group's Annual Report and Accounts.

1.5 Regulatory Developments

Following the introduction of CRD IV in 2014, there have been a number of regulatory changes as CRD IV becomes fully implemented. The following changes have had an impact on the Group in 2016:

- Inclusion of the Prudent Valuation Adjustment within Common Equity Tier 1 (CET1) deductions from capital resources.
- Exclusion of assets held at central banks from leverage exposure in the calculation of the leverage ratio.
- Inclusion of the Capital conservation buffer within Pillar 2 requirements.
- Inclusion of the countercyclical buffer within Pillar 2 requirements.

1.6 Recent Developments

The Group is disclosing its Pillar 2A capital requirement (See section 3.9 below).

Final Minimum Requirement of Eligible Liabilites (MREL) rules have been agreed and the Group will have a transitional requirement of 18% of Risk Weighted Assets (RWAs) from Jan 2020. The Group's plans incorporate compliance with MREL including external capital issuance.

The number of months a mortgage is defined as being in arrears in order to be individually assessed for impairment, has increased from 2 months or more to 3 months or more. This is to align with the accounting treatment in IFRS9.

2 Risk Management

2.1 Risk Management

The activities of financial institutions inevitably involve a degree of risk taking, so the Group's ability to properly identify, measure, monitor and report risk is critical to its soundness and its ability to provide value and fair outcomes to its membership and customers. The Group's risk management framework and governance structures are intended to provide appropriate and comprehensive monitoring, control and ongoing management of the major risks to which the Group is exposed. These are fully set out in the Strategic Report and Risk Management Report in the Annual Report and Accounts.

3 Capital Adequacy

3.1 Capital Management

The Group's management of its capital is based on a number of key principles:

- The Group will at all times ensure it holds sufficient capital, of the right quality and stability, to ensure financial sustainability and the security of members' deposits, to support its strategic objectives, to retain the confidence of key external stakeholders and to fulfil its regulatory requirements.
- The Group will seek to utilise its capital resources in an appropriate manner to ensure that the risk : reward balance is optimised and that the Group obtains a suitable return where capital is utilised. This includes seeking to align its regulatory capital needs with its risk capital needs by means of pursuing an application for the Internal Ratings Based (IRB) approach to calculation of its capital requirements.
- The Group will, as far as possible, seek to ensure an appropriate and efficient mix of capital is available commensurate with its risk profile and strategic ambitions.

- The Group sets a desired risk appetite level for its Common Equity Tier 1 ratio and will seek to generate profits to be self-sustaining at this level given an aspirational long term growth rate. It will supplement this with external capital to meet overall capital, leverage and bail-in requirements.

The Group considers both risk based capital requirements and non-risk based leverage requirements when determining the Group's capital strategy and has adopted a range of performance metrics over and above the regulatory minimum as the Group's risk appetite.

Summarised regulatory capital positions and forecasts (including forecasts under stress scenarios) are reported to the Board and to the Executive Management Committee. Specific capital management reports are presented to the Capital Management Committee and appropriate executive risk and management committees.

Regulatory capital covers the following risks across the Capital Group:

- Pillar 1 risks (i.e. credit risk, counterparty credit risk and operational risk). The minimum capital requirement is calculated using regulatory-prescribed risk weightings. The Group has adopted the standardised approach to both credit and operational risk in order to calculate the Pillar 1 minimum capital requirement.
- Pillar 2A risks (i.e. all other material risks for which the Group does not require the provision of regulatory capital under Pillar 1). Each material risk that the Group has identified outside the scope of Pillar 1 (e.g. pension obligation risk, interest rate risk, concentration risk) has undergone considered and vigorous stress testing to calculate an economic value for each of the material risks across the Group where capital is an appropriate mitigant, and are documented in the Internal Capital Adequacy Assessment Process (ICAAP) document (see section 3.2 below). The Group is disclosing its Pillar 2A capital requirements (see section 3.9 below)
- Capital Conservation Buffer. The Group calculates a Capital Conservation Buffer (CCB), which is a level of buffer capital held as a percentage of RWAs as specified in CRD IV, totalling 0.625% in 2016.
- Pillar 2B/PRA Buffer. The Group calculates an additional capital requirement (in addition to the Pillar 1 and Pillar 2A amounts above) representing the amount by which the Group's capital surplus would reduce through a "severe but plausible" stress scenario over the Group's planning horizon. This additional requirement is known as the PRA buffer and does not form part of the overall regulatory minimum capital requirement. The result of this stress testing is compared to the CCB and an additional PRA Buffer held where the CCB is not sufficient to cover the risk in the scenario.
- Counter Cyclical Buffer. The Group is required to hold a Counter Cyclical Buffer; however this is currently 0%.

3.2 Internal Capital Adequacy Assessment Process

The Group undertakes at least annually an ICAAP, which is an internal assessment of its capital requirement. In performing the ICAAP, the Group considers the key risks to which it is exposed, and the levels of capital and other financial resources that should be held to safeguard the interests of its members and depositors, particularly during times of stress.

This process includes:

- Identification by senior managers of the relevant risk categories for the Group.
- Establishment, under the sponsorship of individual Chief Officers, of separate work streams to consider each risk category in detail.
- Analysis of the risks within each work stream, involving relevant personnel from across the business, and documented in individual risk assessment documents.
- Consideration of whether capital is an appropriate mitigant to the risk. Where this is deemed to be the case, capital requirements are calculated based on the results of stress testing for each risk category. Where capital is not deemed appropriate to mitigate a particular risk, alternative management actions are identified and described within the risk assessment. For certain risks where capital is not an appropriate mitigant, the holding of liquidity can be used to mitigate the risk. In these cases, the risk is considered in more depth as part of the Individual Liquidity Adequacy Assessment Process (ILAAP).
- Calculation of an appropriate PRA Buffer to absorb a "severe but plausible" economic stress event over the Group's planning horizon, should such a scenario materialise, thereby ensuring minimum capital requirements are maintained.
- Approval of individual risk assessment documents by the relevant sponsor and committee.

- Documentation of the overall process and assessment, which is presented to the Executive Risk Committee before being presented to the Group Risk Committee and the Board (with whom ultimate responsibility lies) for challenge and approval.

Further information on the material risks identified as part of the ICAAP can be found in sections 4, 5 and 6 of this document.

3.3 Total Available Capital

At 31 December 2016 and throughout the year, the Group complied with the capital requirements that were in force as set out by European and national legislation. The following table shows the breakdown of the total available capital for the Capital Group and Solo-consolidated Group as at 31 December 2016.

Table 1 - Capital Resources	Group	Group	Solo	Solo
£m	2016	2015	2016	2015
Common Equity Tier 1 (CET1)				
General reserve	2,215.4	2,117.6	2,210.6	2,105.8
AFS reserve	8.2	4.9	8.2	4.9
Deductions from CET1				
Prudent Valuation Adjustment	(1.5)	n/a	(1.2)	n/a
Pension Scheme Adjustment	(31.5)	(45.7)	(31.5)	(45.7)
Intangible fixed assets	(32.9)	(36.8)	(32.9)	(36.8)
Securitisation holdings deducted from capital resources	(36.1)	(27.8)	(36.1)	(27.8)
Deferred tax assets that rely on future profitability	(2.3)	(4.7)	(2.3)	(4.7)
Total CET1	**2,119.3**	**2,007.5**	**2,114.8**	**1,995.7**
Additional Tier 1 Capital				
Permanent Interest Bearing Shares (PIBS)	4.0	4.7	4.0	4.7
Total Tier 1 capital	**2,123.3**	**2,012.2**	**2,118.8**	**2,000.4**
Tier 2 Capital				
Subordinated liabilities	291.5	282.9	291.5	282.9
Collective provisions for impairment	34.4	33.3	34.4	33.3
Total Tier 2 capital	**325.9**	**316.2**	**325.9**	**316.2**
Total capital available	**2,449.2**	**2,328.4**	**2,444.7**	**2,316.6**

3.4 Tier 1 Capital

3.4.1 Common Equity Tier 1 Capital

CET1 Capital comprises the general reserve, AFS reserve and adjustments for items reflected in the general reserve which are treated separately for capital adequacy purposes. The following items are deducted under CRD IV:

- A Prudent Valuation Adjustment is applied to fair-valued positions and is deducted from CET1 capital as per CRD IV.
- Defined benefit scheme pension assets are deducted from CET1 capital resources, net of any associated deferred tax liabilities. At 31 December 2016, the net impact of the adjustment was a reduction in CET1 capital of £31.5m.
- An adjustment is also made in respect of intangible fixed assets. For accounting purposes, items including software development costs, other intangibles resulting from business combinations and goodwill are capitalised as intangible fixed assets where they meet certain criteria. Intangibles are deducted from capital under the regulatory rules and at 31 December 2016, the deduction amounted to £32.9m.
- Securitisation positions (including resecuritisations) that are unrated or have low external ratings can be riskweighted at 1250% or deducted from CET1 capital under CRD IV. The policy used in the Group is to deduct this as in the above table.
- Under CRD IV, deferred tax assets that rely on future profitability are deducted from CET1 capital.

3.4.2 Additional Tier 1 Capital

Additional Tier 1 Capital comprises PIBS. PIBS are unsecured deferred shares and rank behind the claims of all subordinated noteholders, depositors, creditors and investing members of the Group. Further details about PIBS are provided in Note 30 to the Group's Annual Report and Accounts and full terms and conditions of the Group's PIBS can be found on the Group's website:

http://www.ybs.co.uk/your-society/treasury/wholesale_funding/introduction.html

Under CRD IV these instruments are being phased out over a ten year period. Currently 60% of the PIBS balance sheet carrying value qualifies as Tier 1 capital.

3.5 Tier 2 Capital

Tier 2 Capital comprises the Group's qualifying subordinated liabilities, the collective impairment, and adjustments for items treated separately for capital adequacy purposes.

Subordinated notes are unsecured and rank behind the claims of all depositors, creditors and investing members (other than holders of PIBS) of the Group. For regulatory capital purposes, the value of any subordinated liabilities is amortised in the last 5 years to maturity. More details of the subordinated liabilities are include in Note 29 to the Annual Report and Accounts and full terms and conditions for the Group's subordinated liabilities can be found on the Group's website:

http://www.ybs.co.uk/your-society/treasury/wholesale_funding/subordinated-debt-info.html

To the extent that collective provisions for impairment have been recognised in the income and expenditure account, they may be added back to Tier 2 capital.

3.6 Reconciliation of Regulatory Capital to Balance Sheet Capital

The table below shows how the balance sheet capital values in the Annual Report and Accounts reconcile to the regulatory capital equivalent for the Group at December 2016.

Table 2 - Reconciliation of Accounting Capital to Regulatory Capital £m	Accounting Balance Sheet Capital Value	Adjustments to Balance Sheet Capital Value	Regulatory Capital Value	Ref
CET1				
Total equity attributable to members	2,220.9			1
Less reserves not included in regulatory capital:				
Hedging reserve		8.1		2
Non-consolidated subsidiary		(5.4)		6
Total adjustments to Common Equity Tier 1 resources		2.7		
CET1	**2,220.9**	**2.7**	**2,223.6**	
Regulatory deductions from CET1				
Prudent Valuation Adjustment		(1.5)		3
Pension Scheme Adjustment		(31.5)		3
Intangible fixed assets		(32.9)		3
Securitisation holdings deducted from capital resources		(36.1)		3
Deferred tax assets that rely on future profitability		(2.3)		
Total regulatory deductions from Common Equity Tier 1 capital		(104.3)		
Total CET1	**2,220.9**	**(101.6)**	**2,119.3**	
Additional Tier 1 capital				
Subscribed capital (Permanent Interest Bearing Shares)	6.7			1
Adjustment to phase out subscribed capital		(2.7)		
Total Additional Tier 1 capital			4.0	5
Total Tier 1 capital after deductions	**2,227.6**	**(104.3)**	**2,123.3**	
Tier 2 capital				
Subordinated Liabilities	297.0	(5.5)	291.5	1
Collective provisions for impairments		34.4	34.4	4
Tier 2 capital after deductions	**297.0**	**28.9**	**325.9**	
Total capital resources after deductions	**2,524.6**	**(75.4)**	**2,449.2**	

[1] Statement of Financial Position, Annual Report and Accounts
[2] Statement of Changes in Members' Interest, Annual Report and Accounts
[3] Pillar 3 Disclosures, Table 1
[4] Note 9 (Impairment) Annual Report and Accounts
[5] As per 3.4.2 above only 60% of PIBS balance sheet carrying value qualifies as Tier 1 capital
[6] See section 1.3 for further details

3.7 Capital Flow Statement

The table below shows the flow of Group regulatory capital and associated deductions in 2016.

Table 3 - Regulatory Capital Flow Statement £m	2016	Ref
<u>Total CET1 Capital</u>		
1 January 2016	2,007.5	
Total comprehensive income in 2016	116.0	1
Profits allocated to hedging reserve	(14.9)	2
Inclusion of Prudent Valuation Adjustment	(1.5)	
Decrease in pension scheme adjustment	14.1	
Decrease in intangible fixed assets	3.9	
Increase in securitisation holdings deducted from capital resources	(8.2)	
Decrease in deferred tax adjustment	2.4	
Total CET1 Capital at 31 December 2016	**2,119.3**	
<u>Additional Tier 1 capital</u>		
1 January 2016	4.7	
Movement in market valuation of PIBS and eligible percentage	(0.7)	
Additional Tier 1 capital at 31 December 2016	**4.0**	
Total Tier 1 capital at 31 December 2016	**2,123.3**	
<u>Tier 2 capital</u>		
1 January 2016	316.2	
Movement in fair value adjustments to subordinated liabilities	10.7	
Increase in amortisation of subordinated liabilities	(2.1)	
Increase in collective provisions for impairment	1.1	
Tier 2 capital before deductions at 31 December 2016	**325.9**	
Total capital available at 31 December 2016	**2,449.2**	

[1] Statement of Comprehensive Income, Annual Report and Accounts
[2] Statement of Changes in Member's Interest, Annual Report and Accounts

3.8 Minimum Capital Requirement (Pillar 1)

The following tables show the credit and operational risk exposure, average risk weight and RWAs for each of the Group's exposure classes and the resultant Pillar 1 minimum capital requirements (being 8% of RWAs). The exposure is based on the definitions for regulatory capital purposes, before impairment provision and credit risk mitigation. After the impairment provision and credit risk mitigation adjustment the retail capital exposure is reduced to nil, therefore showing an average RW of 0%. Credit Valuation Adjustment (CVA) risk-weighted assets are included in the Financial Institutions line, increasing the average risk weight. Capital requirements and RWAs for operational risk are shown, though without an exposure value as they do no relate to asset exposures.

Table 4a - Pillar 1 Capital Requirement - Group	Exposure	RWAs	Capital Requirements	Average RW
2016	£m	£m	£m	%
Loans secured by mortgages on immovable property				
Loans to individuals	34,073.2	12,018.1	961.5	35.3
Commercial lending (including SME)	480.8	396.1	31.7	82.8
Past due (3 months or more)	226.9	216.7	17.3	101.1
Immovable property total	**34,780.9**	**12,630.9**	**1,010.5**	**36.4**
Wholesale exposure classes				
Securitisation positions	43.7	17.1	1.4	39.2
Central governments or central banks	11,911.6	-	-	-
Financial institutions	906.6	493.3	39.4	97.1
Short term claims on financial institutions and corporates	294.0	58.8	4.7	20.0
Wholesale total	**13,155.9**	**569.2**	**45.5**	**8.7**
Retail				
Current accounts	1.5	-	-	-
Personal loans	1.5	-	-	-
Retail total	**3.0**	-	-	-
Operational risk	n/a	757.2	60.6	n/a
Other assets	277.4	222.4	17.8	80.1
Total	**48,217.2**	**14,179.7**	**1,134.4**	**34.1**

Table 4b - Pillar 1 Capital Requirement - Group	Exposure	RWAs	Capital Requirements	Average RW
2015	£m	£m	£m	%
Loans secured by mortgages on immovable property				
Loans to individuals	33,259.0	11,748.1	939.8	35.4
Commercial lending (including SME)	444.4	365.5	29.2	82.7
Past due (3 months or more)	292.1	278.5	22.3	101.1
Immovable property total	**33,995.5**	**12,392.1**	**991.3**	**36.5**
Wholesale exposure classes				
Securitisation positions	36.9	20.2	1.6	55.1
Central governments or central banks	12,614.8	-	-	-
Financial institutions	784.4	398.8	31.9	142.1
Short term claims on financial institutions and corporates	432.9	86.6	6.9	20.0
Wholesale total	**13,869.0**	**505.6**	**40.4**	**8.0**
Retail				
Current accounts	1.9	-	-	-
Personal loans	2.3	0.3	0.0	75.0
Retail total	**4.2**	**0.3**	**0.0**	**75.0**
Operational risk	**n/a**	736.7	58.9	n/a
Other assets	311.6	248.3	19.9	79.7
Total	**48,180.3**	**13,883.0**	**1,110.5**	**34.2**

Table 5a - Pillar 1 Capital Requirement -Solo	Exposure	RWAs	Capital Requirements	Average RW
2016	£m	£m	£m	%
Loans secured by mortgages on immovable property				
Loans to individuals	34,073.2	12,018.1	961.5	35.3
Commercial lending (including SME)	480.8	396.1	31.7	82.8
Past due (3 months or more)	226.9	216.7	17.3	101.1
Immovable property total	**34,780.9**	**12,630.9**	**1,010.5**	**36.4**
Wholesale exposure classes				
Securitisation positions	43.7	17.1	1.4	39.2
Central governments or central banks	11,911.6	-	-	-
Financial institutions	906.6	493.3	39.4	97.1
Short term claims on financial institutions and corporates	293.6	58.7	4.7	20.0
Wholesale total	**13,155.5**	**569.1**	**45.5**	**8.7**
Retail				
Current accounts	1.5	-	-	-
Personal loans	1.5	-	-	-
Retail total	**3.0**	-	-	-
Operational risk	n/a	762.7	61.0	n/a
Other assets	2,391.9	219.1	17.5	9.2
Total	**50,331.3**	**14,181.8**	**1,134.5**	**32.5**

Table5b - Pillar 1 Capital Requirement -Solo	Exposure	RWAs	Capital Requirements	Average RW
2015	£m	£m	£m	%
Loans secured by mortgages on immovable property				
Loans to individuals	33,259.0	11,748.1	939.8	35.4
Commercial lending (including SME)	444.4	365.5	29.2	82.7
Past due (3 months or more)	292.1	278.5	22.3	101.1
Immovable property total	**33,995.5**	**12,392.1**	**991.3**	**36.5**
Wholesale exposure classes				
Securitisation positions	36.9	20.2	1.6	55.1
Central governments or central banks	12,614.8	-	-	-
Financial institutions	784.3	398.8	31.9	142.1
Short term claims on financial institutions and corporates	432.5	86.5	6.9	20.0
Wholesale total	**13,868.5**	**505.5**	**40.4**	**8.0**
Retail				
Current accounts	1.9	-	-	-
Personal loans	2.3	0.3	0.0	75.0
Retail total	**4.2**	**0.3**	**0.0**	75.0
Operational risk	n/a	841.2	67.3	n/a
Other assets	2,766.1	254.0	20.3	9.2
Total	**50,634.2**	**13,993.1**	**1,119.3**	**32.5**

3.9 Pillar 2A

The Group Pillar 2A requirement as set by the PRA's Individual Capital guidance (ICG) is 2.3% of risk-weighted assets, with 56% of this required to be met by CET1 capital, this equates to approximately 1.3% of risk-weighted assets.

3.10 Capital Adequacy

The table below summarises the Group's capital adequacy position, using key figures from Tables 1, 4 and 5.

Table 6 - Capital Adequacy £m / %	Group 2016	Group 2015	Solo 2016	Solo 2015
<u>Capital Excess</u>				
Total pillar 1 capital requirement	1,134.4	1,110.5	1,134.5	1,119.3
Total capital resources	2,449.2	2,328.4	2,444.7	2,316.6
Excess of own funds over minimum pillar 1 requirement	**1,314.8**	**1,217.9**	**1,310.2**	**1,197.3**
Total risk weighted assets	14,179.7	13,883.0	14,181.8	13,993.1
Common Equity Tier 1 capital resources	2,119.3	2,007.5	2,114.8	1,995.7
Tier 1 capital resources	2,123.3	2,012.2	2,118.8	2,000.4
Total capital resources	2,449.2	2,328.4	2,444.7	2,316.6
Common Equity Tier 1 capital ratio	**14.9%**	**14.5%**	**14.9%**	**14.3%**
Tier 1 capital ratio	**15.0%**	**14.5%**	**14.9%**	**14.3%**
Total capital ratio	**17.3%**	**16.8%**	**17.2%**	**16.6%**

Sections 4 and 5 provide further detail on the significant risks captured under Pillar 1, i.e. credit risk and operational risk, including the nature of the exposures and the key risk management techniques. A summary of other significant risks captured under Pillar 2 is contained in section 6.

Given the total minimum capital requirements are not materially different on a Group or solo consolidated basis, the disclosures in the remainder of this document are on a Group basis.

3.11 RWA Flow Statement

The table below shows the causes of movements in RWAs in the year at the Group level. In the figures below, operational risk has been included to fully illustrate overall RWA movements. Changes in operational risk requirements reflect income growth within the regulatory prescribed income streams.

Table 7 - RWA Flow Statement £m	2015 RWAs	Portfolio Quality	Portfolio Growth	Income Growth	2016 RWAs
Loans secured on immovable property	12,392.1	(46.7)	285.5	-	12,630.9
Wholesale credit risk	505.6	(4.1)	67.7	-	569.2
Retail credit risk	0.3	-	(0.3)	-	-
Other credit risk	248.3	-	(25.9)	-	222.4
Operational risk	736.7	-	-	20.5	757.2
Total risk weighted assets	**13,883.0**	**(50.8)**	**327.0**	**20.5**	**14,179.7**

3.12 Leverage Ratio

This is a non-risk based 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.

The ratio is calculated as:

$$\frac{\text{Tier 1 Capital}}{\text{Total on- and off-balance sheet assets (adjusted for deductions)}}$$

Table 8a below shows the leverage ratio calculation with total exposure including assets held at central banks, being calculated as per the guidelines prior to the PRA statement issued mid 2016. Solo balance sheet assets contain a higher amount of debt securities than the Group balance sheet assets.

Table 8a - Leverage Ratio £m	Group 2016	Group 2015	Solo 2016	Solo 2015
Balance Sheet Assets	**39,590.0**	**38,210.6**	**46,913.3**	**45,246.1**
Adjustments				
Mortgage pipeline	589.7	507.0	589.7	507.0
Other committed facilities	24.5	18.4	24.5	18.4
Repurchase agreements	1,632.6	1,926.6	1,632.6	1,926.6
Netted derivatives adjustment	(121.2)	64.9	116.6	149.1
Tier 1 deductions	(104.3)	(115.0)	(104.0)	(115.0)
Exemption of intragroup exposures (solo basis)	-	-	(2,114.0)	(2,449.1)
Leverage Ratio Assets	**41,611.3**	**40,612.5**	**47,058.7**	**45,283.1**
Tier 1 Capital Resources	**2,123.3**	**2,012.2**	**2,118.8**	**2,000.4**
Leverage Ratio %	**5.1%**	**5.0%**	**4.5%**	**4.4%**

Table 8b below shows the leverage ratio calculation following the Bank of England's Financial Policy Committee statement issued on the 25th July 2016 recommending to the PRA that when applying the leverage ratio, institutions are allowed to exclude from total exposure those assets held at central banks.

Table 8b - Leverage Ratio - Exclusion of Central Bank Assets £m	Group 2016	Group 2015	Solo 2016	Solo 2015
Balance Sheet Assets	**39,590.0**	**38,210.6**	**46,913.3**	**45,246.1**
Adjustments				
Mortgage pipeline	589.7	507.0	589.7	507.0
Other committed facilities	24.5	18.4	24.5	18.4
Repurchase agreements	1,632.6	1,926.6	1,632.6	1,926.6
Netted derivatives adjustment	(121.2)	64.9	116.6	149.1
Tier 1 deductions	(104.3)	(115.0)	(104.0)	(115.0)
Exemption of intragroup exposures (solo basis)	-	-	(2,114.0)	(2,449.1)
Central Banks Exposure Deductions	(3,513.2)	(3,422.7)	(3,513.2)	(3,422.7)
Leverage Ratio Assets	**38,098.1**	**37,189.7**	**43,545.5**	**41,860.4**
Tier 1 Capital Resources	**2,123.3**	**2,012.2**	**2,118.8**	**2,000.4**
Leverage Ratio %	**5.6%**	**5.4%**	**4.9%**	**4.8%**

3.13 Impact of CRD IV

As noted in section 1.1, the Basel III regulations have been written into European law in the form of a Regulation and Directive commonly known as CRD IV, in force from 1 January 2014.

This section is intended to assist in understanding how the regulations will affect the Group's capital position. The table below shows the capital position under the current CRD IV rules as they stand under PRA national implementation, and on a final rules basis (applying the final CRD IV rules without transitional elements, as the rules will stand in 2022). All figures are as at the end of 2016.

Table 9 - CRD IV Capital Position £m	Transitional	Final Rules
Common Equity Tier 1 (CET1)		
General reserve	2,215.4	2,215.4
Regulatory adjustments:		
Available for sale reserve	8.2	8.2
Pension scheme adjustment	(31.5)	(31.5)
CET1 deductions:		
Prudent Valuation Adjustment	(1.5)	(1.5)
Intangible fixed assets	(32.9)	(32.9)
Securitisation holdings deducted from capital resources	(36.1)	(36.1)
Deferred tax assets that rely on future profitability	(2.3)	(2.3)
Total CET1 capital	**2,119.3**	**2,119.3**
Additional Tier 1 (AT1) Capital		
Permanent Interest Bearing Shares (PIBS)	4.0	0.0
Total Tier 1 capital	**2,123.3**	**2,119.3**
Tier 2 (T2) Capital		
Subordinated liabilities	291.5	288.5
Collective provisions for impairment	34.4	34.4
Total Tier 2 capital	**325.9**	**322.9**
Total capital	**2,449.2**	**2,442.2**
Current RWAs	14,179.7	14,179.7
Total RWAs under CRD IV	**14,179.7**	**14,179.7**
CET1 Ratio	**14.9%**	**14.9%**
Tier 1 Ratio	**15.0%**	**14.9%**
Total Capital Ratio	**17.3%**	**17.2%**
Leverage Ratio	**5.1%**	**5.1%**
Leverage Ratio Excluding Central Banks Exposure	**5.6%**	**5.6%**

4 Significant Risk Categories - Credit Risk

4.1 Credit Risk Overview

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.

For the purposes of Pillar 3 disclosures, credit risk is sub-divided into loans secured by mortgages on immovable property, wholesale (treasury) and retail (current accounts & personal loans). Details of the Group's risk management and governance practices can be found in the Risk Management Report in the Group's Annual Report and Accounts, with further details of exposures included in Notes 38 and 39.

4.2 Credit Risk Exposures

The gross credit risk exposure (based on the definitions for regulatory capital purposes, before impairment provision and credit risk mitigation) and the average for the year is summarised as follows:

Table 10 - Credit Risk Exposure £m	Average during 2016	Dec 2016	Average during 2015	Dec 2015
Loans secured by mortgages on immovable property				
Loans to individuals	34,029.5	34,296.8	33,172.1	33,549.2
Commercial lending (including SME)	467.1	484.1	426.5	446.3
Total loans secured on immovable property exposure	**34,496.6**	**34,780.9**	**33,598.6**	**33,995.5**
Wholesale				
Securitisation positions	40.2	43.7	60.6	36.9
Central governments or central banks	12,772.0	11,911.6	9,663.2	12,614.8
Financial institutions	927.5	906.6	798.1	784.4
Short term claims on institutions and corporates	313.3	294.0	311.8	432.9
Total wholesale exposure	**14,053.0**	**13,155.9**	**10,833.7**	**13,869.0**
Retail				
Current accounts	1.7	1.5	2.1	1.9
Personal loans	1.8	1.5	2.9	2.3
Total retail exposure	**3.5**	**3.0**	**5.0**	**4.2**
Other assets exposure	336.6	277.4	305.8	311.6
Total credit risk exposure	**48,889.7**	**48,217.2**	**44,743.1**	**48,180.3**

The section below gives a detailed breakdown of the material risk categories. A further geographical analysis of loans secured by mortgages on immovable property is disclosed in Note 39 in the Annual Report and Accounts.

The geographical distribution of the Group's exposures is as follows.

Table 11 - Credit Risk Exposure - Geographic Distribution 2016 £m	UK	Other European Countries	North America	Rest of the World	Total
Loans secured by mortgages on immovable property					
Loans to individuals	34,253.6	43.2	-	-	**34,296.8**
Commercial lending (including SME)	484.1	-	-	-	**484.1**
Total loans secured on immovable property	**34,737.7**	**43.2**	**-**	**-**	**34,780.9**
Wholesale					
Securitisation positions	-	19.4	-	24.3	**43.7**
Central governments or central banks	11,911.6	-	-	-	**11,911.6**
Financial institutions	561.0	300.0	39.5	6.1	**906.6**
Short-term claims on institutions and corporates	184.2	0.1	109.7	-	**294.0**
Total wholesale credit exposure	**12,656.8**	**319.5**	**149.2**	**30.4**	**13,155.9**
Total credit risk exposure (excl. retail and other assets)	**47,394.5**	**362.7**	**149.2**	**30.4**	**47,936.8**

Table 11 - Credit Risk Exposure - Geographic Distribution 2015 £m	UK	Other European Countries	North America	Rest of the World	Total
Loans secured by mortgages on immovable property					
Loans to individuals	33,497.0	52.2	-	-	**33,549.2**
Commercial lending (including SME)	446.3	-	-	-	**446.3**
Total loans secured on immovable property	**33,943.3**	**52.2**	**-**	**-**	**33,995.5**
Wholesale					
Securitisation positions	-	17.8	-	19.1	**36.9**
Central governments or central banks	12,614.8	-	-	-	**12,614.8**
Financial institutions	395.0	141.4	34.4	213.6	**784.4**
Short-term claims on institutions and corporates	304.4	0.1	128.4	-	**432.9**
Total wholesale credit exposure	**13,314.2**	**159.3**	**162.8**	**232.7**	**13,869.0**
Total credit risk exposure (excl. retail and other assets)	**47,257.5**	**211.5**	**162.8**	**232.7**	**47,864.5**

The residual maturity of the exposures is as follows.

Table 12 - Credit Risk Exposure - Residual Maturity 2016 £m	Up to 12 months	1 to 5 years	5 to 10 years	> than 10 years	Total
Loans secured by mortgages on immovable property					
Loans to individuals	477.8	912.0	2,795.1	30,111.9	34,296.8
Commercial lending (including SME)	26.7	16.2	59.8	381.4	484.1
Total loans secured on immovable property	**504.5**	**928.2**	**2,854.9**	**30,493.3**	**34,780.9**
Wholesale					
Securitisation positions	36.1	-	-	7.6	43.7
Central governments or central banks	3,513.2	157.5	403.0	7,837.9	11,911.6
Financial institutions	1.3	154.1	652.4	98.8	906.6
Short-term claims on institutions and corporates	294.0	-	-	-	294.0
Total wholesale exposure	**3,844.6**	**311.6**	**1,055.4**	**7,944.3**	**13,155.9**
Total credit risk exposure (excl. retail and other assets)	**4,349.1**	**1,239.8**	**3,910.3**	**38,437.6**	**47,936.8**

Table 12 - Credit Risk Exposure - Residual Maturity 2015 £m	Up to 12 months	1 to 5 years	5 to 10 years	> than 10 years	Total
Loans secured by mortgages on immovable property					
Loans to individuals *	455.8	951.0	2,683.4	29,459.0	33,549.2
Commercial lending (including SME)	11.8	28.3	53.1	353.1	446.3
Total loans secured on immovable property *	**467.6**	**979.3**	**2,736.5**	**29,812.1**	**33,995.5**
Wholesale					
Securitisation positions	-	27.9	-	9.0	36.9
Central governments or central banks	3,422.8	77.8	151.3	8,962.9	12,614.8
Financial institutions	-	61.3	492.6	230.3	784.4
Short-term claims on institutions and corporates	432.9	-	-	-	432.9
Total wholesale exposure	**3,855.7**	**167.1**	**643.9**	**9,202.3**	**13,869.0**
Total credit risk exposure (excl. retail and other assets) *	**4,323.3**	**1,146.4**	**3,380.4**	**39,014.4**	**47,864.5**

The maturity of exposures is shown on a contractual basis, and it does not take into account any instalments receivable over the life of the exposure.

Note * This has been restated for 2015 due to using an alternative data source which incorporates term extensions to obtain a more accurate loan maturity date.

For the purposes of generating risk weightings for its wholesale and asset securitisation exposures, the Group uses Standard and Poor’s (S&P), Fitch and Moody's as External Credit Assessment Institutions (ECAIs), using a composite rating where a counterparty is rated by more than one agency. There has been no change in the Group’s use of ECAIs during the year. The following tables show the exposure values associated with each credit quality step for wholesale exposures under the standardised approach:

Table 13 - Sovereign Exposure Credit Quality Steps						2016
Central Government, Central Banks and Multilateral Development Banks						
Credit Quality Step	Risk Weight (<3 months / >3 months)	S&P rating	Fitch rating	Moody's rating	Exposure values £m	Exposure values after mitigation[1] £m
1	0%/0%	AAA to AA-	AAA to AA-	Aaa to Aa3	11,911.6	5,706.2
Total					**11,911.6**	**5,706.2**
						2015
Credit Quality Step	Risk Weight (<3 months / >3 months)	S&P rating	Fitch rating	Moody's rating	Exposure values £m	Exposure values after mitigation[1] £m
1	0%/0%	AAA to AA-	AAA to AA-	Aaa to Aa3	12,614.8	5,574.3
Total					**12,614.8**	**5,574.3**

[1] Mitigation recognises the benefit of collateral held against these investments – see Section 4.6.2 Credit Risk Mitigation: Wholesale

Table 14 - Wholesale Exposure Credit Quality Steps — 2016

Financial institutions, Covered bonds and Short-term claims

Credit Quality Step	Risk Weight (<3 months / >3 months)	S&P rating	Fitch rating	Moody's rating	Exposure values £m	Exposure values after mitigation[1] £m
1	20%/20%	AAA to AA-	AAA to AA-	Aaa to Aa3	370.1	333.6
2	20%/50%	A+ to A-	A+ to A-	A1 to A3	755.0	445.5
3	20%/50%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	72.1	19.8
4	50%/100%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	-	-
5	50%/100%	B+ to B-	B+ to B-	B1 to B3	-	-
6	150%/150%	CCC+ and below	CCC+ and below	Caa1 and below	-	-
Unrated	20%/50%	Unrated	Unrated	Unrated	3.4	3.4
Total					**1,200.6**	**802.3**

2015

Credit Quality Step	Risk Weight (<3 months / >3 months)	S&P rating	Fitch rating	Moody's rating	Exposure values £m	Exposure values after mitigation[1] £m
1	20%/20%	AAA to AA-	AAA to AA-	Aaa to Aa3	493.7	226.7
2	20%/50%	A+ to A-	A+ to A-	A1 to A3	647.8	455.9
3	20%/50%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	72.4	27.6
4	50%/100%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	3.4	3.4
5	50%/100%	B+ to B-	B+ to B-	B1 to B3	-	-
6	150%/150%	CCC+ and below	CCC+ and below	Caa1 and below	-	-
Unrated	20%/50%	Unrated	Unrated	Unrated	-	-
Total					**1,217.3**	**713.6**

Included within the 2016 exposures above, is approximately £84.7m of exposures after mitigation (rated at A+) that relate to centrally cleared counterparties. The exposures have been risk weighted at 2% as per CRD IV rules.

4.3 Securitisation Positions

Issued Securitisations

The Group uses securitisation activities to obtain wholesale funding or to create additional collateral which can be used to source additional funding. It has securitised certain mortgage loans by transferring the loans to special purpose entities (SPEs) under the 'Brass' and 'Tombac' securitisation programmes. The SPEs are fully consolidated into the Group accounts.

The transfer of the mortgage loans to the SPEs are not treated as sales by the Group and therefore no gains or losses are recognised, as these structures were not intended to achieve significant transfer of credit risk away from the Group, but to benefit from attractive funding rates. The Group continues to recognise the mortgage loans on its own balance sheet after the transfer because the risks relating to the underlying mortgage pools, and rewards through the receipt of substantially all of the profits or losses of the securitisation entities, remain with the Group and are included in the 'secured by mortgages on immovable property' sections detailed in this document. These assets are held at amortised cost.

There are no specific capital requirements for the securitisation vehicles. As there has not been a transfer of significant credit risk, the Society does not calculate risk weighted exposure amounts for any positions it holds in the securitisations and these continue to be calculated in line with capital requirements applied to the underlying mortgage assets. The risk relating to the underlying mortgage pool remains with the Society and is included in the residential mortgage tables detailed throughout this document. Note 35 in the Annual Report and Accounts provides more information on the securitisation programme.

The Group has also retained notes from its securitisation issues to be used as collateral for use in sale and repurchase agreements or central bank operations. Investments in self-issued notes and the equivalent 'deemed loan', together with the related income, expenditure and cash flows are not recognised in the Group's consolidated accounts. This avoids the 'grossing-up' of the financial statements that would otherwise arise. Under the terms of the securitisation programme, the nominal amount of the debt securities in issue is paid down to match the payment profile of the mortgages pledged to the programme.

To manage interest rate risk the SPEs enter in to derivative transactions. Treatment of derivatives relating to securitisations can be found in Note 34 of the Annual Report and Accounts.

To manage market and credit risk monthly monitoring of the portfolios is undertaken, including review of statistics of the underlying asset pools and compliance with structural tests where applicable using the investor reports published for each of the investments.

The SPEs also represent a liquidity risk to the Group due to legal covenants which need to be fulfilled in the event of a downgrade of the Group. The cash flows resulting from these covenants are in respect of amounts required to collateralise swaps, based on rating agency methodologies. In the event that the Group is downgraded funds may need to be deposited externally with, or a guarantee obtained from, a suitably rated institution. The cash flows required in the event of downgrade are considered in the Group's ILAAP.

The Society or any of its subsidiaries are under no obligation to support any losses that may be incurred by the securitisation programme or holders of the notes issued and do not intend to provide such further support.

A total of £6.1bn (31 December 2015: £5.3bn) of mortgage loans are currently pledged to the Brass and Tombac securitisation programmes.

For mortgage loans securitised by the Group for the Brass and Tombac programmes as at 31 December 2016, 72 accounts were past due, with a balance of £9.4m. Losses incurred in the securitisation programmes during the year amounted to £35,430 across 4 properties sold.

As at 31 December 2016, the nominal value of outstanding debt securities issued through the securitisation programmes was £6.4bn (2015: £5.7bn) of which £5.7bn (2015: £4.9bn) was retained by the Group. The notes issued by the securitisation programmes are rated by Moody's and Fitch as AAA.

Purchased Securitisations

The Group's exposures listed below relate to purchased securitisation positions, including resecuritisations (which is defined as a securitisation instrument where at least one of the underlying exposures is itself a securitisation).

Table 15 - Securitisation Positions by Investment type	Exposure Values	
£m	2016	2015
Combination Note	7.6	9.0
Synthetic Collateralised Debt Obligation	36.1	27.9
Total	**43.7**	**36.9**

Securitisation exposures are currently limited to legacy portfolios which have been in run off for a significant period. No new investment has been undertaken since 2008, although a small amount was added to the portfolio in 2010 and 2011 following the Chelsea and N&P mergers respectively.

The fair values are based on either quoted market prices, where available, or via valuations provided by external parties.

The increase in value seen in 2016 is mainly attributable to an improving credit outlook on the underlying investments. Both our holdings of synthetic collateralised debt obligations reach maturity in 2017.

The following table shows the Group's aggregate exposure to purchased securitisations, split by their associated credit quality steps:

Table 16 - Securitised Positions Exposure Credit Quality Steps 2016

Credit Quality Step	Risk Weight	S&P rating	Fitch rating	Moody's rating	Exposure values £m
1	20%	AAA to AA-	AAA to AA-	Aaa to Aa3	-
2	50%	A+ to A-	A+ to A-	A1 to A3	-
3	100%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	-
4	350%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	-
5	Deducted	B+ and below	B+ and below	B1 and below	36.1
Total					**36.1**

Table 16 - Resecuritised Positions Exposure Credit Quality Steps 2016

Credit Quality Step	Risk Weight	S&P rating	Fitch rating	Moody's rating	Exposure values £m
1	40%	AAA to AA-	AAA to AA-	Aaa to Aa3	-
2	100%	A+ to A-	A+ to A-	A1 to A3	-
3	225%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	7.6
4	650%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	-
5	Deducted	B+ and below	B+ and below	B1 and below	-
Total					**7.6**

Table 16 - Securitised Positions Exposure Credit Quality Steps 2015

Credit Quality Step	Risk Weight	S&P rating	Fitch rating	Moody's rating	Exposure values £m
1	20%	AAA to AA-	AAA to AA-	Aaa to Aa3	-
2	50%	A+ to A-	A+ to A-	A1 to A3	-
3	100%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	-
4	350%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	-
5	Deducted	B+ and below	B+ and below	B1 and below	27.9
Total					**27.9**

Table 16 - Resecuritised Positions Exposure Credit Quality Steps 2015

Credit Quality Step	Risk Weight	S&P rating	Fitch rating	Moody's rating	Exposure values £m
1	40%	AAA to AA-	AAA to AA-	Aaa to Aa3	-
2	100%	A+ to A-	A+ to A-	A1 to A3	-
3	225%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	9.0
4	650%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	-
5	Deducted	B+ and below	B+ and below	B1 and below	-
Total					**9.0**

4.4 Impairment Provisions

4.4.1 Loans Secured by Mortgages on Immovable Property

Further details of the Group's accounting policy for impairment losses on loans and advances to customers is given in Note 1 of the Annual Report and Accounts.

The following table shows the past due loans and provisions for impaired exposures (equivalent to value adjustments) and charges to the Income Statement for the year ended 31 December 2016. Please note that the figures below show the customer balances used for provisioning as opposed to capital exposure values (which include potential exposures due to undrawn facilities and pipeline business that do not appear on balance sheet) and therefore do not match the totals in capital exposure tables above.

Table 17 - Loans secured on immovable property (£m) Exposures not subject to fair value	Total 2016	Total 2015
Neither past due nor individually impaired	28,983.1	27,449.2
Past Due		
Up to 3 months	531.8	553.7
3 to 6 months	84.9	101.3
6 to 12 months	37.7	48.2
Over 12 months	12.8	16.3
Possessions	5.9	10.2
Total past due	**673.1**	**729.7**
Total exposures	**29,656.2**	**28,178.9**
Provisions	**41.8**	**45.9**
Charge for the year	**1.1**	**12.8**
Fair Value Held	**-**	**-**

Table 17 - Loans secured on immovable property (£m) Exposures subject to fair value	Total 2016	Total 2015
Neither past due nor individually impaired	4,151.4	4,840.9
Past Due		
Up to 3 months	295.5	340.3
3 to 6 months	46.5	70.2
6 to 12 months	22.6	27.9
Over 12 months	9.3	9.3
Possessions	7.2	18.2
Total past due	**381.1**	**465.9**
Total exposures	**4,532.5**	**5,306.8**
Provisions	**0.1**	**0.1**
Credit for the year	**-**	**(2.8)**
Fair Value Held	**52.8**	**58.7**

Table 17 - Loans secured on immovable property (£m) All exposures	Total 2016	Total 2015
Neither past due nor individually impaired	33,134.5	32,290.1
Past Due		
Up to 3 months	827.3	894.0
3 to 6 months	131.4	171.5
6 to 12 months	60.3	76.1
Over 12 months	22.1	25.6
Possessions	13.1	28.4
Total past due	**1,054.2**	**1,195.6**
Total exposures	**34,188.7**	**33,485.7**
Provisions	**41.9**	**46.0**
Charge for the year	**1.1**	**10.0**
Fair Value Held	**52.8**	**58.7**

Impairment is assessed based on the arrears of each loan. Where mortgages are in arrears by 3 months or more, they are individually assessed for impairment. All mortgages that are past due but not impaired are less than three months in arrears. Where retail or commercial mortgages are less than three months in arrears they are assessed for collective impairment, unless individual impairment triggers exist on any of these loans.

The amounts shown as past due represent the full amount of the loan outstanding, not just the amount that is past due. The assets acquired during the mergers with the Chelsea Building Society and N&P Building Society in 2010 and 2011 respectively were subject to a number of significant adjustments to reflect their "fair value" rather than the value at which they were recorded in Chelsea or N&P's own records; i.e. as if they had been acquired, individually, by YBS in standalone transactions. This included an adjustment to reflect the amount that the Group expects to lose, at any point in the future, through borrower defaults. This approach is different to that for the existing mortgage assets where only currently impaired loans can be taken into account for impairment provisions. The effect is, provided the estimate of future losses is accurate, that any future losses on these assets will not be reflected in the Income Statement – it is equivalent to bringing forward future loan loss provisions charges to the effective merger date. These are illustrated in the table showing 'Exposures subject to Fair Value'

Further information on the movement during the year in impairment provisions is provided in Note 9 to the Annual Report and Accounts.

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. Further detail of Forbearance can be found in Note 39 in the Group's Annual Report & Accounts.

4.4.2 Wholesale

Details of accounting policies for impairment losses on debt instruments can be found in Note 1 to the Annual Report and Accounts.

At the statement of financial position date, the Group had an impairment provision of £6.0m on wholesale investments relating to individually assessed CDOs, as shown in Note 15 to the Group's Annual Report and Accounts.

4.4.3 Other

At the statement of financial position date, the Group had an impairment provision of £4.0m on joint venture investments, as shown in Note 41 to the Group's Annual Report and Accounts.

4.5 Credit Risk Concentrations

As a UK residential mortgage lender, the Group is inevitably concentrated in this market. Within this overall concentration however, the Group has put in place controls to mitigate undue concentration risk. Further detail of concentrations can be found in Note 39 in the Group's Annual Report and Accounts.

4.6 Credit Risk Mitigation

The Group uses a range of techniques to manage the credit risk of its retail, commercial and wholesale lending. The most critical of these is performing an assessment of the ability of a borrower to service the proposed level of borrowing without distress. However, the risk is further mitigated by obtaining collateral for the funds advanced.

4.6.1 Loans Secured by Mortgages on Immovable Property

Loans to Individuals
Residential property is the Group's main source of collateral and means of mitigating credit risk inherent in its residential mortgage portfolios. All current mortgage lending activities are supported by an appropriate form of valuation using either an independent firm of valuers (except low LTV re-mortgage cases valued without independent valuation) or indexed valuation for further advances. All residential property must be insured to cover property risks, which may be through a third party. Additional protection is also available to borrowers through optional payment protection insurance.

Commercial Lending
The Group also lends to commercial parties through the N&P brand. All commercial loans are secured by a first charge over a commercial or semi-commercial property and are valued by a panel approved valuer. The property must be insured in line with the amount recommended by the valuer. Where the Group lends to a limited company, a guarantee is obtained from the directors of that company.

The Group also lends to housing associations ('Registered Providers'), via the YBS brand. All of these loans are secured on a portfolio of completed residential properties and are valued by a panel valuer.

4.6.2 Wholesale

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

The Group's legal documentation with its counterparties for derivative transactions grants legal rights of setoff for those transactions. Accordingly, for credit exposure purposes, negative market values on derivatives will offset positive market values on derivatives with the same counterparty in the calculation of credit risk, subject to a minimum absolute exposure of zero by counterparty.

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

Credit risk is further mitigated by the use of central counterparties (CCPs). A CCP is a clearing house that interposes itself between counterparties to contracts traded in one or more financial markets, where a single bilateral contract between the buyer and seller is replaced with two contracts, one between the buyer and CCP and one between the seller and CCP. Since late 2015 the Group has settled eligible derivatives using central counterparties.

Further details on wholesale credit risk can be found in Note 38 in the Group's Annual Report and Accounts.

4.7 Counterparty Credit Risk for Derivative Contracts

The Group uses derivative instruments to hedge interest rate risk, foreign currency risk or other factors of a prescribed description arising from fixed rate mortgage lending and savings products, funding and investment activities. 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. Counterparty credit risk in the context of this disclosure is the risk that a counterparty to a derivative instrument could default before the final settlement of the transaction's cash flows.

As described in section 4.6.2, risk is mitigated by offsetting the amounts due to the same counterparties ("Netting benefits") and by cash deposited by the counterparties ("Collateral held"). The following table shows the exposures to counterparty credit risk for derivative contracts at 31 December 2016. Where derivative transactions meet eligibility for clearing at CCP, counterparty credit risk is replaced by an exposure against the CCP. Counterparty credit risk exposures are calculated using the mark to market method.

Table 18 - Counterparty Credit Risk for Derivative Contracts

£m	2016	2015
Interest rate contracts	905.3	3,215.2
Foreign exchange contracts	2,633.8	2,272.8
Other contracts	236.6	278.5
Gross positive fair value of contracts	**3,775.7**	**5,766.5**
Netting benefits	(3,037.8)	(5,354.3)
Netted current credit exposure	**737.9**	**412.2**
Collateral held	(398.3)	(299.7)
Net derivatives credit exposure	**339.6**	**112.5**
Add on for potential future exposure	165.3	160.5
Total derivatives exposure	**504.9**	**273.0**

The 'other contracts' element mainly reflects funds provided to counterparties as collateral and the collateral held incorporates the positions that mitigate this exposure.

The net derivatives credit exposure represents the credit exposure to derivative transactions after taking account of legally enforceable netting agreements and collateral arrangements. The total derivatives exposure includes uplifts for potential future exposure under the mark to market method for assessing counterparty credit risk.

If the Group is downgraded, there would be no impact on the collateral required to be posted in relation to existing swap agreements, other than those pertaining to securitisations discussed in section 4.3.

Wrong way risk can occur if exposures to a counterparty are negatively correlated to the creditworthiness of that counterparty. As such, there is potential for the exposure to increase as the creditworthiness decreases. Should such a risk arise, this would be taken into account as part of the counterparty review process which allows management to assess what, if any, appropriate mitigating actions are required. Additionally, the Group mitigates wrong way risk by ensuring that exposures on derivatives are managed via Credit Support Annex (CSA) agreements which are regularly re-margined.

Internally, capital is allocated to counterparty credit risk based on the methods shown above. Credit limits are determined by internal ratings from credit assessment and approved by PRC (Prudential Risk Committee).

5 Significant Risk Categories - Operational Risk

5.1 Operational Risk Overview

The Group has adopted the standardised approach to all operational risks and has defined operational risk as: "the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems, and from external events".

This means that for the calculation of minimum capital requirements, the Group calculates its average annual income from prescribed business lines over the past three years. Capital is then held to support operational risk for each business line at prescribed rates from 12% to 18% of its average annual relevant income.

Qualitative requirements for the standardised approach to operational risk have been adopted including:-

- Board and Senior Management oversight of the operational risk management framework.
- Board approved Group wide operational risk management framework and policies in place with framework components including risk identification and assessment activities, control self-assessment, key risk indicators, risk monitoring and loss reporting with oversight and validation activities undertaken as required.
- Stress testing and scenario analysis activities undertaken to define the level of capital required to recover from a severe stress scenario event.
- Board, committee and Senior Management levels reporting on Enterprise and Operational risks with appropriate actions taken as required.

5.2 Operational Risk Framework

Underpinning the Group's approach to operational risk measurement and management is the enterprise-wide risk map. This covers all key risks to which the Group is exposed, including key operational risks, and therefore incorporates the operational risk framework. Each key risk identified is assigned to a risk owner, all of whom are Chief Officers. As described in the Risk Management Report in the Annual Report and Accounts, the Group operates a 'three lines of defence' model. It is the responsibility of the first-line business functions to manage risks to the operation of the business, with facilitation, coaching and challenge from the second line (Group Risk).

5.3 Operational Risk Oversight and Governance

Oversight and governance arrangements for the setting and management of a robust operational risk management policy and framework are the responsibility of the Board, Group Risk Committee (GRC) and the Operational Risk Committee (ORC). Each committee has a defined Terms of Reference allocating their accountability and responsibilities.

Responsibilities of the ORC are to fulfil four fundamental roles including that the right matters are escalated to GRC:

- To approve Risk Appetite and Board delegated Policy
- To oversee MI and risk reports from the 1st line of defence ("the business")
- To receive independent reports from the 2nd line of defence ("Operational Risk & Internal Control")
- To approve key decision papers

5.4 Operational Risk Monitoring and Reporting

In support of the enterprise-wide risk map, the Group has in place a risk dashboard supporting each key risk, including operational risks. These risk dashboards integrate all the available information about a risk, and summarise the status of the risk, identifying:

- Whether a key risk may be changing.
- Whether the operational environment is under stress, stable or improving.
- Whether key controls relied on to mitigate the risks are operating effectively.

Operational Risk & Internal Control (2nd line of defence) conducts independent risk monitoring reviews across key Group-wide operational risks. A monitoring plan is approved by GRC on an annual basis and through 2016 has focussed resources upon technology, data and resilience.

Operational risk assessments and operational risk management information are reported to the Board via the monthly Board risk report. In addition, there is an operational risk update to the Group Risk Committee every quarter, including a review of the enterprise-wide risk map.

A detailed information pack is provided to the ORC on a monthly basis to help it fulfil its role of overseeing operational risk

6 Other Significant Risks - Pillar 2

6.1 Pillar 2 Overview

As noted in section 3.2, the Group undergoes its ICAAP at least annually in line with Pillar 2 requirements. The outcome of the ICAAP is presented within an Internal Capital Assessment document (ICA).

The process is led by the Capital and IRB department, but involves a wide range of personnel from across the Group, including Chief Officers. The ICA, including underlying individual risk assessments for material risk categories, is reviewed by Chief Officers, executive committees, the Group Risk Committee and the Board.

The purpose of the process is to identify the key risks to which the Group is exposed, the levels of capital and other financial resources that should be held to meet the Group's regulatory requirements during a period of severe stress and the extent to which minimum Pillar 1 requirements do not satisfy the findings of the ICA.

The ICA is prepared at a Group level, and currently identifies the following key risk categories:

- Credit Risk[1]
- Interest Rate & Market Risk
- Pension Risk
- Operational, Fraud & Conduct Risk[1]
- Concentration Risk
- Business Risk

In the case of risk categories that have Pillar 1 capital requirements, stress testing is performed on the exposures to determine whether capital is required over and above the Pillar 1 amounts held. For other risks, stress testing determines the level of Pillar 2 capital required to protect against the risk in a severe stress scenario – the amount of capital held against these risks is referred to as 'Pillar 2A'. See below for further details.

Additional capital is required to be held in the form of the Pillar 2B "PRA Buffer" which is the result of a stress test that assesses the capital impact of a "severe but plausible" economic downturn on the Group's strategic plan. Further consideration is provided below within the "Capital Planning Stress Test" section.

[1] These risks are Pillar 1 risks that are considered in detail within Sections 4 and 5 of this document

6.2 Interest Rate Risk

Interest rate risk relates to the impact of re-pricing of assets and liabilities through interest rate movements. Details of interest rate risk can be found in Note 36 to the Group's Annual Report and Accounts; a description of risk appetite and governance can be found in the Risk Management Report of the Annual Report and Accounts.

For assessment of capital requirements, the Group models the impact of a range of severe scenarios on the Group's interest rate position to determine the amount of Pillar 2 capital to hold against this risk.

6.3 Pension Risk

The risk of the Group's defined benefit pension obligations has been modelled, with the help of external actuaries, by applying a severe stress test to the factors that affect the valuation of the scheme. Details of the Group's pension obligations can be found in Note 26 of the Group's Annual Report and Accounts.

6.4 Concentration Risk

The Group routinely considers concentrations in products, geographies, channels, income streams and funding sources as part of its strategic planning and has stress tested any such concentrations as part of the ICAAP. A degree of concentration risk is inevitable given the Group's focus in the UK residential mortgage market.

6.5 Business Risk

Consideration is given to the risk that the Group is unable to pursue its short term business plan or longer term strategy. This includes the impact of shifts in the economic, market or regulatory environment that could fundamentally impact on the Group's key Income Statement and Balance Sheet metrics. It can include, for example, the impact of credit ratings downgrades on the Group's ability to raise funding at planned levels and cost.

6.6 Capital Planning Stress Test

A PRA Buffer has been generated from the results of the Capital Planning Stress Test. This stress test is defined and articulated with the assistance of key business experts and is set at a severity level that is consistent with the PRA's "severe but plausible" requirement.

The test calculates the impact to both capital requirements and resources across the strategic planning period. Based upon the results (after management actions are considered), an additional amount of capital is held above the proposed regulatory minimum. This PRA Buffer can, in extreme times of stress, be utilised without breaching the regulatory minimum.

6.7 Other Risks

After detailed stress testing, no other risks were considered material from a capital perspective as part of the most recent ICAAP.

7 Remuneration

The Pillar 3 disclosures on remuneration are contained in various sections of the Annual Report and Accounts, including the Corporate Governance Report, the Directors' Remuneration Report, the Directors' and Chief Officers' Profiles and the Annual Business Statement.

Appendix 1 – Asset Encumbrance

The amounts disclosed in Templates A and C below are median values calculated using quarterly data and have been prepared in accordance to EBA Guideline EBA/GL/2014/03 on the disclosure of encumbered and unencumbered assets and as such differ from the disclosures contained in the Group's 2016 Annual Report and Accounts.

Template A: Assets

Table 19a - Encumbered Assets (Template A) 2016 £m	Carrying amount of encumbered assets	Fair Value of encumbered assets	Carrying amount of unencumbered assets	Fair Value of unencumbered assets
Assets of the reporting institution	9,161.6		30,678.0	
of which:	-		-	
Equity instruments	-		-	
Debt securities	111.7	111.7	424.9	424.9
Other assets	-		982.8	

Table 19b - Encumbered Assets (Template A) 2015 £m	Carrying amount of encumbered assets	Fair Value of encumbered assets	Carrying amount of unencumbered assets	Fair Value of unencumbered assets
Assets of the reporting institution	9,855.7		27,719.1	
of which:				
Equity instruments	-		-	
Debt securities	373.9	373.9	150.9	150.9
Other assets	-		564.6	

Template B: Collateral

In accordance with PRA Supervisory Statement 11/14, the Group has elected to apply the waiver regarding disclosure of collateral received, therefore Template B has not been disclosed.

Template C: Encumbered Assets/ Collateral Received and Associated Liabilities

Table 20 - Encumbered Assets/ Collateral Received and Associated Liabilities (Template C) £m	Matching laibilities, contingent liabilites or securities lent		Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered	
	2016 £m	2015	2016 £m	2015
Carrying amount of selected financial liabilities	5,091.4	5,951.5	6,447.7	7,450.4

Template D: Information on importance of encumbrance

Encumbrance occurs through the pledging of assets to secured creditors; such assets become unavailable for other purposes. The most material sources of encumbrance for the Society are secured funding via the Society's covered bond and securitisation programmes which are supported by pledging mortgage assets. Assets are encumbered in accordance with the contractual requirements of these programmes. Further detail on these activities is set out in note 35 to the 2016 Annual Report & Accounts. These programmes are continually assessed and a prudent buffer of over-collateralisation is voluntarily maintained for operational efficiency.

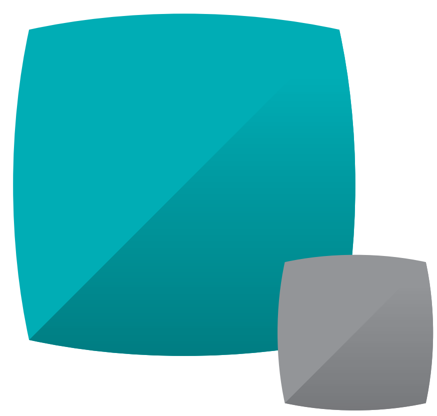
The Society also pledges debt securities as collateral in sale and repurchase transactions. An additional source of encumbrance is the collateralisation of derivatives liabilities. The Society also treats some cash and balances with the Bank of England, some loans and advances to credit institutions and some debt securities as encumbered even though there are no associated liabilities. An example of this would be liquid assets held within the Group's covered bond and securitisation programmes as these are not available for use in the Group's day-to-day operations.

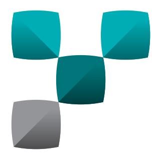
Glossary of Terms

Additional Tier 1 (AT1)	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.
Average Risk Weight (RW)	Risk weighted assets divided by capital exposure.
Common Equity Tier 1 (CET1) capital	The highest quality regulatory capital resources, comprising 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.
Counterparty Credit Risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
Credit Quality Steps (CQS)	A credit quality assessment scale as set out in CRD IV.
CRD IV	A package of legislation incorporating a Regulation (CRR) and a Directive (CRD) that implements the Basel III framework in Europe.
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.
Credit risk mitigation	Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, credit insurance, set off or netting.
Credit Valuation Adjustment (CVA)	These are adjustments applied to the fair values of derivatives to reflect the creditworthiness of the counterparty.
External Credit Assesment Instituion (ECAI)	An ECAI (e.g. Moody's, Standard and Poor's, Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves.
EEA parent institution	A parent financial institution situated in a Member State of the European Economic Area which is not a subsidiary of another financial institution also situated in the EEA.
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.
Guarantee	An agreement by a third party to cover the potential loss to a credit institution should a specified counterparty default on their obligations.
Individual Capital Assessment (ICA)	The document produced as a result of the ICAAP.
Internal Capital Adequacy Assesment 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.
Individual Capital Guidance (ICG)	The minimum amount of capital the Group should hold as set by the PRA under Pillar 2.
Individual Liquidity Adequacy Assessment (ILAA)	The Group's internal assessment of the levels of liquidity that need to be held by the Group to meet its regulatory liquidity requirements.
Interest rate risk	Interest rate risk is the exposure of a firm's financial condition to adverse movements in interest rates.
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.
Individually impaired loans	Where retail or commercial mortgages are in arrears by three months or more, they are individually assessed for impairment. Commercial loans less than three months in arrears are also individually impaired where other factors suggest a measurable decrease in the present value of their future cash flows.
Internal Ratings Based (IRB)	Approach to calculating capital requirements where lenders use their own models of risk to determine the appropriate minimum capital requirement.
International Swaps and Derivatives Assocaition (ISDA)	The global trade association for over-the-counter (OTC) derivatives, and providers of the industry-standard ISDA documentation.
Loan-to-value ratio (LTV)	A ratio showing outstanding loan balance as a percentage of the value of the security.
Maturity	The remaining time in years that a borrower is permitted to take to fully discharge their contractual obligation (principal, interest and fees) under the terms of a loan agreement.

Glossary of Terms continued…

Minimum Capital Requirement	The minimum amount of regulatory capital that a financial institution must hold to meet the Pillar 1 requirements for credit, operational risk and market risk.
Minimum Requirement of Eligible Liabilities (MREL)	The minimum requirements a financial institution must hold to meet the loss absorption and recapitalisation components if an institution were to fail.
Netting	The ability to reduce credit risk exposures by offsetting the value of any deposits against loans to the same counterparty.
Operational risk	The risk of direct and indirect loss resulting from inadequate or failed internal processes, people and systems or from external events.
Past due	Loans which are in arrears by 3 months or more.
Permanent Interest Bearing Shares (PIBS)	Unsecured, sterling denominated Tier 1 capital instruments repayable at the option of the Society.
Pillar 1	The part of the Basel III Framework which sets out the regulatory minimum capital requirements for credit and operational risk.
Pillar 2	The part of the Basel III Framework which sets out the processes by which financial institutions review their overall capital adequacy. Supervisors then evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments. This includes all risks (including Pillar 1 risks) – ICG is an outcome from Pillar 2.
Pillar 3	The part of the Basel III Framework which sets out the disclosure requirements for firms to publish details of their risks, capital and risk management. The aims are greater transparency and strengthening market discipline.
Provisions	Amounts set aside to cover incurred losses associated with credit risks.
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.
Prudent Valuation Adjustment (PVA)	A regulatory deduction applied to CRD IV Common Equity Tier 1 capital calculated in accordance with Article 105 of the Capital Requirements Regulation (CRR). The purpose of the Prudent Valuation Adjustment is to ensure that the valuation of financial instruments for capital reporting is at the more conservative end of any range of plausible valuations.
Resecuritisation	A securitisation transaction or scheme that includes at least one securitisation within its underlying asset pool.
Risk Weighted Assets (RWA)	A regulatory measure that adjusts the value of assets to reflect their level of risk when calculating capital requirements.
Securitisation	A transaction or scheme where assets are sold to a Special Purpose Vehicle (SPV) in return for immediate cash payment. That vehicle raises the immediate cash payment by issuing debt securities in the form of tradable notes or commercial paper to wholesale investors who receive an income from the underlying assets. Some risk is retained on the balance sheet while the remaining risk is transferred to investors. Securitisations may be purchased or retained.
SME	Small and medium-sized enterprise.
SREP	Supervisory Review and Evaluation Process, the PRA assessment of a firm's own capital assessment (ICA) under Basel III Pillar 2.
Stress testing	Various techniques that are used to gauge the potential vulnerability to exceptional but plausible events.
Subordinated debt	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).
The Standardised Approach (credit risks)	The standardised approach to credit risk, calculated by applying varying RWA percentages to credit exposures, depending on the underlying risk.
The Standardised Approach (operational risks)	The standardised approach to operational risk, calculated using three-year historical net income multiplied by a factor of between 12-18%, depending on the underlying business being considered.
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 ratio	The ratio of total capital to Risk Weighted Assets.





YBS
GROUP

References to 'YBS Group' or 'Yorkshire Group' refer to Yorkshire Building Society, the trading names under which it operates (Chelsea Building Society, the Chelsea, Norwich & Peterborough Building Society, N&P and Egg) and its subsidiary companies. Yorkshire Building Society is a member of the Building Societies Association and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Yorkshire Building Society is entered in the Financial Services Register and its registration number is 106085. Head Office: Yorkshire House, Yorkshire Drive, Bradford BD5 8LJ.

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