

**BUCKINGHAMSHIRE BUILDING SOCIETY**

**Pillar 3 Disclosure Document**

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## 1. Introduction

The legislative framework, the Capital Requirements Directive (CRD), commonly referred to as Basel II, governing how much capital all banks and building societies must hold to protect their members, depositors and shareholders, was introduced by the European Union from the beginning of 2007. In the UK this has been implemented by our regulator, the Financial Services Authority (FSA).

Buckinghamshire Building Society (BBS) seeks to ensure the protection of its members by holding sufficient capital at all times.

The new framework is not only concerned about the Society's capital requirement, but it also requires disclosure of key pieces of information, such as risk exposure and the risk assessment process.

Below are the 3 main "Pillars" which make up the CRD.

- |          |   |
|----------|---|
| Pillar 1 | Minimum capital requirement. The assessment is based on a formulaic risk based capital calculation focussing on credit and operational risks to determine the capital resources requirement.  |
| Pillar 2 | Internal assessment of the key risks facing the Society for which capital has not been provided under Pillar 1, this process is called Internal Capital Adequacy Assessment Process (ICAAP). The results of ICAAP are subject to review by the FSA as part of their periodic Supervisory Review and Evaluation Process (SREP). The output of this process results in an additional amount of capital the Society must hold. |
| Pillar 3 | This policy document covers the disclosure requirements set out in CRD, and the information provided here is in accordance to the rules laid out in the FSA handbook BIPRU Chapter 11.  |

This disclosure document has been prepared by BBS on a non-consolidated basis given that there are no subsidiaries or associated entities:

FSA Number 206022

All figures within this document are correct **as at 31 December 2010** unless stated otherwise.

## 2. Risk Management Policies and Objectives

BBS is primarily a producer and retailer of financial products, mainly in the form of mortgages and savings. These products give rise to a financial asset or liability and are termed financial instruments. As well as mortgages and savings the Society also uses wholesale financial instruments to invest liquid asset balances and raise wholesale funding and to manage the interest rate risks arising from its operations.

The Society looks to manage all the risks that arise from its operations, the main risks within its business being credit risk, market risk (including interest rate risk), liquidity risk and operational risk.

The ways in which we manage these risks include using forecasting and stress test models to help guide our business strategies; producing key risk information and indicators to measure and monitor performance; and using management and board committees to monitor and control specific risks. The Society also use a Risk Register to record the key risks to which the Society is exposed, it includes an assessment of their likelihood and impact and is reviewed at each Risk Committee meeting. This document forms part of the ICAAP and is used to assess additional capital requirements under Pillar 2.

- **Strategic Risk** - The Society monitors the external environment in which it operates, as the profitability of its products could be adversely affected by a downturn in the economy or by interest rate volatility. A corporate plan and annual budget is prepared which is agreed by the Board and monitored on a monthly basis. Business risk includes, but is not restricted to, Strategic Risk. Strategic risks are high level risks facing the Society emanating from its business direction.
- **Regulatory Risk** - This refers to the risk that the Society's capital and ability to compete over a period of time might be reduced by the volume and complexity of regulatory issues. It includes, but is not restricted to regulatory & legislative related requirements, including operational procedures for product development and marketing; compliance related areas of operation such as corporate governance, training & competency and complaints..
- **Operational Risk** - Operational risk arises from inadequate or failed processes, people, systems, or external events. The management of operational risk, which includes fraud, regulatory risk and risk associated with both organisational and operational change, is the collective responsibility of senior management.
- **Liquidity Risk** - Liquidity risk is the risk that the Society is unable to meet its current and future payment obligations when they fall due. Payment obligations arise in respect of repayments due to depositors and commitments to lend, in addition to repayment of other borrowings. The responsibility for managing this risk lies with the Finance Director and the Treasury team and is monitored by the Assets & Liabilities Committee who report to the Board within the framework outlined under Board Committees.
- **Market Risk** - Market risk is the risk of fluctuation in financial markets which could impact on the value of the Society's assets and liabilities, primarily as a result of movements in interest rates. The Society's Treasury team manages the underlying risk within a framework and parameters agreed by the Assets and Liabilities Committee (ALCO) and the Board.

- **Credit Risk** - Credit risk arises from the failure of a borrower or counterparty to settle financial or contractual obligations as they fall due. In general, decisions to lend money to individual customers are made in accordance with the Society's Lending Policy Statement. In certain circumstances referral is made to the Board for approval.
- **Conduct Risk** - Conduct risk is the risk that the Society does not adhere to regulatory requirements, in particular the standards required under principles, rules and guidance set by the regulatory bodies. BBS recognises that as a financial institution it has a responsibility to adhere to the general principal of fairness to customers and to comply with the FSA's 11 Principles of Businesses. Further reference is found in the Treating Customers Fairly Policy Statement Q.
- **Pension Obligation Risk** - Pension risk arises from a potential pension liability. BBS no longer provides a defined benefit scheme for staff and it is considered, therefore, that there is no longer a risk in this category.
- **Residual Risk** - The process considered whether there was any necessity to include a capital allocation for risks that are not currently foreseen or measured by our models within our holding. Given the general level of mitigants of all the other identified risks including those under operational risk where a particularly rigorous assessment had been undertaken the level of residual was relatively small and it was concluded that no additional capital for residual risk was necessary. This position is reinforced in that we maintain a level of capital in excess of the minimum required by the FSA.

### 3. Board and Division of Delegated Powers to Committee

#### ALCO

**Composition:** Comprises two non-executive directors under the chairmanship of a non executive director with any two of the following: Chief Executive, Finance Director, Head of Customer Services and Head of Compliance and Risk. *In May 11 the Board approved the Chief Executive to take over the Chair of ALCO in accordance with FSA best practice guidance.*

**Main Function:** To set the Financial Risk Management Policy, to review the implementation of controls contained therein and the authorisation of proposals and recommendations brought forward from within the Society. Financial Risk may be defined as the exposure of the Society's profit and loss account, cashflow statement or balance sheet to adverse change as a result of action or inaction in relation to any product or service offered, or proposed, by the Society.

**Frequency:** The ALCO shall meet not less than monthly, or as required to review Treasury and balance sheet risk related activities.

#### Audit Compliance and Risk Committee (ACR)

**Composition:** Three non-executive directors under the chairmanship of any non executive director, other than the Chairman of the Board.

**Main Functions:** The Audit Compliance and Risk Committee monitors the integrity of the Society's Financial Statements, and the application of accounting policies. The Committee also reviews the Society's internal financial controls. The Committee monitors the effectiveness of the Society's Internal Audit function and ensures that a robust audit is performed by the external auditors. It ensures the Society is compliant with requirements and standards of the regulatory system and any codes of practice.

ACR has two sub committees to report on Treating Customers Fairly and the Society's Risk Register.

It will approve the annual Compliance Monitoring Plan, and assess the resources and skills of those involved in it.

**Frequency:** The Committee meets on a quarterly basis with additional meetings held as the need arises.

*In January 2011 the Board approved the division of the Audit Compliance and Risk Committee, creating a new Risk Committee, in place of the ACR Risk sub-Committee. The first meetings in this form for both the Audit & Compliance Committee and Risk Committee were held in March 2011.*

#### Remuneration Committee

**Composition:** Comprises the Chairman, Vice-Chairman and one other non-executive director.

**Main Functions:** The Remuneration Committee reviews and effects appropriate remuneration levels for executive, staff and non-executive directors. It monitors and recommends the remuneration package of staff and directors with regard to their duties, responsibilities and performance. It also considers all benefits, holiday entitlement, bonus schemes, pension arrangements and contracts of employment issues.

**Frequency:** Meetings shall be held annually, and as such determined by the Committee. It also reports, at the July Board meeting, the recommendations of Management for all staff.

## **Nominations Committee**

**Composition:** All serving non-executive directors are eligible for membership of the Committee, but at least three must meet to fulfil quorum requirements.

**Main Functions:** Responsible to identify and nominate candidates for approval of the Board to fill vacancies as they arise. Review existing skills, knowledge and experience of Board members. Give full consideration to succession planning and make recommendations, taking into account challenges and opportunities being faced, and what skills and expertise are needed in the future. Regularly review the structure, size and composition of the Board, and review the leadership needs of the Society.

**Frequency:** The Nomination Committee meets as required and at an appropriate time to consider Board appointments as and when they arise.

#### 4. Capital Resources

The Capital Resources of the Society are calculated under Pillar 1 of the Capital Requirements Directive. The Capital Resources are comprised of:

- General Reserves accumulated by the Society, representing Tier 1 Capital
- Revaluation and provisions, included in Tier 2 Capital

Tier 1 and 2 Capital Resources have been set out in the table below

<b><u>Capital Resources Breakdown</u></b>	£'000s	£'000s
Profit and Loss and other Reserves	9,350	
<b>Total Tier 1 Capital</b>		<b>9,350</b>
Revaluation Reserve	801	
General Provisions less Specific Provisions	<u>207</u>	
<b>Total Tier 2 Capital</b>		<b><u>1,008</u></b>
<b>Total Capital</b>		<b>10,358</b>

Total Society assets as at 31 December 2010 were £169.29m

## **5. Capital Resources Integrated into Business Strategy**

BBS aims to maintain sufficient capital resources to allow it to make advances and provide other financial services. In order to maintain this capital the Society needs to generate and retain profits that will add to the general reserves, the main sources of capital.

### **Strategy and Planning**

The Corporate Plan process establishes risk appetites for business lines being developed by the Society and for each of the risk categories.

The Society ensures it has sufficient financial and non-financial resource to meet the Corporate Plan objectives.

### **Capital Adequacy Assessment Process**

In addition to the Corporate Plan we have an Internal Capital Adequacy Assessment Process (ICAAP), which focuses on ensuring capital resources of the Society are sufficient to support its plan both in normal and stressed conditions.

This process involves reviewing all business areas with estimates for capital allocation across the Corporate Plan period. The Board can then agree (with input from the results of the Society stress models) the economic scenarios to be used in calculating capital requirements.

Finally the Board approves the capital assessment taking into account any areas where they may feel the models and internal assessments do not adequately capture the full risk exposure and holding extra capital where appropriate.

### **Lending & Business Decisions**

The Society translates its overall risk appetite for credit risk into individual lending limits controlling the exposures to be taken on by the Society. The performance against these limits is monitored monthly and reviewed at least annually. In addition, the Society credit risk is stress tested by type of business and the results reflected in business decisions.

### **Pricing**

Our pricing models also include capital assessment by products. Pricing models are in use for all mortgages launched. Pricing models provide guidance as to the level of interest rates required to ensure an appropriate level of return is achieved.

## 6. Risk Weighted Exposure Amounts & Operational Risk Capital

The assets of the Society are allocated risk based amounts in line with the “Standardised Approach” under the Capital Requirements Directive. In addition an evaluation of capital required to cover Operational Risk is calculated under the “Basic Indicator Approach” and determined by reference to the net income of the Society averaged over the previous 3 years.

### Pillar 1 Capital Resource Requirement

	Asset	Risk Weighted Asset	Capital
	£'000s	£'000s	£'000s
<b>Treasury Assets</b>			
Cash balances held	45	0	0
Claims or contingent claims on central governments or central banks	9,878	0	0
Claims or contingent claims on regional governments or local authorities	0	0	0
Claims or contingent claims on institutions	31,280	7,164	573
SWAPs held duration of 1 year or more	10,000	50	4
<b>Total Treasury Assets</b>	<b>51,203</b>	<b>7,214</b>	<b>577</b>
<b>Loans &amp; Advances to Customers</b>			
Claims or contingent claims on Corporate	5,600	5,600	448
Claims or contingent claims secured on real estate property	119,221	42,430	3394
Past due items	449	465	37
Retentions	57	29	2
<b>Total Loans &amp; Advances to Customers</b>	<b>125,327</b>	<b>48,524</b>	<b>3,881</b>
<b>Other Assets</b>			
Debtors and Prepayments	90	90	7
Fixed Assets	1,935	1,935	155
<b>Total Other Assets</b>	<b>2,025</b>	<b>2,025</b>	<b>162</b>
<b>Total Credit Risk Exposures</b>	<b>178,555</b>	<b>57,763</b>	<b>4,620</b>
<b>Operational risk Capital Requirement</b>			<b>309</b>
<b>Total Pillar 1 Capital Resource Requirement</b>			<b>4,929</b>

### Counterparty Credit Risk

The purpose of the Society's Financial Risk Management Policy is to ensure that the Society has sufficient liquidity to meet it's obligations as they fall due.

The methodology for establishing counterparty limits involves consideration of the background rating information and balance sheet data relevant to the counterparty. The minimum rating required under Fitch ratings are:

- Short term facilities up to and including one year in maturity: rated counterparty to have a short term credit rating of at least F1;
- Facilities over one year and up to and including 5 years in maturity: rated counterparty to have a long term credit rating of at least A

Replacement values of outstanding hedging instruments are calculated and counterparty limits are adjusted to reflect an off-balance sheet exposure.

New limits are approved and existing limits removed only on the recommendation of ALCO to the Board. The Finance Director prepares a submission for the approval of new, or the removal of existing counterparties. Limits may be suspended by Treasury Department pending removal in the events of adverse market intelligence. No dealing will take place with counterparties which do not have a pre-approved limit. Where appropriate, exposure to counterparties is monitored on a consolidated basis.

7. Geographical exposure of loan book showing “Past Due” (Loans > 3 months in arrears), performing and total split by category for the Buckinghamshire Building Society as at 31<sup>st</sup> December 2010

	Buckinghamshire Building Society		
Geographic Region	Residential		
	Past Due £'000s	Performing £'000s	Total £'000s
Outer South East		16,373	16,373
Greater London	102	26,465	26,566
Outer Metropolitan	207	53,701	53,908
East Anglia		2,654	2,654
South West		9,169	9,169
West Midlands		2,183	2,183
East Midlands	90	2,365	2,455
North West		1,392	1,392
Yorkshire and Humberside		2,363	2,363
North		1,411	1,411
Wales	51	1,144	1,195
<b>Total</b>	<b>449</b>	<b>119,221</b>	<b>119,670</b>
Geographic Region	Non-Residential		
	Past Due £'000s	Performing £'000s	Total £'000s
Outer South East		832	832
Greater London		1,709	1,709
Outer Metropolitan		2,766	2,766
East Anglia		154	154
South West			
West Midlands			
East Midlands			
North West			
Yorkshire and Humberside			
North		139	139
Wales			
<b>Total</b>		<b>5,601</b>	<b>5,601</b>
<b>Total Mortgage Book</b>	<b>449</b>	<b>124,821</b>	<b>125,270</b>

\* Past Due amounts relate to overall mortgage balances not the amount in arrears

## 8. Provisions

Having regard to the size of the Society's mortgage assets and the limited number of arrears cases provisioning is carried out on an individual basis. A **general provision** is made to cover losses, which, although not yet specifically identified, are from experience known to exist within the loan portfolio. Such cases will include arrears cases not yet 1.5% in arrears. In addition the Society also carries out a provisioning exercise using industry standard methodology, which is based upon indexation, discounts and possession propensity factors from the differing arrears groupings using industry standard figures supplied by the Society's auditor. If this exercise were to produce a higher provision figure than calculated under our manual assessment procedure then the Society would adopt the higher figure. General Provisions are reviewed on a six-monthly basis, at the half-year and year end. Specific Provisions are reviewed quarterly. A **specific provision** is made for all accounts, where the arrears are greater than 1.5% of the mortgage debt and other accounts where there are early signs of distress. The level of provision is based upon the following: -

- An individual review of the default history and an assessment of whether the case is likely to recover, whether the mortgage will be repaid or whether the case will proceed to possession irrespective of when this may occur.
- An assessment of the current market value of the property and the likely selling price that could be obtained with the Society selling as mortgagee in possession.
- A discount factor of 10% is used currently in this assessment.
- A 10% allowance to cover realisation and selling costs.
- The balance on the mortgage including all unpaid interest and other expenses.

Where the security property has been sold and there remains a residual debt, a **specific provision** of the amount of that residual debt plus 10% for costs of recovery will be created.

## 9. Breakdown of Treasury Assets under the Standardised Approach

Fitch Ratings Services	Maturity of Treasury Investment			
	<3 months £'000s	3 months to 1 year £'000s	> 1 year £'000s	Total £'000s
AAA to AA-	22,764	3,512		26,276
A+ to A-				
BBB+ to BBB-				
BB+ to BB-				
B+ to B-				
UK Government Securities		2,105	7,773	9,878
Unrated Building Societies / Local Government	3,048	1,012	2,013	6,073
<b>Total</b>	<b>25,812</b>	<b>6,629</b>	<b>9,786</b>	<b>42,227</b>

## **10. Remuneration Policy**

**The Society may be subject to excessive risk if remuneration policies and practices result in staff being rewarded for decisions inconsistent with the Board's risk appetite. It is therefore the Society's policy to ensure that its remuneration decisions are in line with effective risk management.**

**The Society through its Remuneration Committee seeks to ensure that its remuneration policies and decisions are in line with its business strategy and long term objectives, and consistent with the Society's current and future financial position. It also seeks to establish an appropriate balance between the fixed and variable elements of remuneration. Variable remuneration will only be paid if the Society's current and expected future financial position is sufficiently strong. Performance measurements used to calculate variable remuneration are therefore adjusted to take into account current or potential risks to the business and are consistent with the need to retain a strong capital base. Guaranteed incentive payments do not form part of any remuneration package and all incentive schemes are non-contractual.**

**The Society's Remuneration Committee is responsible for determining the level of Executive Directors' pay and benefits. The Society's members are invited, at the AGM, to vote on the adoption of the Directors' remuneration report.**

### **Executive Directors' remuneration**

**The Board's policy is designed to ensure that Executive remuneration reflects performance and enables the Society to attract, retain and motivate a sufficient number of Executives to lead and direct the Society in an increasingly regulated and competitive market.**

### **The main components**

#### **Basic salary**

**This takes account of job content and responsibilities as well as salary levels in comparative organisations. The Remuneration Committee uses external advisers to provide advice in this area.**

#### **Directors Fees**

**Consistent with Non Executive Directors.**

#### **Annual bonus**

**Any bonus payable is linked to the Society's and individual's performance based on a number of key targets set by the Board.**

#### **Contracts**

**No Executive Director holds a contract with a notice period of more than 12 months.**

## Remuneration paid

Executive Directors	Salary £000's	Directors Fee £000's	Bonus £000's	Benefits £000's	Employers Pension Contributions £000's	Total 2010 £000's	Total 2009 £000's
I J Gould * (Chief Executive)	89	12	-	2	9	112	74
R K Patel ** (Finance Director)	42	8	-	1	4	55	-
J Mundell *** (Chief Executive)							38
<b>Total</b>	<b>131</b>	<b>20</b>	<b>0</b>	<b>3</b>	<b>13</b>	<b>167</b>	<b>112</b>
* Appointed May 2009		** Co-opted onto the Board on 26th May 2010			*** Resigned April 2009		

Remuneration of other officers whose professional activities could have a material impact on the Society's risk profile (the Head of Customer Services\* and the Head of Compliance and Risk):

Cost	Total 2010 £000's	Total 2009 £000's
<b>Total</b>	<b>97</b>	<b>40</b>

\* Head of Customer Services Appointed December 2009

## 11. Conclusion

This disclosure document is intended to provide background information on the Society's approach to risk management as related to maintaining and preserving the capital position of the Society. It also provides asset information and capital calculations under Pillar 1.

In the event that a user of this document has comments or requires further information then they are requested to contact Rajesh Patel, Finance Director at:

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