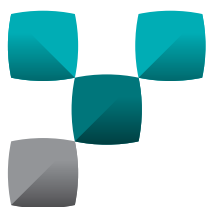
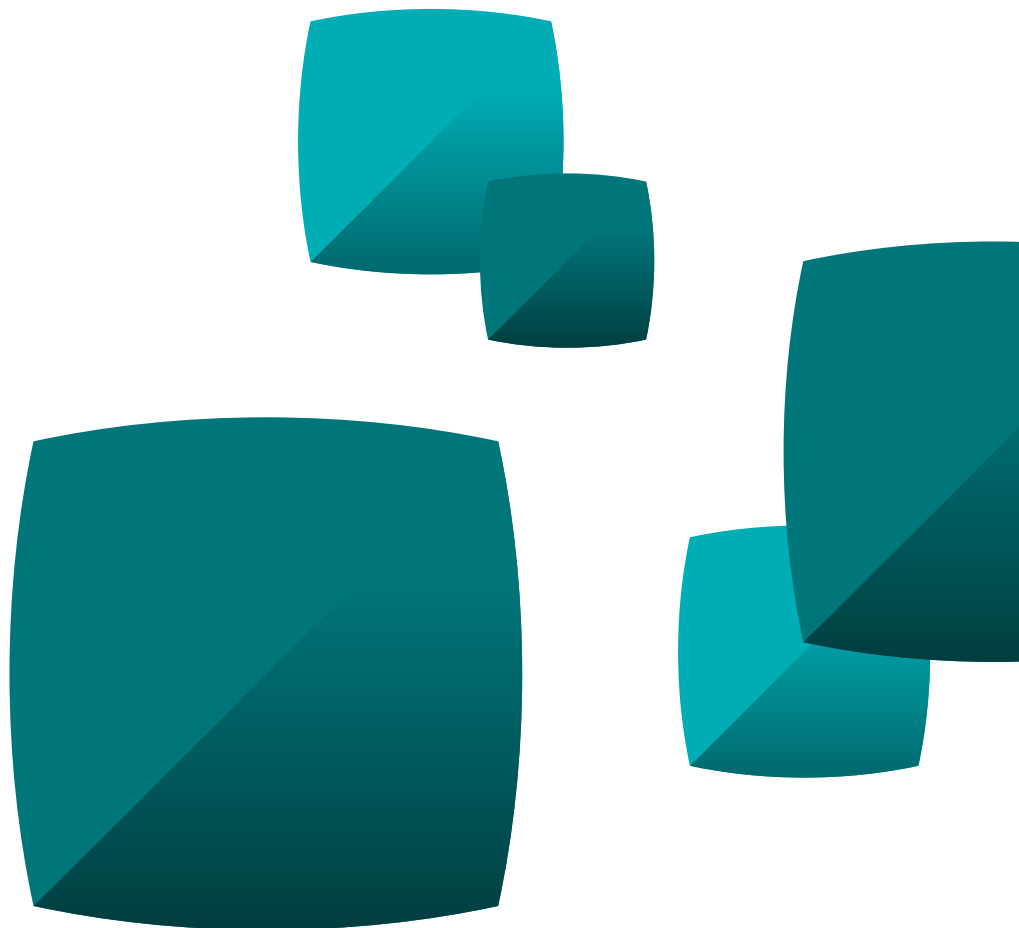


PILLAR 3 DISCLOSURES 2014



**YBS
GROUP**

Contents

1 Overview.....	1
1.1 Background.....	1
1.2 Basis and Frequency of Disclosures.....	1
1.3 Scope.....	1
1.4 Location and Verification.....	2
1.5 Regulatory Developments.....	2
1.6 Recent Developments.....	2
2 Risk Management.....	2
2.1 Risk Management.....	2
3 Capital Adequacy.....	3
3.1 Capital Management.....	3
3.2 Internal Capital Adequacy Assessment Process.....	3
3.3 Total Available Capital.....	4
3.4 Tier 1 Capital.....	5
3.4.1 Common Equity Tier 1 Capital.....	5
3.4.2 Additional Tier 1 Capital.....	5
3.5 Tier 2 Capital.....	5
3.6 Reconciliation of Regulatory Capital to Balance Sheet Capital.....	6
3.7 Capital Flow Statement.....	7
3.8 Minimum Capital Requirement (Pillar 1).....	8
3.9 Capital Adequacy.....	9
3.10 RWA Flow Statement.....	10
3.11 Leverage Ratio.....	10
3.12 Impact of CRD IV.....	11
4 Significant Risk Categories - Credit Risk.....	12
4.1 Credit Risk Overview.....	12
4.2 Credit Risk Exposures.....	12
4.3 Securitisation Positions.....	17
4.4 Impairment Provisions.....	19
4.4.1 Loans Secured by Mortgages on Immovable Property.....	19
4.4.2 Wholesale.....	20
4.5 Credit Risk Concentrations.....	20
4.6 Credit Risk Mitigation.....	21
4.6.1 Loans Secured by Mortgages on Immovable Property.....	21
4.6.2 Wholesale.....	21
4.7 Counterparty Credit Risk for Derivative Contracts.....	22
5.1 Operational Risk Overview.....	23
5.2 Operational Risk Framework.....	23
5.3 Operational Risk Oversight and Governance.....	23
5.4 Operational Risk Monitoring and Reporting.....	23
6 Other Significant Risks - Pillar 2.....	24
6.1 Pillar 2 Overview.....	24
6.2 Interest Rate Risk.....	24
6.3 Pension Risk.....	24
6.4 Concentration Risk.....	25
6.5 Business Risk.....	25
6.6 Capital Planning Stress Test.....	25
6.7 Other Risks.....	25
7 Remuneration.....	25
Glossary of Terms.....	26

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 2014.

CRD IV came in to 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.

Yorkshire Building Society Group ("the Group") has adopted the Pillar 1 standardised approach to credit risk and operational risk, and is also subject to Pillars 2 and 3. The rules are enforced in the UK by the Prudential Regulation Authority (PRA).

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 431-451 of the CRR. Unless otherwise stated, all figures are as at 31 December, the Group's financial year-end.

The introduction of CRD IV on 1 January 2014 means that the 2014 capital position will not be comparable to the capital position reported in 2013 as they are not prepared on the same basis.

Prior year comparatives have been provided on a Basel II basis for information only. Basel II equivalent items have been included on the same line where broadly comparable, e.g. Common Equity Tier 1 (CRD IV) and Core Tier 1 (Basel II).

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 Ltd, which provides 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. 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 deficiency relating to Group legal entities that do not form part of the Capital Group.

Under CRD IV, YBS as a legal entity must also maintain a 'solo' capital requirement. In this area, YBS has made use of provisions laid down in CRD IV (Solo-Consolidation) 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 resource requirements and the reserves of such solo subsidiaries to be aggregated to the parent when calculating capital resources.

The Group entities included under solo consolidation in 2014 were:

Yorkshire Building Society

Accord Mortgages Limited

Norwich & Peterborough (LBS) Ltd

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

In October 2014, European authorities released an amendment to CRD IV that changes the calculation of the leverage ratio. This is based on proposals from the Basel Committee and therefore brings CRD IV in line with global standards.

The key changes are:

- Application of credit conversion factors for off balance sheet exposures to match the capital rules (with 10% floor), which for YBS, largely applies to the mortgage pipeline.
- The ratio will be calculated at a point in time rather than a 3 month average.
- Increased netting for collateral received against derivative positions.

Additionally in October 2014, the Financial Policy Committee (FPC) of the Bank of England released the outcome of its review of the role of the leverage ratio within the UK's capital framework which recommended:

- A base leverage ratio of 3%.
- Systemic leverage buffers added at 35% of the risk weighted buffer.
- Countercyclical buffers can be added, a guideline is 35% of the risk weighted buffer.
- Additional Tier 1 Capital is available to meet a maximum of 25% of the base ratio.

Further details on the leverage ratio can be found in section 3.11.

1.6 Recent Developments

In November 2014, Yorkshire Building Society successfully re-entered the wholesale capital markets to raise £250 million of Tier 2 subordinated debt with a ten-year maturity but an option to call, or early redeem, the debt after 5 years. The transaction was designed to boost the Group's overall capital strength, providing additional protection for members and ensuring the Group remains in a favourable position in anticipation of future regulatory capital requirements currently under development.

Further information can be found in the Strategic Report and Note 29 in the Annual Report and Accounts.

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 structure are intended to provide appropriate and comprehensive monitoring, control and ongoing management of the major risks to which the Group is exposed and 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 efficient manner to ensure that the capital invested by members in the business obtains an appropriate return. 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 the 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. Again, this is in line with its status as a deposit taker and a mutual organisation.

The Group will seek to generate profit to be self-sustainable from a capital perspective based on a long term growth aspiration, although the Group would consider using external capital under certain circumstances.

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 monthly to the Board and quarterly to the Group Risk 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 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 2 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).
- Capital Planning. The Group calculates an additional capital requirement (in addition to the Pillar 1 and Pillar 2 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 Capital Planning Buffer and does not form part of the overall regulatory minimum capital requirement. The existing fixed £ value for Capital Planning Buffer will be replaced by a Capital Conservation Buffer of 2.5% of risk weighted assets by 2019.
- Counter Cyclical Buffer. The Group currently has no requirement to hold additional capital.

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 (ILAA) process.

- Calculation of an appropriate Capital Planning 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 Risk Overlap Committee before being presented to 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 2014 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 2014. The comparative numbers are based on the legislation in force at 31 December 2013 (i.e. they have not been restated).

Table 1 - Capital Resources	Group	Group	Solo	Solo
£m	2014	2013	2014	2013
<u>Common Equity Tier 1 (CET1)/Core Tier 1 Capital¹</u>				
General reserve	1,989.5	1,805.9	1,991.1	1,787.9
Pension scheme adjustment	(51.5)	(3.0)	(51.5)	(3.0)
<u>Deductions from CET1/ Core Tier 1 Capital</u>				
Intangible fixed assets	(35.7)	(34.9)	(35.7)	(34.9)
Material holdings	-	(3.5)	-	(3.6)
Securitisation holdings deducted from capital resources	(27.4)	(7.9)	(27.4)	(7.9)
Deferred tax assets that rely on future profitability	(7.2)	0.0	(7.2)	0.0
Total CET1/ Core Tier 1 capital	1,867.7	1,756.6	1,869.3	1,738.5
<u>Additional Tier 1 Capital</u>				
Permanent Interest Bearing Shares (PIBS)	5.5	6.8	5.5	6.8
Total Tier 1 capital	1,873.2	1,763.4	1,874.8	1,745.3
<u>Tier 2 Capital</u>				
Subordinated liabilities	299.5	48.7	299.5	48.7
Adjustment to subordinated liabilities	(11.2)	(8.2)	(11.2)	(8.2)
Collective provisions for impairment	23.4	12.7	23.4	12.7
<u>Deductions for Tier 2 Capital</u>				
Material holdings	-	(3.5)	-	(3.5)
Securitisation holdings deducted from capital resources	-	(7.9)	-	(7.9)
Total Tier 2 capital	311.7	41.8	311.7	41.8
Other items excluded	-	(5.8)	-	(5.3)
Total capital available	2,184.9	1,799.4	2,186.5	1,781.8

¹ Common Equity Tier 1 (CET1) Capital applies to 2014. Core Tier 1 Capital applies to 2013.

3.4 Tier 1 Capital

Tier 1 capital comprises the general reserve, PIBS and adjustments for items reflected in the general reserve which are treated separately for capital adequacy purposes.

3.4.1 Common Equity Tier 1 Capital

Common Equity Tier 1 Capital comprises:

- Defined benefit scheme pension assets are deducted from Tier 1 capital resources, net of any associated deferred tax liabilities. At 31 December 2014, the net impact of the adjustment was a reduction in Tier 1 capital of £51.5m.
- An adjustment is also made in respect of intangible 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 2014, the deduction amounted to £35.7m.
- Securitisation positions (including resecuritisations) that are unrated or have low external ratings can be risk weighted 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. In the 2013 Pillar 3, this deduction was split, after the deduction of tax, equally between Core Tier 1 and Tier 2.
- Under CRD IV, deferred tax assets that rely on future profitability are to be deducted from CET1 capital.

3.4.2 Additional Tier 1 Capital

Additional Tier 1 Capital includes:

- 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. Under CRD IV subscribed capital is being phased out over a ten year period. Currently 80% of the subscribed capital balance sheet carrying value qualifies as Tier 1 capital.

Full terms and conditions of the Group's Permanent Interest Bearing Shares can be found on the Group's website; http://www.ybs.co.uk/your-society/treasury/wholesale_funding/introduction.html

3.5 Tier 2 Capital

Tier 2 capital comprises the Group's qualifying subordinated liabilities, the collective impairment provision, 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. Following the issuance of £250 million of Tier 2 subordinated debt detailed in section 1.6, the subordinated notes increased considerably in 2014. More details of the subordinated liabilities are included in Note 29 to the Annual Report and Accounts.

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 2014.

Table 2 - Reconciliation of Accounting Capital to Regulatory Capital	Accounting Balance Sheet Capital Value	Adjustments to Balance Sheet Capital Value	Regulatory Capital Value	Ref
£m				
<u>CET1</u>				
Total equity attributable to members	1,960.2			1
<i>Less reserves not included in regulatory capital:</i>				
Hedging reserve		36.8		2
Available for sale reserve		(3.5)		2
Non-consolidated subsidiary		(4.0)		6
Total adjustments to Core Tier 1 resources		29.3		
CET1	1,960.2	29.3	1,989.5	
<u>Regulatory deductions from CET1</u>				
Intangible fixed assets		(35.7)		3
Securitisation holdings deducted from capital resources		(27.4)		3
Defined benefit pension fund assets		(64.4)		3
Deferred tax liability associated with defined pension fund assets		12.9		3
Deferred tax assets that rely on future profitability		(7.2)		
Total regulatory deductions from Core Tier 1 capital		(121.8)		
Total CET1	1,960.2	(92.5)	1,867.7	
<u>Additional Tier 1 capital</u>				
Subscribed capital (Permanent Interest Bearing Shares)	6.9			1
Adjustment to phase out subscribed capital		(1.4)		
Total Additional Tier 1 capital	6.9	(1.4)	5.5	5
Total Tier 1 capital after deductions	1,967.1	(93.9)	1,873.2	
<u>Tier 2 capital</u>				
Collective provisions for impairment	-	23.4	23.4	4
Subordinated liabilities	299.5	(11.2)	288.3	1
Tier 2 capital after deductions	299.5	12.2	311.7	
Total capital resources after deductions	2,266.6	(81.7)	2,184.9	

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 an adjustment of 20% is applied as only 80% of subscribed capital 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 regulatory capital and associated deductions in 2014.

Table 3 - Regulatory Capital Flow Statement		2014	Ref
£m			
<u>Total CET1 Capital</u>			
1 January 2014		1,742.5	
Total comprehensive income in 2014		150.9	1
Losses allocated to available for sale reserve		4.9	2
Profits allocated to hedging reserve		31.9	2
Increase in pension scheme adjustment		(48.5)	
Increase in intangible fixed assets		(0.8)	
Increase in securitisation holdings deducted from capital resources		(11.6)	3
Decrease in deferred tax adjustment		2.4	
Regulatory change in respect of treatment of non-consolidated subsidiary		(4.0)	4
Total CET1 Capital at 31 December 2014		1,867.7	
<u>Additional Tier 1 capital</u>			
1 January 2014		5.4	
Movement in market valuation of PIBS		0.1	
Additional Tier 1 capital at 31 December 2014		5.5	
Total Tier 1 capital at 31 December 2014		1,873.2	
<u>Tier 2 capital</u>			
1 January 2014		53.2	
Capital issued		248.2	5
Movement in fair value adjustments to subordinated liabilities		2.6	
Increase in amortisation of subordinated liabilities		(3.0)	
Increase in collective provisions for impairment		10.7	
Tier 2 capital before deductions at 31 December 2014		311.7	
Total capital available (closing value)		2,184.9	

¹ Statement of Comprehensive Income, Annual Report and Accounts

² Statements of Changes in Members' Interest, Annual Report and Accounts

³ Reduction largely due to ratings upgrades of formerly low rated investments

⁴ See section 1.3 for further details

⁵ See section 1.6 for further details

3.8 Minimum Capital Requirement (Pillar 1)

The following tables show the risk weighted assets (RWA) for each of the Group's exposure classes and the resultant Pillar 1 minimum capital requirements (being 8% of RWAs).

Table 4 - Risk Weighted Assets	Group	Group	Solo	Solo
£m	2014	2013	2014	2013
<u>Loans secured by mortgages on immovable property</u>				
Loans to individuals	10,951.4	10,523.2	10,951.4	10,523.2
Commercial lending (including SME)	357.8	501.9	357.8	501.9
Past due	755.0	437.9	755.0	437.9
Immovable property risk weighted assets	12,064.2	11,463.0	12,064.2	11,463.0
<u>Wholesale exposure classes</u>				
Securitisation positions	137.6	175.1	137.6	175.1
Central government or central banks	-	-	-	-
Covered bonds	-	-	-	-
Financial institutions	349.1	102.3	349.1	102.3
Multilateral development banks	-	-	-	-
Short term claims on financial institutions and corporates	77.0	82.5	76.9	82.2
Wholesale risk weighted assets	563.7	359.9	563.6	359.6
<u>Retail</u>				
Current accounts	1.4	0.4	1.4	0.4
Personal loans	0.1	2.5	0.1	2.5
Retail risk weighted assets	1.5	2.9	1.5	2.9
Operational risk weighted assets	649.2	565.6	764.0	711.8
Other credit risk weighted assets	277.1	204.0	284.7	213.3
Total risk weighted assets	13,555.7	12,595.4	13,678.0	12,750.6

Table 5 - Pillar 1 Requirements £m	Group 2014	Group 2013	Solo 2014	Solo 2013
<u>Loans secured by mortgages on immovable property</u>				
Loans to individuals	876.1	841.8	876.1	841.8
Commercial lending (including SME)	28.6	40.2	28.6	40.2
Past due	60.4	35.0	60.4	35.0
Immovable property requirement	965.1	917.0	965.1	917.0
<u>Wholesale exposure classes</u>				
Securitisation positions	11.0	14.0	11.0	14.0
Central government or central banks	-	-	-	-
Covered bonds	-	-	-	-
Financial institutions	27.9	8.2	27.9	8.2
Multilateral development banks	-	-	-	-
Short term claims on financial institutions and corporates	6.2	6.6	6.2	6.6
Wholesale requirement	45.1	28.8	45.1	28.8
<u>Retail</u>				
Current accounts	0.1	-	0.1	-
Personal loans	-	0.2	-	0.2
Retail requirement	0.1	0.2	0.1	0.2
Operational risk pillar 1 requirement	51.9	45.2	61.1	56.9
Other credit risk assets	22.3	16.3	22.8	17.1
Minimum capital requirement	1,084.5	1,007.5	1,094.2	1,020.0

3.9 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 2014	Group 2013	Solo 2014	Solo 2013
<u>Capital Excess</u>				
Total pillar 1 capital requirement	1,084.5	1,007.5	1,094.2	1,020.0
Total capital resources	2,184.9	1,799.4	2,186.5	1,781.8
Excess of own funds over minimum pillar 1 requirement	1,100.4	791.9	1,092.3	761.8
Total risk weighted assets	13,555.7	12,595.4	13,678.0	12,750.6
CET1/Core Tier 1 capital resources	1,867.7	1,756.6	1,869.3	1,738.5
Tier 1 capital resources	1,873.2	1,763.4	1,874.8	1,745.3
Total capital resources	2,184.9	1,799.4	2,186.5	1,781.8
CET1/Core Tier 1 capital ratio	13.8%	13.9%	13.7%	13.6%
Tier 1 capital ratio	13.8%	14.0%	13.7%	13.7%
Total capital ratio	16.1%	14.3%	16.0%	14.0%

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.

3.10 RWA Flow Statement

The table below shows the causes of movements in risk weighted assets 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	2013 RWAs	Portfolio Quality	Portfolio Growth	Regulatory Changes	Income Growth	2014 RWAs
Loans secured on real estate	11,463.0	(179.6)	823.8	(43.0)	-	12,064.2
Wholesale credit risk	359.9	(17.9)	(19.2)	240.9	-	563.7
Banking credit risk	3.0	-	(1.5)	-	-	1.5
Other credit risk	203.9	-	19.9	53.3	-	277.1
Operational Risk	565.6	-	-	-	83.6	649.2
Total risk weighted assets	12,595.4	(197.5)	823.0	251.2	83.6	13,555.7

3.11 Leverage Ratio

CRD IV also introduces 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 until 2017 for the UK's eight largest institutions, when it will be reviewed before becoming mandatory for all other institutions (including the Group) in 2018. The ratio is calculated as:

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

Table 8 - Leverage Ratio £m	2014
Starting Point: Balance Sheet Assets	37,567.2
Adjustments	
Mortgage pipeline	452.9
Other committed facilities	17.5
Repurchase agreements	1,437.3
Netted derivatives adjustment	5.2
Tier 1 deductions	(121.8)
End Point: Leverage Ratio Assets	39,358.3
Tier 1 Capital Resources	1,873.2
Leverage Ratio %	4.8%

3.12 Impact of CRD IV

As noted in section 1.1, the Basel III regulations have been written in to 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 2014.

Table 9 - CRD IV Capital Position £m	Transitional	Final Rules
<u>Common Equity Tier 1 (CET1)</u>		
General reserve	1,989.5	1,989.5
Regulatory adjustments:		
Available for sale reserve	-	3.5
Pension scheme adjustment	(51.5)	(51.5)
CET1 deductions:		
Intangible fixed assets	(35.7)	(35.7)
Securitisation holdings deducted from capital resources	(27.4)	(27.4)
Deferred tax assets that rely on future profitability	(7.2)	(7.2)
Total CET1 capital	1,867.7	1,871.2
<u>Additional Tier 1 (AT1) Capital</u>		
Permanent Interest Bearing Shares (PIBS)	5.5	-
Total Tier 1 capital	1,873.2	1,871.2
<u>Tier 2 (T2) Capital</u>		
Subordinated liabilities	288.3	288.3
Collective provisions for impairment	23.4	23.4
Total Tier 2 capital	311.7	311.7
Total capital	2,184.9	2,182.9
Current RWAs	13,555.7	13,555.7
Total RWAs under CRD IV	13,555.7	13,555.7
CET1 Ratio	13.8%	13.8%
Tier 1 Ratio	13.8%	13.8%
Solvency Ratio	16.1%	16.2%
Leverage Ratio	4.8%	4.8%

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 (banking & 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 2014	Dec 2014	Average during 2013	Dec 2013
<u>Loans secured by mortgages on immovable property</u>				
Loans to individuals	31,520.3	32,414.0	28,478.6	29,807.9
Commercial lending (including SME)	418.1	415.1	550.2	615.0
Loans secured on immovable property exposure	31,938.4	32,829.1	29,028.8	30,422.9
<u>Wholesale</u>				
Securitisation positions	142.3	133.6	165.6	154.3
Central governments or central banks	8,957.5	9,588.7	4,951.3	7,139.9
Covered bonds	-	-	1.3	-
Financial institutions	2,385.3	2,457.5	1,115.5	2,232.3
Multilateral development banks	-	-	154.4	152.5
Short term claims on institutions and corporates	319.0	348.1	249.0	371.7
Total wholesale exposure	11,804.1	12,527.9	6,637.1	10,050.7
<u>Retail</u>				
Current accounts	2.6	2.4	3.3	2.9
Personal loans	4.7	3.7	7.8	6.1
Total retail exposure	7.3	6.1	11.1	9.0
Other assets exposure	273.2	324.4	243.1	204.0
Total credit risk exposure	44,023.0	45,687.5	35,920.1	40,686.6

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

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

Table 11 - Credit Risk Exposure - Geographic Distribution					
2014	UK	Other European Countries	North America	Rest of the World	Total
£m	2014	2014	2014	2014	
<u>Loans secured by mortgages on immovable property</u>					
Loans to individuals	32,352.6	61.4	-	-	32,414.0
Commercial lending (including SME)	415.1	-	-	-	415.1
Total loans secured on immovable property	32,767.7	61.4	-	-	32,829.1
<u>Wholesale</u>					
Securitisation positions	61.2	44.2	10.7	17.5	133.6
Central governments or central banks	9,588.7	-	-	-	9,588.7
Covered bonds	-	-	-	-	-
Financial institutions	1,141.2	487.5	170.1	658.7	2,457.5
Multilateral development banks	-	-	-	-	-
Short-term claims on institutions and corporates	255.1	1.5	91.5	-	348.1
Total wholesale credit exposure	11,046.2	533.2	272.3	676.2	12,527.9
Total credit risk exposure (excl. retail and other assets)	43,813.9	594.6	272.3	676.2	45,357.0
Table 11 - Credit Risk Exposure - Geographic Distribution					
2013	UK	Other European Countries	North America	Rest of the World	Total
£m	2013	2013	2013	2013	
<u>Loans secured by mortgages on immovable property</u>					
Loans to individuals	29,735.3	72.6	-	-	29,807.9
Commercial lending (including SME)	615.0	-	-	-	615.0
Total loans secured on immovable property	30,350.3	72.6	-	-	30,422.9
<u>Wholesale</u>					
Securitisation positions	85.0	42.9	10.7	15.7	154.3
Central governments or central banks	7,139.9	-	-	-	7,139.9
Covered bonds	-	-	-	-	0.0
Financial institutions	1,045.9	341.1	194.8	650.5	2,232.3
Multilateral development banks	-	152.5	-	-	152.5
Short-term claims on institutions and corporates	369.5	2.1	0.1	-	371.7
Total wholesale credit exposure	8,640.3	538.6	205.6	666.2	10,050.7
Total credit risk exposure (excl. retail and other assets)	38,990.6	611.2	205.6	666.2	40,473.6

The Residual maturity of the exposures is as follows.

Table 12 - Credit Risk Exposure - Residual Maturity	Up to 12	1 to 5	5 to 10	> than 10	
2014	months	years	years	years	Total
£m	2014	2014	2014	2014	
<u>Loans secured by mortgages on immovable property</u>					
Loans to individuals	3,492.8	2,175.2	3,942.1	22,803.9	32,414.0
Commercial lending (including SME)	13.8	38.5	52.0	310.8	415.1
Total loans secured on immovable property	3,506.6	2,213.7	3,994.1	23,114.7	32,829.1
<u>Wholesale</u>					
Securitisation positions	20.1	27.4	-	86.1	133.6
Central governments or central banks	3,652.0	-	373.3	5,563.4	9,588.7
Covered bonds	-	-	-	-	-
Financial institutions	1,402.5	76.2	333.2	645.6	2,457.5
Multilateral development banks	-	-	-	-	-
Short-term claims on institutions and corporates	348.1	-	-	-	348.1
Total wholesale exposure	5,422.7	103.6	706.5	6,295.1	12,527.9
Total credit risk exposure (excl. retail and other assets)	8,929.3	2,317.3	4,700.6	29,409.8	45,357.0
Table 12 - Credit Risk Exposure - Residual Maturity					
2013	Up to 12	1 to 5	5 to 10	> than 10	Total
£m	2013	2013	2013	2013	
<u>Loans secured by mortgages on immovable property</u>					
Loans to individuals	402.7	1,197.4	2,712.9	25,494.9	29,807.9
Commercial lending (including SME)	155.4	43.5	61.8	354.3	615.0
Total loans secured on immovable property	558.1	1,240.9	2,774.7	25,849.2	30,422.9
<u>Wholesale</u>					
Securitisation positions	-	45.1	-	109.2	154.3
Central governments or central banks	3,957.4	2,955.5	227.0	-	7,139.9
Covered bonds	-	-	-	-	-
Financial institutions	1,805.4	5.2	292.7	129.0	2,232.3
Multilateral development banks	-	152.5	-	-	152.5
Short-term claims on institutions and corporates	371.7	-	-	-	371.7
Total wholesale exposure	6,134.5	3,158.3	519.7	238.2	10,050.7
Total credit risk exposure (excl. retail and other assets)	6,692.6	4,399.2	3,294.4	26,087.4	40,473.6

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.

For the purposes of generating risk weightings for its wholesale and asset securitisation exposures, the Group uses Standard and Poor's and 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							2014
Central Government, Central Banks and Multilateral Development Banks							
<u>Credit Quality Step</u>	<u>Risk Weight</u> <u>(<3 months /</u> <u>>3 months)</u>	<u>S&P</u> <u>rating</u>	<u>Fitch</u> <u>rating</u>	<u>Moody's</u> <u>rating</u>	<u>Exposure</u> <u>values</u> <u>£m</u>	<u>Exposure</u> <u>values after</u> <u>mitigation¹</u> <u>£m</u>	
1	0%/0%	AAA to AA-	AAA to AA-	Aaa to Aa3	9,588.7	5,412.3	
Total					9,588.7	5,412.3	
							2013
<u>Credit Quality Step</u>	<u>Risk Weight</u> <u>(<3 months /</u> <u>>3 months)</u>	<u>S&P</u> <u>rating</u>	<u>Fitch</u> <u>rating</u>	<u>Moody's</u> <u>rating</u>	<u>Exposure</u> <u>values</u> <u>£m</u>	<u>Exposure</u> <u>values after</u> <u>mitigation¹</u> <u>£m</u>	
1	0%/0%	AAA to AA-	AAA to AA-	Aaa to Aa3	7,292.4	5,253.3	
Total					7,292.4	5,253.3	

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

2014

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	Exposure
					values	values
					£m	after mitigation ¹ £m
1	20%/20%	AAA to AA-	AAA to AA-	Aaa to Aa3	890.5	186.6
2	20%/50%	A+ to A-	A+ to A-	A1 to A3	1,906.3	437.8
3	20%/50%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	-	-
4	50%/100%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	3.1	3.1
5	50%/100%	B+ to B-	B+ to B-	B1 to B3	-	-
6	150%/150%	CCC+ and below	CCC+ and below	Caa1 and below	5.7	5.7
Unrated	20%/50%	Unrated	Unrated	Unrated	-	-
Total					2,805.6	633.2

Credit Quality Step	Risk Weight (<3 months / >3 months)	S&P rating	Fitch rating	Moody's rating	Exposure	Exposure
					values	values
					£m	after mitigation ¹ £m
1	20%/20%	AAA to AA-	AAA to AA-	Aaa to Aa3	870.4	202.9
2	20%/50%	A+ to A-	A+ to A-	A1 to A3	1,727.3	445.4
3	20%/50%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	-	-
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	6.3	6.3
Unrated	20%/50%	Unrated	Unrated	Unrated	-	-
Total					2,604.0	654.6

2013

4.3 Securitisation Positions

Issued Securitisations

The Group 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 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 risks relating to the underlying mortgage pools therefore remains with the Group and is included in the 'secured by mortgages on immovable property' sections detailed in this document. There are no specific capital requirements for the securitisation vehicles. 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 Society's financial statements. This avoids the 'grossing-up' of the financial statements that would otherwise arise.

To manage interest rate risk the SPEs enter in to derivative transactions. Derivatives relating to securitisations are treated as explained in the derivatives and hedge accounting policy, which can be found in Note 34 of the Annual Report and Accounts.

For Tombac, sub-classes of fixed rate note tranches were issued to provide a degree of natural hedging for the fixed rate loans in the underlying pool of mortgages.

The Society and 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

The total value of notes issued to third parties as at 31 December 2014 is £0.8 billion (31 December 2013: £0.9 billion). A total of £1.1 billion (31 December 2013: £1.2 billion) of mortgage loans are currently pledged as security on these issues. The notes issued are rated by Moody's and Fitch.

Purchased Securitisations

The Group's exposures listed below are used to purchase 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 £m	Exposure Values	
	2014	2013
Collateralised Debt Obligation (CDO)	9.2	7.5
Collateralised Loan Obligation	15.6	25.1
Principal Protected Note	10.7	10.6
UK Prime RMBS	49.7	72.8
UK Buy to Let RMBS	11.6	12.2
Synthetic Collateralised Debt Obligation	36.8	26.1
Total	133.6	154.3

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.

Monthly monitoring of the portfolios is undertaken, including review of statistics of the underlying asset pools and compliance with structural tests where applicable. This is done from use of the investor reports published for each of the investments, and reported to the Wholesale and Commercial Credit Committee on a regular basis.

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

Post 31 December 2014, the whole of the UK prime RMBS has been disposed of, leaving the exposure now limited to buy to let RMBS and Structured Credit.

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
2014**

<u>Credit Quality Step</u>	<u>Risk Weight</u>	<u>S & P rating</u>	<u>Fitch rating</u>	<u>Moody's rating</u>	<u>Exposure values £m</u>
1	20%	AAA to AA-	AAA to AA-	Aaa to Aa3	56.1
2	50%	A+ to A-	A+ to A-	A1 to A3	25.2
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	27.4
Total					108.7

**Table 16 - Resecuritised Positions Exposure Credit Quality Steps
2014**

<u>Credit Quality Step</u>	<u>Risk Weight</u>	<u>S & P rating</u>	<u>Fitch rating</u>	<u>Moody's rating</u>	<u>Exposure values £m</u>
1	40%	AAA to AA-	AAA to AA-	Aaa to Aa3	7.8
2	100%	A+ to A-	A+ to A-	A1 to A3	-
3	225%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	-
4	650%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	17.0
5	Deducted	B+ and below	B+ and below	B1 and below	0.0
Total					24.8

**Table 16 - Securitised Positions Exposure Credit Quality Steps
2013**

<u>Credit Quality Step</u>	<u>Risk Weight</u>	<u>S&P rating</u>	<u>Fitch rating</u>	<u>Moody's rating</u>	<u>Exposure values £m</u>
1	20%	AAA to AA-	AAA to AA-	Aaa to Aa3	80.6
2	50%	A+ to A-	A+ to A-	A1 to A3	23.5
3	100%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	-
4	350%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	10.3
5	Deducted	B+ and below	B+ and below	B1 and below	15.7
Total					130.1

**Table 16 - Resecuritised Positions Exposure Credit Quality Steps
2013**

<u>Credit Quality Step</u>	<u>Risk Weight</u>	<u>S & P rating</u>	<u>Fitch rating</u>	<u>Moody's rating</u>	<u>Exposure values £m</u>
1	40%	AAA to AA-	AAA to AA-	Aaa to Aa3	-
2	100%	A+ to A-	A+ to A-	A1 to A3	8.4
3	225%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	-
4	650%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	15.8
5	Deducted	B+ and below	B+ and below	B1 and below	-
Total					24.2

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 2014. 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 real estate property (£m)	Total	Total
Exposures not subject to fair value	2014	2013
<u>Neither past due nor individually impaired</u>	25,303.3	21,363.3
<u>Past Due</u>		
Up to 3 months	656.2	831.9
3 to 6 months	126.4	156.7
6 to 12 months	59.6	71.4
Over 12 months	23.7	24.1
Possessions	19.2	24.3
Total past due	885.1	1,108.4
Total exposures	26,188.4	22,471.7
Provisions	43.3	38.9
Charge for the year	20.2	18.9
Fair Value Held	-	-

Table 17 - Loans secured on real estate property (£m)	Total	Total
Exposures subject to fair value	2014	2013
<u>Neither past due nor individually impaired</u>	5,591.8	6,588.1
<u>Past Due</u>		
Up to 3 months	441.6	521.0
3 to 6 months	84.6	105.4
6 to 12 months	32.4	41.7
Over 12 months	11.8	12.0
Possessions	23.3	32.5
Total past due	593.7	712.6
Total exposures	6,185.5	7,300.7
Provisions	3.0	7.3
(Credit)/ charge for the year	(4.3)	3.9
Fair Value Held	68.7	99.8

Table 17 - Loans secured on real estate property (£m)	Total 2014	Total 2013
All exposures		
<u>Neither past due nor individually impaired</u>	30,895.1	27,951.4
<u>Past Due</u>		
Up to 3 months	1,097.8	1,352.9
3 to 6 months	211.0	262.1
6 to 12 months	92.0	113.1
Over 12 months	35.5	36.1
Possessions	42.5	56.8
Total past due	1,478.8	1,821.0
Total exposures	32,373.9	29,772.4
Provisions	46.3	46.2
(Credit)/ charge for the year	15.9	22.8
Fair Value Held	68.7	99.8

Impairment is assessed based on the arrears of each loan. Where mortgages are in arrears by 2 months or more, they are individually assessed for impairment. All mortgages that are past due but not 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, 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, temporary interest only concessions, payments arrangements, payment holidays 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 9 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 the Risk Management Report and Note 39 in the Group's Annual Report & 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, and further details of the tools used to perform this assessment are contained in the Risk Management Report in the Group's Annual Report and Accounts. 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 actively 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 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.

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 2014.

Table 18 - Counterparty Credit Risk for Derivative Contracts		
£m	2014	2013
Interest rate contracts	3,451.6	4,240.9
Foreign exchange contracts	1,487.8	598.1
Other contracts	295.8	140.4
Gross positive fair value of contracts	5,235.2	4,979.4
Netting benefits	(4,803.7)	(4,655.5)
Netted current credit exposure	431.5	323.9
Collateral held	(318.4)	(189.3)
Net derivatives credit exposure	113.1	134.6

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 net exposure value of derivatives at 31 December 2014 was £231.6m, which includes uplifts for potential future credit exposure under the mark to market method for assessing counterparty credit risk.

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.

5 Significant Risk Categories - Operational Risk

5.1 Operational Risk Overview

The Group has adopted the standardised approach to operational risk and has defined operational risk as: "the risk of loss arising from inadequate or failed internal processes, people and systems, or from external events; it includes the risk of non-compliance with laws and regulations, and the risk of internal or external fraud".

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 monitoring and loss reporting with oversight and validation activities undertaken as required.
- Three lines of defence articulated and rolled out with sufficient resources available in each line to satisfy Operational Risk framework requirements and ongoing review.
- Stress testing activities undertaken to define the level of capital required to recover from a 1 in 200 year 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 is moving towards 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 and the Group Operational and Regulatory Risk Committee (GORRC). Each committee has defined Terms of Reference allocating their accountability and responsibilities.

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 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 GORRC on a monthly basis to help it fulfil its role of overseeing operational and compliance risks (including conduct risk, i.e. the risk of not delivering fair customer outcomes).

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) and was last subject to the PRA's Supervisory Review and Evaluation Process (SREP) in 2013. Following the SREP, the PRA set an Individual Capital Guidance (ICG) for the Group.

The process is led by the Strategy and Insight 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 risk appetite 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:

- Retail Credit Risk (to individuals secured on real estate property).¹
- Wholesale Credit Risk.¹
- Interest Rate & Market Risk.
- Pension Risk.
- Operational, Fraud & Conduct Risk.¹
- Concentration Risk.
- Commercial Credit Risk.¹
- Banking Risk.¹
- Structured Credit Risk.¹
- 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. See below for further details.

Additional capital is required to be held in the form of the "Capital Planning 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 its interest rate exposure in four areas: repricing risk, prepayment risk, pipeline risk and basis risk. This stress testing involves the consideration of a range of upward or downward rate shocks and forms part of the ICAAP.

6.3 Pension Risk

The risk of the Group's defined benefit pension obligations has been modelled, with the help of external actuaries, by identifying the key factors likely to affect future obligations to fund the existing liabilities, namely:

- Interest rates (the AA corporate bond yield).
- Implied inflation rates.
- Life expectancy assumptions.
- Asset values

The Group has taken these assumptions and stressed them severely to assess the quantity of Pillar 2 capital requirement for pension obligation risk. 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 Capital Planning 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 Capital Planning 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 submission.

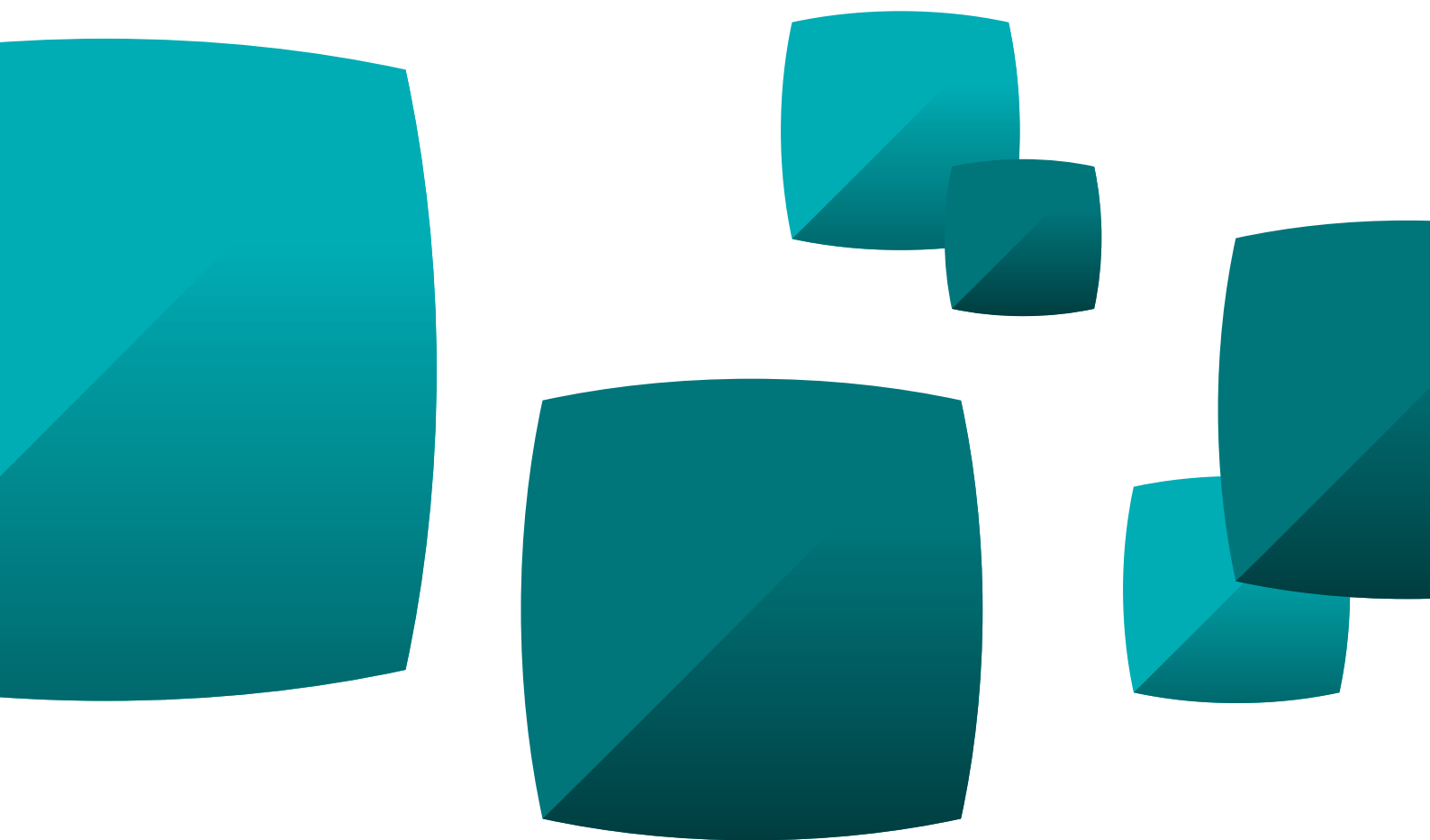
7 Remuneration

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.

Glossary of Terms

Basel II Framework / Basel II	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. The Accord is structured around Pillars 1, 2 & 3, became law in the EU Capital Requirements Directive, and was implemented in the UK in the FSA/PRA Handbook. This framework was in place until 31 December 2013 and all disclosures (with the exception of specific Basel III comparisons in section 3.12) are under the Basel II basis.
Basel III Framework / Basel III	The Basel Committee on Banking Supervision's updated framework on capital adequacy; this came in to force in Europe on 1 January 2014 through the 'CRD IV' legislation.
BIPRU	The Prudential Sourcebook for banks, building societies and investment firms which forms part of the PRA Handbook for Basel II.
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.
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.
CQS (Credit Quality Steps)	A credit quality assessment scale as set out in BIPRU 3.4 (Risk weights under the standardised approach to credit risk) and BIPRU 9 (Securitisation).
CRD IV	A package of legislation incorporating a Regulation and a Directive 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.
ECAI	External Credit Assessment Institution. 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.
Guarantee	An agreement by a third party to cover the potential loss to a credit institution should a specified counterparty default on their obligations.
ICA	Internal Capital Assessment – the document produced as a result of the ICAAP.
ICAAP	Internal Capital Adequacy Assessment Process. The process the Group follows to determine capital requirements under Basel II Pillar 2.
ICG	Individual Capital Guidance. The minimum amount of capital the Group should hold as set by the PRA under Basel II Pillar 2.
ILAA	Individual Liquidity Adequacy Assessment. 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 which have been assessed and there is evidence to suggest that the Group will not receive all of the cash flows or there is an expectation that these will be received at a later date.
Individually impaired loans	Where retail or commercial mortgages are in arrears by two months or more, they are individually assessed for impairment.
ISDA	International Swaps and Derivatives Association is the global trade association for over-the-counter (OTC) derivatives, and providers of the industry-standard ISDA documentation.
LIBOR (London Interbank Offered Rate)	A benchmark interest rate which banks can borrow funds from other banks in the London interbank market.
LTV	Loan-To-Value. A ratio showing outstanding mortgage balance as a percentage of the value of the property.
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.

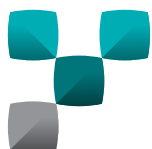
Minimum Capital Requirement	The minimum amount of regulatory capital that a financial institution must hold to meet the Pillar 1 requirements for credit and operational risk.
Netting	The ability to reduce credit risk exposures by offsetting the value of any deposits against loans to the same counterparty.
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 have missed their monthly repayment amount.
PIBS	Permanent Interest Bearing Shares. Unsecured, sterling denominated Tier 1 capital instruments repayable at the option of the Society.
Pillar 1	The part of the Basel II Framework which sets out the regulatory minimum capital requirements for credit and operational risk.
Pillar 2	The part of the Basel II 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 II 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.
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.
Provisions	Amounts set aside to cover incurred losses associated with credit risks.
Resecuritisation	A securitisation transaction or scheme that includes at least one securitisation within its underlying asset pool.
RWA	Risk weighted assets. 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.
SREP	Supervisory Review and Evaluation Process, the PRA assessment of a firm's own capital assessment (ICA) under Basel II 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.
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.



References to 'YBS Group' or 'Yorkshire Group' refer to Yorkshire Building Society, the trading names under which it operates (Barnsley Building Society, the Barnsley, 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.

Yorkshire Building Society Charitable Foundation Registered Charity No: 1069082.

Marie Cure Cancer Care, Registered Charity No. 207994 in England and Wales, Sco38731 in Scotland.



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