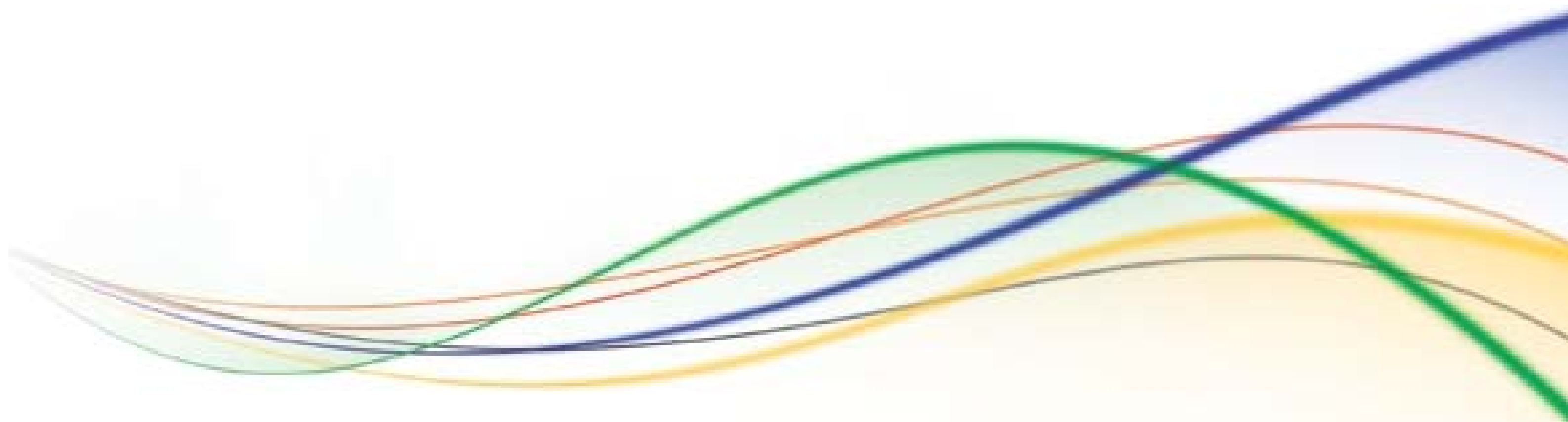
PILLAR 3
DISCLOSURES 2013



Contact
Tanya Jackson
Corporate Affairs Manager
Email: tjjackson@ybs.co.uk

Contents

1 Overview ... 4
- 1.1 Background ... 4
- 1.2 Basis and Frequency of Disclosures ... 4
- 1.3 Scope ... 4
- 1.4 Location and Verification ... 5
- 1.5 Remuneration Disclosures ... 5
- 1.6 Regulatory Developments ... 5
- 1.7 Recent Developments – Capital Buy Back & Portfolio Sale ... 5
- 1.8 Restatement of 2012 Capital Resources ... 6

2 Risk Management Objectives and Policies ... 7
- 2.1 Risk Management Objectives ... 7
- 2.2 Risk Appetite ... 7
- 2.3 Risk Management Framework ... 7
- 2.4 Risk Identification, Measurement and Control ... 8
- 2.5 Risk Oversight ... 8
- 2.6 Risk Monitoring and Reporting ... 9

3 Capital Adequacy ... 10
- 3.1 Capital Management ... 10
- 3.2 Internal Capital Adequacy Assessment Process ... 10
- 3.3 Total Available Capital ... 12
- 3.4 Tier 1 Capital ... 12
- 3.5 Tier 2 Capital ... 13
- 3.6 Reconciliation of Regulatory Capital to Balance Sheet Capital ... 14
- 3.7 Capital Flow Statement ... 15
- 3.8 Minimum Capital Requirement (Pillar 1) ... 17
- 3.9 Capital Adequacy ... 19
- 3.10 RWA Flow Statement ... 19
- 3.11 Leverage Ratio ... 19
- 3.12 Impact of CRD IV ... 20

4 Significant Risk Categories - Credit Risk ... 21
- 4.1 Credit Risk Overview ... 21
- 4.2 Credit Risk Exposures ... 21
- 4.3 Asset Securitisation ... 25
- 4.4 Impairment Provisions ... 27
  - 4.4.1 Loans Secured on Real Estate Property ... 27
  - 4.4.2 Wholesale ... 29
- 4.5 Credit Risk Concentrations ... 29
- 4.6 Credit Risk Mitigation ... 29
  - 4.6.1 Loans Secured on Real Estate Property ... 29
  - 4.6.2 Wholesale ... 30
- 4.7 Counterparty Credit Risk for Derivative Contracts ... 31

5 Significant Risk Categories - Operational Risk ... 32
- 5.1 Operational Risk Overview ... 32
- 5.2 Operational Risk Framework ... 32
- 5.3 Operational Risk Oversight and Governance ... 32
- 5.4 Operational Risk Monitoring and Reporting ... 32

6 Other Significant Risks - Pillar 2 ... 34
- 6.1 Pillar 2 Overview ... 34
- 6.2 Interest Rate Risk ... 34

6.3 Pension Risk 35
6.4 Concentration Risk 35
6.5 Business Risk 35
6.6 Capital Planning Stress Test 35
6.7 Other Risks 35
Glossary of Terms 36

Tables

Table 1 - Capital Resources....12
Table 2 - Reconciliation of Accounting Capital to Regulatory Capital....14
Table 3 - Regulatory Capital Flow Statement....15
Table 4 - Risk Weighted Assets....17
Table 5 - Pillar 1 Requirements....18
Table 6 - Capital Adequacy....19
Table 7 - RWA Flow Statement....19
Table 8 - CRD IV Capital Position....20
Table 9 - Credit Risk Exposure....21
Table 10 - Loans Secured on Real Estate Property Geographic Distribution....22
Table 11 - Wholesale Exposure - Geographic Distribution....22
Table 12 - Credit Risk Exposure - Residual Maturity....23
Table 13 - Sovereign Exposure Credit Quality Steps....24
Table 14 - Wholesale Exposure Credit Quality Steps....24
Table 15 - Securitised Assets by Investment Type....25
Table 16 - Securitised Asset Exposure Credit Quality Steps....26
Table 17 - Impairment Provisions - Loans Secured on Real Estate Property....27
Table 18 - Counterparty Credit Risk for Derivative Contracts....31

1 Overview

1.1 Background

This document is prepared under the BIPRU capital rules in place on 31 December 2013, the effective date of the document. These rules were introduced in the UK by the Financial Services Authority, which was replaced by the Prudential Regulation Authority (PRA) in 2013, to implement the European Union Capital Requirements Directive (CRD) which came into effect on 1 January 2007.

The Basel II framework (upon which the Capital Requirements Directive was based) consists of three “pillars”. 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. The aim of Pillar 3 is to improve market discipline by requiring firms to publish certain details of their risks, capital and risk management.

Yorkshire Building Society Group (“the Group”) adopted the Pillar 1 standardised approach to credit risk and operational risk from 1 January 2008. It also became subject to Pillars 2 and 3 from that date.

The Basel II framework has been replaced by Basel III from 2014, see section 1.6 for details.

1.2 Basis and Frequency of Disclosures

This disclosure document has been prepared by the Group in accordance with the requirements of Pillar 3. Unless otherwise stated, all figures are as at 31 December 2013, 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. The Basel II Framework 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:

- There is one Group company (computer services provider Yorkshire Key Services Ltd) that, due to the non-financial nature of its activities, is outside the scope of the Basel II framework to be included for capital purposes, but is fully consolidated in the Annual Report and Accounts. This company is immaterial in its impact on Group capital positions.
- Some definitions of assets and capital differ between the regulatory capital adequacy rules and the statutory accounting balance sheet standards; Table 2 gives a detailed reconciliation of accounting capital values to regulatory capital values.

There are no restrictions or impediments to the movement of capital between legal entities within the consolidated Capital Group, and there is no material capital surplus or deficiency for legal entities that comprise the statutory accounting group but not the Capital Group.

Under PRA rules, YBS as a legal entity must also maintain a solo capital requirement. In this area, YBS has made use of the provisions laid down in BIPRU 2.1 (Solo consolidation) to provide capital resources and requirements to the PRA under a solo consolidated basis. This enables both the major 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 principal subsidiaries included under solo consolidation in 2013 were:

- Yorkshire Building Society
- Accord Mortgages Limited
- Norwich & Peterborough (LBS) Ltd

Further details of the 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 Risk Committee on behalf of the Group's Board and are published on the Group's corporate website (www.ybs.co.uk). The disclosures are subject to periodic internal independent review by Group Internal Audit but 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 Remuneration Disclosures

The Group's full remuneration disclosures for 2013 can be found on pages 52 to 72 of the Annual Report and Accounts, which can be found on the Group's Internet site.

1.6 Regulatory Developments

The Basel III regulations have been written in to European law in the form of a Regulation and Directive commonly known as CRD IV, which came in to force on 1 January 2014. The disclosures in this document are therefore under the Basel II rules that were in place as at 31 December 2013; however, an illustration of the Group's position under CRD IV rules is provided in Table 8.

1.7 Recent Developments – Capital Buy Back & Portfolio Sale

In 2013, the Group bought back £75m of Tier 2 capital in a transaction designed to improve longer term capital generation by reducing interest payments.

In the shorter term this has had the impact of reducing the Total Capital Ratio, with a smaller reduction in the Core Tier 1 and Tier 1 ratios, though as noted above, the transaction will strengthen Core Tier 1 capital generation in the medium term.

In 2013, the Group also sold a £200m equity release mortgage book inherited from the merger with Chelsea Building Society in 2010. This sale removes the uncertainties about the future profitability of the book and reduces associated capital requirements. Further information on both of these developments can be found in the Strategic Report, page 18 of the Annual Report and Accounts.

1.8 Restatement of 2012 Capital Resources

A restatement of 2012 reserves was made as part of the 2013 Annual Report and Accounts, to reflect changes in accounting policy. The restatement of prior year reserves has been incorporated into the 2012 comparison figures for capital resources in tables 1, 3 and 6 of these disclosures. Further information on the restatement can be found in the Group's Annual Report and Accounts, page 85.

2 Risk Management Objectives and Policies

2.1 Risk Management Objectives

The activities of financial institutions inevitably involve a degree of risk taking. With this in mind the Group's risk management framework and governance structure is intended to provide appropriate and comprehensive monitoring, control and ongoing management of the major risks to which it is exposed, so as to protect its customers and ensure the security of its members' funds. 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.

2.2 Risk Appetite

The Board has defined its risk appetite as part of its overall risk management strategy. At a more pragmatic level, the Group's risk appetite is used for several practical purposes:

- To provide an objective measure against which the Group's various risk committees can measure the Group's current and proposed risk positions, ensuring compliance with the strategic direction set by the Board
- To provide a set of measures against which management can look to optimise the risk versus reward equation
- To provide a base for setting objective measures for different parts of the business, giving them clarity over the parameters within which they must operate.

The Group's overall statement of business risk appetite is:

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

Underneath this overall statement of appetite are a number of specific risk appetites:

- Retail Credit Risk Appetite
- Wholesale Credit Risk Appetite
- Liquidity and Funding Risk Appetite
- Market Risk Appetite
- Operational Risk Appetite
- Conduct Risk Appetite
- Business Risk Appetite

2.3 Risk Management Framework

The Group's risk management framework and governance structure provides a mechanism for proactively identifying and addressing the key risks to the achievement of the Group's objectives.

The Board is ultimately responsible for every aspect of the Group's activities. In particular, its role is to focus on the Group's strategy and ensure that the necessary resources are in place to meet its objectives and to ensure that robust financial controls and systems of risk management are in place.

2.4 Risk Identification, Measurement and Control

The Group has a framework of consistently articulated risk appetites and a regularly updated Group Risk Map by which the Group aims to identify the major sources of risk to its strategic objectives, its assets and operations. The Group then deploys appropriate measures to control and monitor those risks. The key risks are plotted on the Group Risk Map with their position determined by the assessment of net impact and likelihood of occurrence, together with an assessment of confidence in our capability to manage the risk effectively. Supporting each risk assessment is a risk dashboard that integrates all the relevant information about the risk, including key risk indicators, control assessments, audit and compliance points, emerging issues, and actions being taken. The risk dashboards are updated monthly and reviewed by the Group's Executives in detail on a quarterly basis. The Group Risk Committee reviews the dashboards relating to the most significant risks on a quarterly basis. On an annual basis, the Group Risk Map is completely refreshed via a "blank sheet" exercise, going back to first principles.

The individual risks, and the Group's response to them, are considered in more detail within the context of the risk committees established to oversee them under delegated authority of the Board, see below. The risk categories into which the key risks to the Group can be categorised are in turn considered as part of the Group's ICAAP (Internal Capital Adequacy Assessment Process).

2.5 Risk Oversight

The Group Risk Committee has been established by the Board to oversee the Group's risk governance framework and to provide an entity-wide perspective on all risk matters. It comprises four non-executive directors and is usually attended by the Group's other non-executive directors, senior executive directors and the Group's Chief Risk Officer. Its primary responsibilities are detailed on page 46 of the 2013 Annual Report and Accounts.

The Group Risk Committee has put in place a suite of risk management policies which document the Group's approach to risk management across its major risk categories, the governance structure it has put in place, responsibilities of individual risk committees and functions within the risk framework. There is also a comprehensive set of limits and triggers used by the Board and its sub committees to monitor the risk profile of the Group against its risk appetite.

The Group's approach to risk management is founded on robust corporate governance practices and a clear risk culture demonstrating that all are accountable for risk management. The Board takes the lead by establishing the tone from the top including an effective Board Risk Committee (the Group Risk Committee).

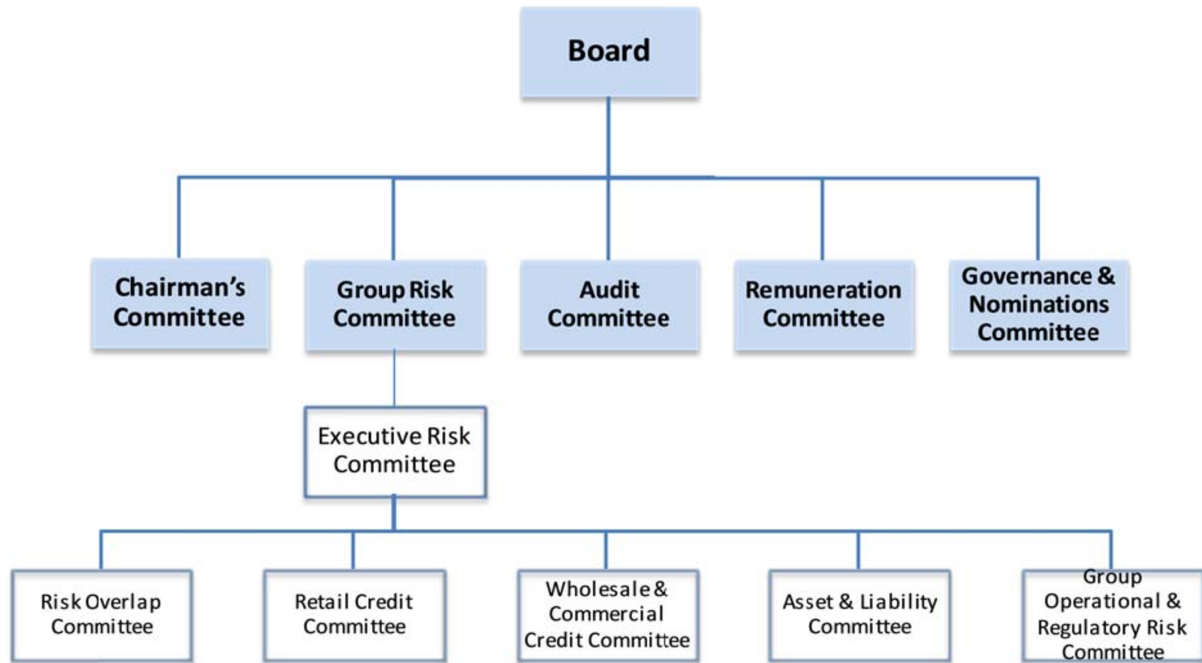
The industry best practice, and the Group's practice, of a three lines of defence risk management model is appropriate and allows for clear accountability where demarcation between the lines of defence exists. The core roles of each line of defence are defined as follows:

1st Line of Defence
Day to day accountability for running the business, within a clear risk and control framework (e.g., appetite, policy, controls, outcome testing) to assess, control and mitigate risks.

2nd Line of Defence
Substantially the Group Risk function and the Governance Committees supporting, coaching, independently overseeing/challenging, and if necessary giving direct instruction.

3rd Line of Defence
The Internal Audit function providing independent assurance including the effectiveness of internal controls and of policy implementation.

The risk governance committee structure of the Group is illustrated in the following diagram:



2.6 Risk Monitoring and Reporting

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

3 Capital Adequacy

3.1 Capital Management

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

- The maintenance of sufficient quality and quantity of regulatory capital to meet solvency requirements and to ensure the Group's risk appetite is not breached. This relates to both current and projected capital (i.e. the levels of capital in light of the Group's strategy and corporate plans, current capital and risk weighted assets combined with future balance sheet movements and profitability, and with the potential for raising external capital).
- The maintenance of sufficient capital strength within the balance sheet to provide comfort to interested third parties, and to safeguard access to wholesale markets and maintain investor confidence.
- The efficient and effective allocation of capital across the Group's operations. Again, this is commensurate with its status as a deposit taker and a mutual organisation.

The Group targets a level of capital that appropriately balances the efficient usage of its financial resources with a suitable level of protection against risk. In setting the desired levels of capital, the Group considers its current and future risk profile, results of stress and scenario testing and additional levels of buffer to ensure that it is able to operate even in an adverse environment.

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 also included in the monthly packs of the 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 laid out in the PRA's rulebooks. The Group has adopted the standardised approach to both credit and operational risk since 1 January 2008 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.
- 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.

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 severe 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 2013 and throughout the year, the Group complied with the capital requirements that were in force as set out by the PRA. The following table shows the breakdown of the total available capital for the capital group and solo-consolidated group as at 31 December 2013:

Table 1 - Capital Resources £m	Group Dec-2013	Group Dec-2012	Solo Dec-2013	Solo Dec-2012
Core Tier 1 Capital				
General reserve	1,805.9	1,694.4	1,787.9	1,712.9
Pension scheme adjustment	(3.0)	(16.6)	(3.0)	(16.6)
Deductions from Core Tier 1 Capital				
Intangible fixed assets	(34.9)	(34.3)	(34.9)	(34.2)
Material holdings	(3.5)	(1.7)	(3.6)	(1.7)
Securitisation holdings deducted from capital resources	(7.9)	(11.6)	(7.9)	(11.6)
Total Core Tier 1 capital	**1,756.6**	**1,630.2**	**1,738.5**	**1,648.8**
Additional Tier 1 Capital				
Permanent Interest Bearing Shares (PIBS)	6.8	7.3	6.8	7.3
Total Tier 1 capital	**1,763.4**	**1,637.5**	**1,745.3**	**1,656.1**
Tier 2 Capital				
Subordinated liabilities	48.7	122.8	48.7	122.8
Adjustment to subordinated liabilities	(8.2)	(5.6)	(8.2)	(5.6)
Collective provisions for impairment	12.7	6.3	12.7	6.3
Deductions for Tier 2 Capital				
Material holdings	(3.5)	(1.7)	(3.5)	(1.7)
Securitisation holdings deducted from capital resources	(7.9)	(11.6)	(7.9)	(11.6)
Total Tier 2 capital	**41.8**	**110.2**	**41.8**	**110.2**
Other items excluded	(5.8)	(4.1)	(5.3)	(6.0)
Total capital available	**1,799.4**	**1,743.6**	**1,781.8**	**1,760.3**

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.

- Defined benefit scheme pension assets are deducted from Tier 1 capital resources, net of any associated deferred tax liabilities. At 31 December 2013, the net impact of the adjustment was a reduction in Tier 1 capital of £3.0m.
- 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 2013, £34.9m has been deducted from capital in respect of intangible assets.
- Securitisation positions (including resecuritisations) that are unrated or have low external ratings can be risk weighted at 1250% or deducted from capital resources, with deductions applied equally between Tier 1 and Tier 2. In 2013, the Group deducted £7.9m from Tier 1 and £7.9m from Tier 2 capital relating to low rated and unrated securitisations.

- 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.

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. More details of the subordinated liabilities are included in note 29 to the Annual Report and Accounts. For regulatory capital purposes, the value of any subordinated liabilities is amortised in the last 5 years to maturity. Following the buy back of Tier 2 capital detailed in section 1.7, the subordinated notes reduced considerably in 2013.
- To the extent that collective provisions for impairment have been recognised in the income and expenditure account these 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 translate to a regulatory capital equivalent for the Group at December 2013:

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.
Core Tier 1 Capital				
Total equity attributable to members	1,809.4			1
Less reserves not included in regulatory capital:				
Hedging reserve		4.9		2
Available for sale reserve		(8.4)		2
Total adjustments to Core Tier 1 resources		(3.5)		
Core Tier 1 capital before deductions	**1,809.4**	**(3.5)**	**1,805.9**	
Regulatory deductions from Core Tier 1 capital				
Intangible fixed assets		(34.9)		3
Material holdings		(3.5)		3
Securitisation holdings deducted from capital resources		(7.9)		3
Defined benefit pension fund assets		(3.8)		3
Deferred tax liability associated with defined pension fund assets		0.8		3
Total regulatory deductions from Core Tier 1 capital		(49.3)		
Total Core Tier 1 capital after deductions	**1,809.4**	**(52.8)**	**1,756.6**	
Additional Tier 1 capital				
Subscribed capital (Permanent Interest Bearing Shares)	6.8		6.8	1
Total Tier 1 capital after deductions	**1,816.2**	**(52.8)**	**1,763.4**	
Tier 2 capital				
Collective provisions for impairment		12.7	12.7	4
Subordinated liabilities	48.7			1
Regulatory amortisation of subordinated liabilities		(8.2)		3
Subordinated liabilities (regulatory value)			40.5	3
Tier 2 capital before deductions	**48.7**	**4.5**	**53.2**	
Deductions from Tier 2 capital				
Material holdings		(3.5)		3
Securitisation holdings deducted from capital resources		(7.9)		3
Total Tier 2 capital after deductions	**48.7**	**(6.9)**	**41.8**	
Deductions from total capital resources				
Qualifying investments in non-financial subsidiaries		(5.8)		3
Total capital resources after deductions	**1,864.9**	**(65.5)**	**1,799.4**	

References:
1 – Statements of Financial Position, Annual Report and Accounts, Page 81
2 – Statements of Changes in Members' Interest, Annual Report and Accounts, Page 82
3 – Pillar 3 Disclosures, Table 1
4 – Note 9 (Impairment), Annual Report and Accounts, Page 97

3.7 Capital Flow Statement

The table below shows the flow of regulatory capital and associated deductions in 2013:

Table 3 - Regulatory Capital Flow Statement £m	2013
Total Core Tier 1 Capital	
Opening value	1,630.2
Total comprehensive income in 2013[1]	167.9
- losses allocated to available for sale reserve[2]	14.5
- profits allocated to hedging reserve[2]	(54.4)
- reallocation of tax[2]	(16.5)
Reduction in pension scheme adjustment	13.6
Increase in intangible fixed assets	(0.6)
Reduction in securitisation holdings deducted from capital resources[3]	3.7
Increase in material holdings due to additional investment[4]	(1.8)
Total Core Tier 1 capital (closing value)	**1,756.6**
Additional Tier 1 capital	
Opening value	7.3
Movement in market valuation of PIBS	(0.5)
Additional Tier 1 capital (closing value)	**6.8**
Total Tier 1 capital (closing value)	**1,763.4**
Tier 2 capital	
Opening value	110.2
Redeemed capital[5]	(74.1)
Changes in adjustment for amortisation of subordinated liabilities	(2.6)
Increase in collective provisions for impairment	6.4
Reduction in securitisation holdings deducted from capital resources[3]	3.7
Increase in material holdings due to additional investment[4]	(1.8)
Tier 2 capital before deductions	**41.8**
Other items excluded:	
Opening value	(4.1)
Increase in reserves of deducted subsidiary	(1.7)
Closing value	(5.8)
Total capital available (closing value)	**1,799.4**

[1] Please see Statements of Comprehensive Income, Annual Report and Accounts, page 80
[2] Please see Statements of Changes in Members' Interest, Annual Report and Accounts, page 82
[3] Reduction largely due to ratings upgrades of formerly low rated investments
[4] A further investment was included as a material holding in 2013
[5] Please see section 1.7 for further details

3.8 Minimum Capital Requirement (Pillar 1)

The following table shows the risk weighted assets (RWA) for each of the Group's exposure classes:

Table 4 - Risk Weighted Assets £m	Group Dec-2013	Group Dec-2012	Solo Dec-2013	Solo Dec-2012
Loans secured on real estate property classes				
Loans to individuals	10,952.5	10,431.2	10,952.5	10,431.2
Commercial lending	510.5	445.6	510.5	445.6
Exposures secured on real estate property risk weighted assets	**11,463.0**	**10,876.8**	**11,463.0**	**10,876.8**
Wholesale exposure classes				
Asset securitisation	175.1	80.7	175.1	80.7
Central government or central banks	0.0	0.0	0.0	0.0
Covered bonds	0.0	0.5	0.0	0.5
Financial institutions	102.3	105.1	102.3	105.1
Multilateral development banks	0.0	0.0	0.0	0.0
Short term claims on financial institutions and corporates	82.5	44.3	82.2	44.0
Wholesale risk weighted assets	**359.9**	**230.6**	**359.6**	**230.3**
Banking & Personal loans				
Current accounts	0.4	1.1	0.4	1.1
Personal loans	2.5	3.2	2.5	3.2
Banking risk weighted assets	**2.9**	**4.3**	**2.9**	**4.3**
Operational risk weighted assets	565.6	538.7	711.8	623.8
Other credit risk weighted assets	204.0	255.3	213.3	266.0
Total risk weighted assets	**12,595.4**	**11,905.7**	**12,750.6**	**12,001.2**

Pillar 1 minimum capital requirements are defined as 8% of risk weighted assets:

Table 5 - Pillar 1 Requirements £m	Group Dec-2013	Group Dec-2012	Solo Dec-2013	Solo Dec-2012
Loans secured on real estate property classes				
Loans to individuals	876.2	834.5	876.2	834.5
Commercial lending	40.8	35.6	40.8	35.6
Exposures secured on real estate property pillar 1 requirement	**917.0**	**870.1**	**917.0**	**870.1**
Wholesale exposure classes				
Asset securitisation	14.0	6.5	14.0	6.5
Central government or central banks	0.0	0.0	0.0	0.0
Covered bonds	0.0	0.0	0.0	0.0
Financial institutions	8.2	8.4	8.2	8.4
Multilateral development banks	0.0	0.0	0.0	0.0
Short term claims on financial institutions and corporates	6.6	3.6	6.6	3.5
Wholesale credit risk pillar 1 requirement	**28.8**	**18.5**	**28.8**	**18.4**
Banking & Personal loans				
Current accounts	0.0	0.1	0.0	0.1
Personal loans	0.2	0.3	0.2	0.3
Banking credit risk pillar 1 requirement	**0.2**	**0.4**	**0.2**	**0.4**
Operational risk pillar 1 requirement	45.2	43.1	56.9	49.9
Other credit risk assets	16.3	20.4	17.1	21.3
Minimum capital requirement	**1,007.5**	**952.5**	**1,020.0**	**960.1**

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 Dec-2013	Group Dec-2012	Solo Dec-2013	Solo Dec-2012
Capital Excess				
Total pillar 1 capital requirement	1,007.5	952.5	1,019.8	960.1
Total capital resources	1,799.4	1,743.6	1,781.8	1,760.3
Excess of own funds over minimum pillar 1 requirement	**791.9**	**791.1**	**762.0**	**800.2**
Capital Ratios				
Total risk weighted assets	12,595.4	11,905.7	12,750.6	12,001.2
Core Tier 1 capital resources	1,756.6	1,630.2	1,738.5	1,648.8
Tier 1 capital resources	1,763.4	1,637.5	1,745.3	1,656.1
Total capital resources	1,799.4	1,743.6	1,781.8	1,760.3
Core Tier 1 capital ratio	**13.9%**	**13.7%**	**13.6%**	**13.7%**
Tier 1 capital ratio	**14.0%**	**13.8%**	**13.7%**	**13.8%**
Total capital ratio	**14.3%**	**14.6%**	**14.0%**	**14.7%**

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. See section 1.7 for details of portfolio disposal.

Table 7 - RWA Flow Statement £m	2012 RWAs	Portfolio Quality	Portfolio Growth	Portfolio Disposal	Income Growth	2013 RWAs
Loans secured on real estate	10,876.8	-177.9	969.4	-205.3	0.0	11,463.0
Wholesale credit risk	230.6	117.4	11.9	0.0	0.0	359.9
Banking credit risk	4.3	0.0	-1.4	0.0	0.0	2.9
Other credit risk assets	255.3	0.0	-51.3	0.0	0.0	204.0
Operational risk	538.7	0.0	0.0	0.0	26.9	565.6
Total risk weighted assets	**11,905.7**	**-60.5**	**928.6**	**-205.3**	**26.9**	**12,595.4**

3.11 Leverage Ratio

The leverage ratio is a new capital adequacy measure prescribed under CRD IV. It is a non-risk based ratio comparing capital resources to an adjusted measure of total on and off balance sheet assets. As this is a CRD IV measure, the leverage ratio is included in the analysis of CRD IV impact within section 3.12.

3.12 Impact of CRD IV

As noted in section 1.6, the Basel III regulations have been written in to European law in the form of a Regulation and Directive commonly known as CRD IV, which comes in to force on 1 January 2014. These rules make substantial changes to the definition of capital resources and include additional capital requirements (for example, for counterparty credit risk). The Group's PIBS will cease to be eligible capital for regulatory purposes and will be phased out over a 10 year period, in line with the new regulations. As noted above, a leverage ratio measure is also introduced under the proposals.

This section is intended to assist in understanding how the upcoming regulations will affect the Group's capital position. The table below shows the capital position under the current Basel II rules, a transitional basis (applying the CRD IV rules as they stand, under PRA national implementation, in 2014) and 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 2013:

Table 8 - CRD IV Capital Position £m	Current Rules	Transitional	Final Rules
Common Equity Tier 1 (CET1)			
General reserve	1,805.9	1,805.9	1,805.9
Regulatory adjustments:			
Available for sale reserve	0.0	0.0	8.4
Pension scheme adjustment	(3.0)	(3.0)	(3.0)
CET1 deductions:			
Intangible fixed assets	(34.9)	(34.9)	(34.9)
Securitisation holdings deducted from capital resources	(7.9)	(15.7)	(15.7)
Material holdings	(3.5)	0.0	0.0
Deferred tax assets that rely on future profitability	0.0	(9.8)	(9.8)
Total Common Equity Tier 1 capital	**1,756.6**	**1,742.5**	**1,750.9**
Additional Tier 1 (AT1) Capital			
Permanent Interest Bearing Shares (PIBS)	6.8	5.4	0.0
Total Tier 1 capital	**1,763.4**	**1,747.9**	**1,750.9**
Tier 2 (T2) Capital			
Subordinated liabilities	40.5	40.5	40.5
Collective provisions for impairment	12.7	12.7	12.7
T2 deductions:			
Securitisation holdings deducted from capital resources	(7.9)	0.0	0.0
Material holdings	(3.5)	0.0	0.0
Total Tier 2 capital	**41.8**	**53.2**	**53.2**
Other items excluded	(5.8)	0.0	0.0
Total capital	**1,799.4**	**1,801.1**	**1,804.1**
Current RWAs	12,595.4	12,595.4	12,595.4
Additional CRD IV RWAs	0.0	341.1	341.1
Total RWAs under CRD IV	**12,595.4**	**12,936.5**	**12,936.5**
CET1 Ratio	**13.9%**	**13.5%**	**13.5%**
Leverage Ratio	**4.6%**	**4.6%**	**4.6%**
(End point with AT1 instruments included)	**-**	**-**	**4.6%**

4 Significant Risk Categories - Credit Risk

4.1 Credit Risk Overview

Credit risk is defined as the risk that circumstances emerge such that counterparties fail to meet loan payment obligations resulting in financial loss.

For the purposes of Pillar 3 disclosures, credit risk is sub-divided into loans secured on real estate property, wholesale (treasury) and banking & personal loans. Details of risk management and governance practices can be found in the Risk Management Report in the Group's Annual Report and Accounts (page 45), with further details of exposures included in notes 38 and 39 (pages 132-142).

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 9 - Credit Risk Exposure **£m**	**Average during 2013**	**Dec-2013**	**Average during 2012**	**Dec-2012**
Loans secured on real estate property				
Loans to individuals	28,478.6	29,807.9	27,518.3	27,602.9
Commercial lending	550.2	615.0	497.0	513.3
Total loans secured on real estate property	**29,028.8**	**30,422.9**	**28,015.3**	**28,116.2**
Wholesale				
Asset securitisation	165.6	154.3	357.7	196.3
Central governments or central banks	4,951.3	7,139.9	3,494.2	4,265.0
Covered bonds	1.3	0.0	5.1	5.0
Financial institutions	1,115.5	2,232.3	1,165.4	733.5
Multilateral development banks	154.4	152.5	213.4	153.3
Short term claims on institutions and corporates	249.0	371.7	214.9	221.3
Total wholesale exposure	**6,637.1**	**10,050.7**	**5,450.7**	**5,574.4**
Banking & Personal loans				
Current accounts	3.3	2.9	10.7	3.6
Personal loans	7.8	6.1	12.9	10.3
Total banking exposure	**11.1**	**9.0**	**23.6**	**13.9**
Other assets	243.1	204.0	256.3	255.3
Total credit risk exposure	**35,920.1**	**40,686.6**	**33,745.9**	**33,959.8**

The sections below give detailed breakdowns of material risk categories (loans secured on real estate property and wholesale).

The geographical distribution of these exposures at 31 December 2013 is as follows:

Table 10 - Loans Secured on Real Estate Property Geographic Distribution £m	Commercial lending Dec-2013	Loans to individuals Dec-2013	Commercial lending Dec-2012	Loans to individuals Dec-2012
Scotland	13.1	2,066.5	13.1	1,978.7
North East	6.6	1,086.6	7.1	1,103.0
Yorkshire & Humberside	18.8	2,954.8	18.0	2,938.0
North West	70.4	2,892.9	42.6	2,831.7
Midlands	50.5	3,577.1	47.5	3,451.8
East Anglia	25.9	1,367.6	26.6	1,380.5
South West	29.4	1,805.7	28.4	1,720.7
Greater London	160.4	6,241.4	132.5	5,250.1
South East	146.6	5,947.0	146.6	5,373.5
Wales & Northern Ireland	39.3	1,161.0	26.0	1,174.8
Spain	0.0	20.8	0.0	23.3
Gibraltar	0.0	51.8	0.0	59.4
Multiple/Unassigned	38.2	2.6	16.3	5.3
Undrawn	15.8	632.1	8.6	312.1
Total loans secured on real estate property	**615.0**	**29,807.9**	**513.3**	**27,602.9**

Table 11 - Wholesale Exposure - Geographic Distribution £m	UK Dec-2013	Other European Countries Dec-2013	North America Dec-2013	Rest of the World Dec-2013	Total
Asset securitisation	85.0	42.9	10.7	15.7	**154.3**
Central governments or central banks	7,139.9	0.0	0.0	0.0	**7,139.9**
Covered bonds	0.0	0.0	0.0	0.0	**0.0**
Institutions	1,045.9	341.1	194.8	650.5	**2,232.3**
Multilateral development banks	0.0	152.5	0.0	0.0	**152.5**
Short-term claims on institutions and corporates	369.5	2.1	0.1	0.0	**371.7**
Total wholesale credit exposure	**8,640.3**	**538.6**	**205.6**	**666.2**	**10,050.7**

Table 11 - Wholesale Exposure - Geographic Distribution £m	UK Dec-2012	Other European Countries Dec-2012	North America Dec-2012	Rest of the World Dec-2012	Total
Asset securitisation	134.5	38.5	10.6	12.7	**196.3**
Central governments or central banks	4,265.0	0.0	0.0	0.0	**4,265.0**
Covered bonds	5.0	0.0	0.0	0.0	**5.0**
Financial institutions	353.4	115.9	256.7	7.5	**733.5**
Multilateral development banks	0.0	0.0	0.0	153.3	**153.3**
Short-term claims on institutions and corporates	211.7	9.4	0.2	0.0	**221.3**
Total wholesale credit exposure	**4,969.6**	**163.8**	**267.5**	**173.5**	**5,574.4**

The following table shows the residual maturity of the exposures at 31 December 2013:

Table 12 - Credit Risk Exposure - Residual Maturity 2013	Up to 12 months	1 to 5 years	5 to 10 years	> than 10 years	
£m	Dec-2013	Dec-2013	Dec-2013	Dec-2013	Total
Loans secured on real estate property					
Loans to individuals	402.7	1,197.4	2,712.9	25,494.9	29,807.9
Commercial lending	155.4	43.5	61.8	354.3	615.0
Total loans secured on real estate property	**558.1**	**1,240.9**	**2,774.7**	**25,849.2**	**30,422.9**
Wholesale					
Asset securitisation	0.0	45.1	0.0	109.2	154.3
Central governments or central banks	3,957.4	2,955.5	227.0	0.0	7,139.9
Covered bonds	0.0	0.0	0.0	0.0	0.0
Financial institutions	1,805.4	5.2	292.7	129.0	2,232.3
Multilateral development banks	0.0	152.5	0.0	0.0	152.5
Short-term claims on institutions and corporates	371.7	0.0	0.0	0.0	371.7
Total wholesale exposure	**6,134.5**	**3,158.3**	**519.7**	**238.2**	**10,050.7**
Total credit risk exposure (excl. banking and other assets)	**6,692.6**	**4,399.2**	**3,294.4**	**26,087.4**	**40,473.6**

Table 12 - Credit Risk Exposure - Residual Maturity 2012	Up to 12 months	1 to 5 years	5 to 10 years	> than 10 years	
£m	Dec-2012	Dec-2012	Dec-2012	Dec-2012	Total
Loans secured on real estate property					
Loans to individuals	385.3	1,216.7	2,713.9	23,287.0	27,602.9
Commercial lending	89.4	46.2	66.9	310.8	513.3
Total loans secured on real estate property	**474.7**	**1,262.9**	**2,780.8**	**23,597.8**	**28,116.2**
Wholesale					
Asset securitisation	0.0	40.5	4.0	151.8	196.3
Central governments or central banks	4,153.6	0.0	0.0	111.4	4,265.0
Covered bonds	0.0	0.0	5.0	0.0	5.0
Financial institutions	210.4	50.5	143.1	329.5	733.5
Multilateral development banks	0.0	153.3	0.0	0.0	153.3
Short-term claims on institutions and corporates	221.3	0.0	0.0	0.0	221.3
Total wholesale exposure	**4,585.3**	**244.3**	**152.1**	**592.7**	**5,574.4**
Total credit risk exposure (excl. banking and other assets)	**5,060.0**	**1,507.2**	**2,932.9**	**24,190.5**	**33,690.6**

The maturity of exposures is shown on a contractual basis. In addition, 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, Fitch and Moody's as External Credit Assessment Institutions (ECAIs), using a composite rating where a counterparty is rated by more than one agency. 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

Central Government, Central Banks and Multilateral Development Banks

Dec-2013						
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	7,292.4	5,253.3
Total					**7,292.4**	**5,253.3**
Dec-2012						
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	4,418.3	4,413.4
Total					**4,418.3**	**4,413.4**

Table 14 - Wholesale Exposure Credit Quality Steps

Financial institutions, Covered bonds and Short-term claims

Dec-2013						
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	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	0.0	0.0
4	50%/100%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	0.0	0.0
5	50%/100%	B+ to B-	B+ to B-	B1 to B3	0.0	0.0
6	150%/150%	CCC+ and below	CCC+ and below	Caa1 and below	6.3	6.3
Unrated	20%/50%	Unrated	Unrated	Unrated	0.0	0.0
Total					**2,604.0**	**654.6**
Dec-2012						
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	251.2	244.4
2	20%/50%	A+ to A-	A+ to A-	A1 to A3	703.2	281.6
3	20%/50%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	5.4	5.4
4	50%/100%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	0.0	0.0
5	50%/100%	B+ to B-	B+ to B-	B1 to B3	0.0	0.0
6	150%/150%	CCC+ and below	CCC+ and below	Caa1 and below	0.0	0.0
Unrated	20%/50%	Unrated	Unrated	Unrated	0.0	0.0
Total					**959.8**	**531.4**

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

4.3 Asset Securitisation

The Group has issued securitisations under the 'Brass' programme. The strategy for launching Brass was to benefit from attractive funding rates and the structure was not intended to achieve significant transfer of credit risk away from the Group. The risk relating to the underlying mortgage pool therefore remains with the Group and is included in the 'secured on real estate' sections detailed in this document. There are no specific capital requirements for the Brass vehicles. Note 35 in the Annual Report and Accounts gives more information on the Brass programme.

The Group's exposures listed below are 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). The majority of this exposure is to UK residential mortgage-backed securities (RMBS) which accounts for £85m of the £154m portfolio. The UK RMBS were all rated AAA at issuance and rank in the senior positions in the capital structure. The following table illustrates the breakdown of investment by type:

Table 15 - Securitised Assets by Investment Type	Exposure Values	
£m	Dec-2013	Dec-2012
Collateralised Debt Obligation (CDO)	7.5	4.9
Collateralised Loan Obligation	25.1	28.0
Principal Protected Note	10.6	10.6
UK Prime RMBS	85.0	134.5
Synthetic Collateralised Debt Obligation	26.1	18.3
Total	**154.3**	**196.3**

The Group has not invested in new securitised investments during the year, however increases in market valuations for some investments have increased the exposure amount, causing some categories to show an increase in exposure in the year.

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

Table 16 - Securitised Asset Exposure Credit Quality Steps
Dec-2013

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	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	0.0
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 Asset Exposure Credit Quality Steps
Dec-2013

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	0.0
2	100%	A+ to A-	A+ to A-	A1 to A3	8.4
3	225%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	0.0
4	650%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	15.8
5	Deducted	B+ and below	B+ and below	B1 and below	0.0
Total					**24.2**

Table 16 - Securitised Asset Exposure Credit Quality Steps
Dec-2012

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	129.7
2	50%	A+ to A-	A+ to A-	A1 to A3	31.8
3	100%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	0.0
4	350%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	8.2
5	Deducted	B+ and below	B+ and below	B1 and below	18.2
Total					**187.9**

Table 16 - Resecuritised Asset Exposure Credit Quality Steps
Dec-2012

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	0.0
2	100%	A+ to A-	A+ to A-	A1 to A3	2.2
3	225%	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3	0.0
4	650%	BB+ to BB-	BB+ to BB-	Ba1 to Ba3	1.3
5	Deducted	B+ and below	B+ and below	B1 and below	4.9
Total					**8.4**

4.4 Impairment Provisions

4.4.1 Loans Secured on Real Estate Property

Further details of the Group's accounting policy for impairment losses on loans and advances to customers is given in the 2013 Annual Report and Accounts, on page 87.

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 2013. 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 - Impairment Provisions - Loans Secured on Real Estate Property	**Total**	**Total**
Exposures not subject to Fair Value £m	**Dec-2013**	**Dec-2012**
Neither past due nor impaired	**21,335.0**	**18,076.4**
Past Due		
Up to 3 months	860.2	781.2
3 to 6 months	156.7	144.9
6 to 12 months	71.4	73.9
Over 12 months	24.1	30.5
Possessions	24.3	38.0
Total past due	**1,136.7**	**1,068.5**
Total exposures	**22,471.7**	**19,144.9**
Provisions	**38.9**	**48.2**
Charge for the year	**18.9**	**25.4**
Fair Value Held	**-**	**-**

Table 17 - Impairment Provisions - Loans Secured on Real Estate Property Exposures subject to Fair Value £m	Total Dec-2013	Total Dec-2012
Neither past due nor impaired	**6,556.6**	**7,850.5**
Past Due		
Up to 3 months	552.5	613.0
3 to 6 months	105.4	90.8
6 to 12 months	41.7	39.2
Over 12 months	12.0	15.2
Possessions	32.5	39.4
Total past due	**744.1**	**797.6**
Total exposures	**7,300.7**	**8,648.1**
Provisions	**7.3**	**13.9**
Charge for the year	**3.9**	**13.9**
Fair Value Held	**99.8**	**212.7**

Table 17 - Impairment Provisions - Loans Secured on Real Estate Property All Exposures £m	Total Dec-2013	Total Dec-2012
Neither past due nor impaired	**27,891.6**	**25,926.9**
Past Due		
Up to 3 months	1,412.7	1,394.2
3 to 6 months	262.1	235.7
6 to 12 months	113.1	113.1
Over 12 months	36.1	45.7
Possessions	56.8	77.4
Total past due	**1,880.8**	**1,866.1**
Total exposures	**29,772.4**	**27,793.0**
Provisions	**46.2**	**62.1**
Charge for the year	**22.8**	**39.3**
Fair Value Held	**99.8**	**212.7**

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. 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 2013 Annual Report and Accounts on page 97.

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 on page 88.

At the statement of financial position, 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 on page 50 of the Group's Annual Report & Accounts.

4.6 Credit Risk Mitigation

The Group uses a range of techniques to reduce credit risk of its retail, commercial and wholesale lending. The most basic 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 on Real Estate 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 historical 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 afforded to borrowers through optional payment protection insurance.

Commercial Lending

The Group also lends to commercial parties. This is actively lent 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 via the YBS brand, properly known as 'Registered Providers'. 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 certain of the counterparties ("Collateral held"). The following table shows the exposures to counterparty credit risk for derivative contracts at 31 December 2013:

Table 18 - Counterparty Credit Risk for Derivative Contracts		
£m	**Dec-2013**	**Dec-2012**
Interest rate contracts	4,240.9	1,051.4
Foreign exchange contracts	598.1	643.9
Other contracts	140.4	356.9
Gross positive fair value of contracts	**4,979.4**	**2,052.2**
Netting benefits	(4,655.5)	(1,622.5)
Netted current credit exposure	**323.9**	**429.7**
Collateral held	(189.3)	(271.9)
Net derivatives credit exposure	**134.6**	**157.8**

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 2013 was £237.9m, which includes uplifts for potential future credit exposure under the mark to market method for assessing counterparty credit risk.

5 Significant Risk Categories - Operational Risk

5.1 Operational Risk Overview

The Group has adopted the standardised approach to operational risk, compliant with the requirements set out in BIPRU 6, 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 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.

For the amount of capital required to be held against operational risks, please refer to section 3.8.

There are certain qualitative requirements for the standardised approach to operational risk which the Group has adopted. The key areas are described in more detail in the sections below.

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 previously, 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 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 review of the enterprise-wide risk map.

A detailed information pack is provided to the Group Operational and Regulatory Risk Committee 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 Basel II Pillar 2 requirements. The outcome of the ICAAP is presented within an Internal Capital Assessment document (ICA) and in 2013 was subject to the PRA's Supervisory Review and Evaluation Process (SREP). 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 Risk
- Pension Risk
- Operational and Fraud Risk (including Conduct Risk)[1]
- Concentration Risk
- Commercial Credit Risk[1]
- Banking Risk[1]
- Structured Credit Risk[1]
- Business Risk

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

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.

6.2 Interest Rate Risk

Interest rate risk relates to the impact of repricing 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 (page 45) of the Annual Report and Accounts.

For assessment of capital requirements, the Group models its interest rate exposure in three areas: repricing risk, prepayment 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; and
- 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 to 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.

Glossary of Terms

Term	Definition
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.
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 potential to incur losses from the failure of a borrower or counterparty to meet its obligation to pay interest or repay capital on an outstanding loan.
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.
FSA	Financial Services Authority. The financial services industry regulator in the UK until April 2013, when prudential regulation was taken over by the PRA.
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.
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 Inter-Bank Offered Rate.
LTV	Loan-To-Value. The ratio of current exposure value as a proportion of the value of the asset held as security (usually residential property) expressed as a percentage.

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 Basel II 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	Operational risk is 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.
PIBS	Permanent Interest Bearing Shares. Unsecured, deferred shares that are a form of Tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors and creditors of the Group.
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.
PRA	Prudential Regulation Authority. The financial services regulator with responsibility for prudential regulation in the UK from April 2013.
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. The value of an on- or off-balance sheet exposure adjusted under Pillar 1 rules to reflect the degree of risk it presents.
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	A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors, and investing members (other than holders of PIBS).
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.
Value at Risk (VaR)	A statistical technique to estimate the maximum loss that could be made for a given factor of confidence over a set time horizon under normal market conditions.